



TRADE PRACTICES
CONSULTATIVE COMMITTEE

Small business and the Trade Practices Act

VOLUME 1
DECEMBER 1979

TRADE PRACTICES CONSULTATIVE COMMITTEE

SMALL BUSINESS
AND
THE TRADE PRACTICES ACT

Volume 1

December 1979

AUSTRALIAN GOVERNMENT PUBLISHING SERVICE

CANBERRA 1979

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ISBN for set of two volumes: 0 642 04748 0

ISBN for Volume 1: 0 642 04746 4

Volume 2 will contain submissions made to the Committee.

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10 December, 1979.

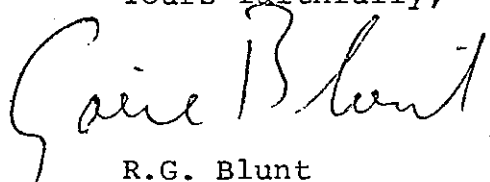
The Honourable Victor Garland M.P.,
The Minister for Business &
Consumer Affairs
Parliament House
Canberra A.C.T. 2600

Dear Minister,

Your predecessor, the Hon. Wal Fife M.P., asked this Committee to report to him on the question of Small Business and the Trade Practices Act. The Terms of Reference Mr. Fife gave the Committee are reproduced on page 7 of Volume 1. of our Report.

The Report which we have now completed is in two volumes; Volume 1 being our views and recommendations and Volume 2 being submissions made to the Committee.

Yours faithfully,



R.G. Blunt
CHAIRMAN

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| | |
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PREAMBLETERMS OF REFERENCE

The Terms of Reference were set out in a letter to the Committee from the Honourable Wal. Fife M.P., Minister for Business and Consumer Affairs on 19 December 1978, the text of which is reproduced below.

"The Government has been giving close attention to the continuing and developing role of small business in Australia. It is the firm policy of the Government to encourage such business so far as practicable by government policies and ensure that they are a viable force for competition in Australia.

Having regard to the high priority given by the Government to this policy, I should be glad if your Committee would give consideration to the relationship between the restrictive trade practices provisions of the Trade Practices Act and small business.

Specifically, I ask your Committee to make an examination along the following lines:

Consistent with the general objective of the development and maintenance of free and fair competition in the Australian economy, is there any action in relation to the Trade Practices Act 1974 which your Committee considers should be taken, with the objective of the improvement of the market position of small business in Australia. Particular attention should be had to the provisions of the Act dealing with monopolization (section 46), exclusive dealing section 47, price discrimination (section 49) and relevant ancillary provisions.

I would expect that your Committee will, in respect of this examination, actively solicit views (by public advertisement or otherwise) from the Australian public generally, and small business in particular. I hope that you will be able to report to me on this matter by September 1979."

Subsequently it was decided to expand the terms of reference and this decision is reflected in the following extract from a media statement by the Minister on 3 May 1979:

"Moreover, in considering the submissions on small business, the Committee found that it was necessary to consider whether it should recommend that the Commonwealth should introduce a law relating to franchising. Consequently, the Committee has examined such matters as the termination of a franchise, continuation of supply on just and equitable terms under a franchise, the assignment of a franchise and the property transactions upon which a franchise may be based. In this context, the Committee has also examined problems relating to the concept of protecting goodwill under franchise agreements."

In further correspondence on 13 July 1979 regarding the terms "free and fair competition" the Minister said the Committee should take account of the general Government objective of developing and maintaining economic and efficient industry in Australia.

SUBMISSIONS TO THE COMMITTEE

The Committee advertised widely in the Australian community for submissions to this enquiry. It obtained over one hundred submissions many of which are reproduced in volume 2 of this Report. While these are indicative of small business problems, the Committee has borne in mind that this selection of submissions may not necessarily be representative in that, it is not unreasonable to assume, many small businessmen would lack the time and resources to make submissions to the Committee.

The Committee wishes to express its gratitude to those that have made submissions. We publish the submissions (of those who have given us permission to do so) to make them available to others interested in this area.

SECRETARIAT

The Committee wishes expressly to thank Michael Lawless, Director of the Competition Policy Branch of the Department of Business and Consumer Affairs, who has been Secretary to the Committee since its creation. He has worked tirelessly on the production of this Report since the time we completed our last Report on Primary Production in June of this Year. We also express our gratitude to Michael Lysewycz, David Shaw and Mark Dickens, also officers of the Department, who at various times over the last year undertook research for the Committee. All of these officers are qualified in law, economics or both and provided valuable assistance to the Committee. Our thanks are also due to the many people particularly Sue Davis and Judy Pearce who have unstintingly assisted the Committee in editing, typing and producing this Report.

COMMITTEE RECOMMENDATIONS AT A GLANCE

This is a very brief list of our recommendations.

(Reference should be made to the body of the Report for the reasoning and detail behind our recommendations).

1. The Committee recommends that there be no change of thrust to the Competition provisions, Part IV, of the Trade Practices Act and recommends that there be no change to Sections 45, 45B, 45D, 47, 48 or 50. (See chapters 4, 6, 7 and 8).
2. The Committee recommends that the ambit of Section 46 (Monopolization) be extended. Presently it applies only to those firms that substantially control markets. Its ambit should be extended so that it applies to all firms that have a substantial degree of market power. (See chapter 9).
3. The Committee recommends the repeal of Section 49 (Price Discrimination). (See chapter 10).
4. The Committee recommends the introduction of a franchisee protection law that would require certain matters to be disclosed to a franchisee, allow a franchisee to assign his franchise and limit the grounds upon which a franchisor could terminate or fail to renew a franchise. (See chapter 11).
5. The Committee recommends that -
 - government agencies cooperate with small business bodies and trade associations to increase the awareness and understanding that small business has of the Act.
 - the same protection from intimidation that witnesses before the Federal Court are given be afforded those that provide information to the Trade Practices Commission.
 - lower Courts have jurisdiction under the Act.
 - legal aid for private litigation be more freely available. (See chapter 12).

SUMMARY OF THE REPORT

Our views and recommendations are set put in this Summary but reference should be made to the body of the Report for our reasoning and views in full.

Introduction

1. In this Report we identify what small business is, we examine some major problems small business has and isolate those problems that are relevant to this enquiry.

2. We then examine the policy aims of competition rules (the provisions of Part IV) of the Trade Practices Act 1974. We then examine these provisions with our terms of reference in mind to explore what could and should be done to improve the market position of small business.

CHAPTER 1 - CAN "SMALL BUSINESS" BE DEFINED

3. The Committee examined a number of small business definitions but concluded that it was not possible to arrive at a universally applicable definition of small business.

4. The various definitions employed in studies to date rely on a variety of quantitative or qualitative tests to define small business. These definitions appear tailor made for the various studies for which they were employed.

5. However, to give an indication of the areas of industry which we consider the term "small business" generally covers, we adopt the following guidelines. A "small business" is one which:

- employs less than about 50 persons;
- is owned and controlled by a few working proprietors (say, less than 5);
- is not associated with a public company; and
- has a value added of less than approximately \$500,000 per annum.

6. Roughly speaking, it can be said that small business constitutes approximately 90% of Australian enterprises and accounts for approximately 40% of employment in the private sector and somewhere between 20% and 25% of gross non-farm domestic product. Accordingly it can be seen that small business is very important to the Australian economy.

CHAPTER 2 - SMALL BUSINESS PROBLEMS

7. Small business appears to have a variety of problems many of which are not associated with market power or competition. Such problem areas relate to management, capital and funding, taxation and technology. These problems cannot be specifically addressed by the competition rules of the Trade Practices Act.

8. However, small business also has problems associated with lack of market power, for example powerful firms may deny small business access to markets or to supplies. In our view small business problems flowing from lack of market power may be appropriately dealt with in a competition statute like the Trade Practices Act. This Report examines the competition provisions with a view to assessing what can and should be done to meet these problems and improve the market position of small business in the context of the Government's policy of maintaining and fostering economic and efficient industry in Australia.

9. We do not examine the impact of government activities. Obviously difficulties do flow from monopolies created by, or restrictive practices encouraged by, governments. We do not comment on these because we do not consider this area within our Terms of Reference.

CHAPTER 3 - WHERE DOES SMALL BUSINESS PREDOMINATE AND WHAT SMALL BUSINESS HAS COMPETITION PROBLEMS

10. The sectors of the Australian economy most important to small business, ranked in order of their contribution to total small business employment, are: manufacturing, then retailing, followed by selected services, motor trades, and wholesaling.

11. However, the ranking is different when sectors are ranked according to the predominance of small business within them, that is, according to the contribution small business makes to total employment in a particular sector. On this ranking, small business predominates most in the motor trades, then retailing, followed by selected services, manufacturing and wholesaling, in that order.

12. Two areas of complaints were predominant in submissions made to us. These were "corner store" retailers experiencing difficulties in competing with large "discount" stores or chain-stores; and "franchised" dealers (particularly in the motor trades) experiencing difficulties because of the economic power of their suppliers. There were other areas of complaint in submissions to us. These were complaints from small business about having to compete amongst themselves, their inability to obtain satisfactory terms from those with whom they deal and the predatory acts of others in the market place, but these areas of complaint are not as major as the two categories outlined above.

CHAPTER 4 - POLICY AIMS OF PART IV, THE COMPETITION RULES OF THE TRADE PRACTICES ACT

13. There are a variety of social and political aims that competition laws may be designed to achieve: Preventing the concentration of economic power, promoting fair dealing, protecting small business, and promoting the welfare of consumers, are some of these possible aims. However, the economic goal of efficiency of firms and ultimately efficiency of

the economy as a whole, promoted by the effective working of the market mechanism, which is maintained by the competition rules of the Trade Practices Act, is seen by us as the most important objective. We endorse the competition provisions being directed to this aim and recommend against any change of thrust.

CHAPTER 5 - OVERSEAS EXPERIENCE

14. The competition laws of other countries, particularly of the United States, treat small business substantially in the same manner as small business is treated in Australia. If anything, Australia has more precise law designed to improve the market position of small business. In particular, Australia has clear law on recommended price agreements and joint buying and advertising agreements designed specifically to assist small business.

15. Like most other comparable countries, Australia has competition laws that prohibit anti-competitive conduct like boycotts and price fixing. It prohibits powerful suppliers (or buyers) tying or imposing territorial or customer restrictions on those with whom they deal, if those restrictions result in a substantial lessening of competition. Mergers are prohibited if they lead to firms controlling or dominating markets. Predatory conduct or the prevention of entry, by those substantially in control of markets is also prohibited.

CHAPTERS 6, 7, 8 - AGREEMENTS AFFECTING COMPETITION

EXCLUSIVE DEALING

RESALE PRICE MAINTENANCE

16. The provisions of section 45, (anti-competitive contracts etc.), 45D (secondary boycotts), 47 (exclusive dealing) and 48 (resale price maintenance) are examined and no change is recommended. These sections already contain a number of provisions designed to assist small business in a manner consistent with their primary thrust - promoting efficiency through the maintenance of the market mechanism.

RECOMMENDATION

17. We do not consider there should be any amendment to the Act to afford more lenient treatment to small business in this area.

CHAPTER 9 - ABUSE OF MARKET POWER

18. In our view there should be stronger law regulating the abuse of market power to ensure that the predatory conduct of all firms with a substantial degree market power (including predatory price discrimination) is prohibited when that power is being used against a firm with less power in the relevant market.

19. At present section 46 only restrains a firm stopping others from competing if that firm is in a position substantially to control a market.

RECOMMENDATION

20. We think the class of firms to which section 46 applies should be extended to include all those that have a substantial degree of market power. Our recommendation, in the form of a redraft of Section 46 is set out at paragraph 9.36.

21. The provision should not be extended so as to put at risk legitimate aggressive market behaviour. Accordingly we recommend the insertion of a new provision in section 46 that will remove from section 46 conduct of firms directed at firms with comparable market power. (This provision is sub-section (2A) in our draft set out in paragraph 9.36).

22. Section 46, amended, as we recommend, will not put at risk the conduct of firms taking advantage of their efficiency (flowing from economies of scale, for example). However firms with substantial market power will be at risk when they purposefully abuse their market power to block competition from weaker firms or to eliminate weaker competitors.

23. We consider this amendment to section 46 would considerably improve the market position of small business.

CHAPTER 10 - PRICE DISCRIMINATION

24. Section 49 (price discrimination) is examined and we consider (as did the Trade Practices Act Review Committee (Swanson Committee) in 1976)) that it causes detrimental price inflexibility, and uncertainty and causes distortions in the market place which disadvantage consumers, big business and small business.

25. It places a heavy evidentiary burden on those who seek to rely upon it and it does not prohibit the predatory pricing conduct of powerful firms that amounts to an abuse of market power. When Section 49 has been invoked by small business, in the main, it has been invoked against the predatory conduct of powerful firms. It has largely failed small business because its thrust is against conduct that lessens competition in a market and not against conduct that hurts particular competitors.

26. Accordingly, it is our view that section 49 is only of dubious assistance to small business but at the cost of causing such distortions as to disadvantage the community as a whole.

27. We consider that adoption of our recommendation regarding section 46 will give the protection from predation that small business has expected under section 49.

RECOMMENDATION

28. We recommend that section 49 be repealed.

29. It should not be changed to make it closer to the U.S. Robinson Patman Act (which outlaws price discrimination that hurts competitors), because that would adversely affect price competition and be against the thrust of the anti-price fixing provisions of the Act (section 45 and 45A).

CHAPTER 11 - FRANCHISING

RECOMMENDATION

30. The Committee recommends that a law be introduced, as part of the Trade Practices Act, that would give franchisees a number of rights.

31. In our view, such a law should -

- . require a franchisor (and, in the case of a franchisee assigning the franchise, require a franchisee) to disclose certain matters to an incoming franchisee - (see section 2 of the draft legislation at paragraph 11.51 for a detailed description of the matters the Committee would see disclosed in pursuance to this obligation);
- . that the law provide a "shopping list" of situations which would permit a franchise relationship to be terminated or not renewed by the franchisor; termination or non-renewal outside of those situations would render the franchisor liable for damages for unjust termination or non-renewal;
- . that a franchisee be permitted by law to assign his franchise to another person, subject to the consent of the franchisor, which consent shall not be unreasonably withheld;
- . that in both the assignment and the termination or non-renewal situations there be an apportionment of any goodwill between the franchisor and the franchisee on the basis of the principle of fair apportionment having regard to the relative inputs of the franchisee and franchisor, both of capital (including general marketing costs which the franchisor may have incurred to promote the tradename, etc.) and labour, so that any goodwill is apportioned having regard to that relationship.

32. The Committee is aware that the Government is also working on proposals concerning a franchising law in the context of the petroleum industry. The Committee believes that its specific proposals, in the form of a draft bill set out in paragraph

11.51, would work more generally than in just the petroleum industry. If the Government were to adopt our proposals then we suggest it should merge the petroleum proposals into the general franchising law and not have a separate law for the petroleum marketing area.

CHAPTER 12 - PROCEDURES AND REMEDIES

RECOMMENDATION

33. The Committee recommends that Government agencies like the Department of Business and Consumer Affairs, The Department of Industry and Commerce, and the Trade Practices Commission co-operate with small business agencies and trade associations to provide small business with information and advice on the operation of the Act.

34. The Committee recommends that the protection to witnesses in Courts from intimidation afforded by section 36A of the Crimes Act 1914 (Cth) be given to witnesses in the Commission's adjudication and enforcement procedures.

35. The Committee acknowledges that the prospect of lengthy and costly litigation would deter small business from taking advantage of the Act. Accordingly it recommends that the Government should give serious consideration to conferring jurisdiction over trade practice matters to the lesser (state) courts.

36. The Committee makes no recommendation with respect to the adoption of class actions other than that they should be considered when the Australian Law Reform Commission finally reports on that subject.

37. The Committee adopts the Australian Law Council's recommendation that more funds should be made available by way of legal aid for private litigation under the Act.

CHAPTER 1

CAN "SMALL BUSINESS" BE DEFINED?

Introduction

1.1 In this Report the effect of the operation of the Trade Practices Act on primary industry is not considered. This question has recently been the subject of an extensive examination by the Committee. A report to the Minister for Business and Consumer Affairs on this specific question was tabled in Federal Parliament on 5 June 1979. Accordingly, because of this and because the Committee considers that primary industry is unique and distinct from other areas of the economy it is not considered here.

Definitions

1.2 The most widely accepted conceptual definition of a small business in Australia is that proposed by the Committee on Small Business ("the Wiltshire Committee") in 1971:

"a business in which one or two persons are required to make all the critical management decisions, finance, accounting, personnel, purchasing, processing or servicing, marketing, selling, without the aid of internal specialists and with specific knowledge in only one or two functional areas".

(Report of the Committee on Small Business, Canberra, Department of Trade and Industry, 1971, paragraph 3.1)

1.3 This definition has recently been endorsed by the Small Business Advisory Council, a representative body established to provide a link between the Commonwealth Government and the small business sector and to advise the Minister for Industry and Commerce on small business policy issues.

1.4 This definition focusses exclusively on the internal management characteristics of the firm as the criteria for considering it "small".

1.5 In the United Kingdom, the Committee of Inquiry on Small Firms ("the Bolton Committee"), after an extensive study of the nature and problems of small business in the United Kingdom, adopted the following definition:

"Firstly, in economic terms, a small firm is one that has a relatively small share of its market. Secondly, an essential characteristic of a small firm is that it is managed by its owners or part-owners in a personalised way, and not through the medium of a formalised management structure. Thirdly, it is also independent in the sense that it does not form part of a larger enterprise and that the owner-managers should be free from outside control in taking their principal decisions".

(SMALL FIRMS: Report of the Committee of Inquiry on Small Firms Cmnd. 4811 (H.M.S.O. 1972) paragraph 1.4)

1.6 In the United States, the Small Business Administration operates under the following statutory definition:

"For the purposes of this Act, a small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria the Administrator, in making a detailed definition, may use these criteria, among others: number of employees and dollar volume of business. Where the number of employees is used ... the maximum number of employees which a small business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and to take proper account of other relevant factors".

(Small Business Act 1953, reproduced as paragraph 632 title 15 (Commerce and Trade) of the U.S. Code annotated)

1.7 These definitions lay emphasis on qualitative characteristics intuitively associated with the term "small business" - independent ownership, personalised management and low market power.

1.8 In the Committee's view, a small market share should not be regarded as either a necessary or a sufficient criterion of small business, since a particular enterprise may have a large share of a specialised or local market and yet suffer other disadvantages due to its qualitative smallness. Conversely, a large enterprise may possess only a small share of a particular market, but nevertheless not be disadvantaged due to its freedom from the other disabilities associated with smallness.

1.9 From the qualitative formulations flow two shortcomings. First, none of these formulations is sufficiently precise to serve as the basis for concrete statistical research or analysis and, secondly, they would be difficult, if not impossible, to apply for legislative purposes in Australia.

1.10 The studies cited above have also attempted a quantitative definition of a small business, based on number of employees, value of assets, value of sales or turnover. In the United States, for example, a "small" manufacturing firm is defined as one employing 500 or fewer employees; in the United Kingdom, the Bolton Committee set a variety of turnover and other standards for small firms:

- (a) Manufacturing: 200 employees or less.
- (b) Retailing: turnover 50,000 or less.
- (c) Wholesaling: turnover 200,000 or less.
- (d) Construction: 25 employees or less.

- (e) Mining/quarrying: 25 employees or less.
- (f) Motor trades: turnover 100,000 or less.
- (g) Miscellaneous services: turnover 50,000 or less.
- (h) Road transport: five vehicles or less.
- (i) Catering: all excluding multiple and brewery-managed public houses.

1.11 In Australia, the Small Business Advisory Council has tentatively settled on the following quantitative benchmarks:

- . for a manufacturing firm; fewer than 100 employees and turnover of less than \$3 million p.a.
- . for a wholesaling firm; fewer than 20 employees and turnover of less than \$3 million p.a.
- . for a retailing firm; fewer than 20 employees and turnover of less than \$1 million p.a.
- . for a service firm; less than 20 persons.

Conclusions

1.12 Objective, quantitative and generally applicable definitions are important if concrete statistical research is to be undertaken, but the selection of a cut-off figure must always be to some extent arbitrary and subject to regular review. The advantage gained in the certainty of application of a quantitative definition is counterbalanced by the loss of regard to other important characteristics that the employment of a rigid benchmark entails.

1.13 No entirely satisfactory 'definition' of small business either by qualitative or quantitative means may be arrived at. The "definitions" that have been produced all appear to reflect the purpose for which they are designed, and to some extent are definitions of convenience.

1.14 However, the process of categorising business as "Small", on the basis of certain characteristics, has pitfalls and can be misleading. Such a process may automatically define the problems of small business and may focus attention on particular problems while other problems are ignored. By way of simple illustration a small business could be defined as one with few managers and not part of a large enterprise (meaning a sole trader, partnership or private company). The problems that would be highlighted by this definition would be lack of managerial ability, lack of internal specialists and so on. In short, if small businesses were defined as having few managers the conclusion which would result from an analysis would be that the business has management problems. Such an analysis is tautological. This approach to definition does not advance matters much and can draw attention away from other problems experienced by small businesses.

1.15 In any event the task of the Committee is to examine what measures may be taken by the government in relation to the Trade Practices Act to improve the market position of small business.

1.16 Accordingly, a flexible approach to delimiting the area of concern is preferable. When we use the term "small business" in this report we bear in mind the qualitative definition of the Wiltshire Committee as well as the following characteristics:

- . employs less than 50 persons;
- . is owned and controlled by a few (say less than 5) proprietors (usually working);
- . is not associated with a public company; and
- . has a value added of less than approximately \$500,000 per annum.

1.17 The value added amount chosen here is an educated guess designed to be indicative of the right order of magnitude. "Value added" is the value of sales after the allowance for costs of materials bought in. It, therefore, equals the total of wages, surplus and indirect taxes of the enterprise.

1.18 The criterion of 50 employees, rather than 100 employees, is chosen because in many cases enterprises engaging between 50 and 100 employees may be larger than what many people would regard as being small businesses. However, in Chapter 3 our analysis is based on the test of less than 100 employees for the manufacturing sector and less than 20 employees in other sectors.

1.19 Without using our "working definition" specifically, and taking account of the variety of Australian studies, it can be said that small business constitutes approximately 90% of business enterprises by number in Australia, and accounts for approximately 40% of employment in the private sector and somewhere between 20% and 25% of Gross non-farm Domestic Product.

CHAPTER 2

SMALL BUSINESS PROBLEMS

Introduction

2.1 In undertaking the task of examining means that may be adopted to improve the market position of small business it is appropriate to obtain an overview of the problems that small businesses generally have.

2.2 Small businesses in Australia face problems, among other things, in relation to:

1. Management;
2. Capital and funding;
3. Access to technology;
4. Access to supplies;
5. Taxation; and
6. Market or economic power.

Management

2.3 Often small businesses are owned and operated by one key person responsible for all major decisions not only in technical matters but also in finance, marketing, sales and employment matters. These disparate responsibilities require a variety of skills and training that are possessed by relatively few people.

Capital and Funding

2.4 Small businesses frequently must rely on their own sources for capital. Other sources are trade creditors, and the trading banks and finance companies. Also funds for small business may be available from the Commonwealth Development Bank or Government instrumentalities such as Industrial Research and Development Incentives Board, the Export Development Grants Board and the Australian Industry Development Corporation. However, because lender risk is higher they do not have open to them the variety of sources that larger enterprises have.

Access to Technology

2.5 It is uncertain whether small firms have a severe disadvantage regarding access to technology or to developments and innovations. Some studies indicate that large firms are advantaged by having access to technology and developments in technology. Others indicate that small firms are responsible for considerable research, development and innovation. It appears no general conclusion may be made but rather that the peculiarities of individual industries or sectors determine whether small businesses have less access to technology and developments in technology vis a vis their large competitors.

Taxation

2.6 Most forms of tax, with the exceptions noted below, are levied at rates that do not discriminate between large and small

corporations or firms. On some occasions, however, there is an incidental form of discrimination if, for instance, the availability of the Commonwealth Government Investment Allowance (now at 20% of the value of defined investment outlays in excess of \$500.00 or \$1,000.00 with partial or full recompense respectively) may be more difficult to obtain for small businesses. Again, on some occasions, it may happen, coincidentally, that small businesses are more or less intensively engaged in activities in which trading stock is held and in relation to which, in times of inflation, the trading stock valuation adjustment did apply and now no longer applies.

2.7 There are two areas in the field of taxation which do merit some specific comment concerning the position of small businesses.

2.8 First, the existence of exemption limits in relation to the payment of payroll tax (collected for the most part by the States) gives an implicit subsidy to small businesses in respect of payroll tax payments per employee. (But this would only apply for payrolls up to \$5,500 per month in N.S.W.).

2.9 However larger businesses may have available to them exemptions of a general nature (e.g. in decentralised areas), and both large and small business incur the same disincentive to the employment of additional labour (i.e. the marginal rate of payroll tax). This does not apply to the small business which is so small as to be within the exemption limit entirely.

2.10 Secondly, Division 7 tax applies not directly to sole traders or partnerships but explicitly to proprietary companies. The overlap is not exact in the following two senses:

(a) Some companies may be proprietary companies but not "small businesses" on our definition because they may be associated with a public company or because they may have more than 50 employees or because they may have more than the stipulated number of working proprietors.

(b) Some small businesses, on our definition, may not incur Division 7 Tax because they are not incorporated.

2.11 Bearing in mind these qualifications, the burden of Division 7 Tax falls on smaller companies and this acts clearly to restrict their ability to finance their operations from internal resources, compared with the situation that would exist if they were able to escape Division 7 Tax. Given the difficulties that seem to face small businesses, relative to large businesses, in relation to the securing of external finance, this point should be seen in that context.

Access to Supplies

2.12 Small businesses, buying in limited quantities and not being part of large enterprises may, on occasion, have difficulties in obtaining supplies of materials or obtaining

materials at prices that allow them to be competitive in the market.

Market or Economic Power

2.13 Small businesses, particularly where they have numerous competitors each producing substantially identical products, cannot individually raise prices or lower quality without being penalised by the market.

2.14 Small businesses moreover may have unequal bargaining power vis a vis others in the economy. A small business might be in a position of only being able to supply its products to a few powerful enterprises, or alternatively a few large enterprises may be dominant in the sector from which a small business must obtain its supplies of raw materials. Also a small business may compete for customers with a small number of powerful enterprises. In any of these circumstances small business would be disadvantaged due to the relative lack of market power.

Conclusion

2.15 In the Committee's view small business problems, other than those relating to market power, cannot be addressed by the Trade Practices Act and, accordingly, cannot be dealt with in this Report.

Government and Small Business

2.16 The Committee notes that there is increasing awareness by State and Federal Governments of the importance and problems of small business, reflected in a broad bi-partisan consensus that measures should be taken to encourage and strengthen the market position of small business.

2.17 The Committee also notes that there are many difficulties (experienced most severely by those without market power) flowing from governments (state and federal) creating monopolies or encouraging restrictive business practices. We make no comment regarding this because we do not consider this question to be within our Terms of Reference and because any critical comment would amount to criticising the policy of a government which we do not see as our function.

CHAPTER 3

WHERE DO SMALL BUSINESSES PREDOMINATE AND WHAT SMALL BUSINESSES HAVE "COMPETITION" PROBLEMS

Introduction

3.1 We attempted to gain a statistical picture of the importance of small business in particular sectors of the economy, in the economy as a whole and of the importance of particular sectors of the economy to small business.

3.2 Unfortunately the available statistical information is inadequate to permit the formation of a complete, up to date, picture.

3.3 The statistics most appropriate to a study of the place of small business are the Enterprise Statistics published by the Australian Bureau of Statistics, which provide information broken down according to the size of the "enterprise" (or business) as measured by amount of employees.

3.4 The latest available Enterprise Statistics (covering the manufacturing, wholesaling, retail selected services, and motor trades sectors of the economy) are for the year 1968/69. In the main we have relied on these statistics. More recent comparable statistics will not be available until the completion of the Integrated Economic Census for the year ending 30 June 1980.

3.5 More recent enterprise statistics for the year 1974/75 are available for the manufacturing sector and these have been taken into account in the section of this Chapter dealing with manufacturing. A possible source of more recent information as to the place of small business is the Establishment Statistics published by the Australian Bureau of Statistics. Statistics for the years 1974/75 and 1976/77 are available for the manufacturing sector and for the year 1973/74 for the retail and selected services sector.

3.6 Considerable difficulties arise, however, in attempting to use establishment statistics to assess the place of small business. The chief difficulty is that establishment statistics count separately each establishment belonging to large enterprises.

3.7 An indication of the inaccuracies resulting from using establishment statistics as a measure of small business (on the assumption that a large number of small establishments will probably indicate a large number of small enterprises) can be gained from Table 1, which ranks particular areas within the manufacturing sector according to the proportion of total employment in that area accounted for by small enterprises. The second column of that table shows the proportion of total employment in that sector which is accounted for by small establishments.

3.8 A second difficulty is that establishment statistics for the manufacturing sector are compiled on the basis of the number of employees per establishment, while those for the retail and selected services sector are compiled on the basis of annual sales. This severely limits the comparability of these data.

3.9 For these reasons, we have preferred to rely on the available enterprise statistics rather than on the more recent establishment statistics. We have used establishment statistics only for the purpose of adjusting the 1974/75 Enterprise Statistics for the Manufacturing Sector by incorporating statistics for single establishment enterprises with less than 4 employees, which were excluded from enterprise statistics.

3.10 In 1968/69, small business enterprises accounted for somewhere around 95% of the total number of enterprises, 41% of employment and 32% of value added in the economy as a whole.

3.11 A "small business enterprise" was classified as one with less than 100 employees in the manufacturing sector and less than 20 employees in the mining, wholesale, retail and selected services, and motor trades sectors.

3.12 Since the figures published do not cover agriculture, transport, building and construction, nor the financial or professional services sector, it is likely that these figures understate the importance of small businesses in the economy as a whole.

3.13 We will now deal with the Manufacturing, Retailing, Selected Services, Motor Trades and wholesaling sectors and the submissions made to the Committee concerning these sectors.

SECTION 1 - MANUFACTURING

Statistics

3.14 Of 32,291 "enterprises" engaged in manufacturing in 1968/69, 30,399 employed fewer than 100 persons. Collectively these small firms accounted for 32% of employment in manufacturing and 26% of value added in manufacturing.

3.15 The manufacturing sector accounted in 1968/69 for 38.2% of the total employment by those small enterprises included in the Study of the Australian Bureau of Statistics.

3.16 At 30 June 1975 there were 33,455 enterprises engaged in manufacturing, of which 31,768 employed fewer than 100 persons (95.0%). These small firms accounted for 29.4% of total employment in the manufacturing sector, and 23.9% of value added.

3.17 The causes and significance of this apparent change in the importance of small enterprises in the manufacturing sector are not clear. However import competition may be of significance.

3.18 Table 1 shows the proportion of employment in particular areas of the manufacturing sector which was accounted for by enterprises with less than 100 employees.

3.19 Manufacturing industries in which small businesses accounted for more than 50% of total employment at the end of June 1975 were: wood and wood products; furniture and mattresses; fabricated structural metal products; clothing; leather products; and sheet metal products.

3.20 Manufacturing industries in which small businesses were of little importance (i.e. accounted for less than 15% of total employment in that industry) were: petroleum refining; tobacco products; basic iron and steel; non-ferrous basic metal products; basic chemicals; sugar and other food products; motor vehicles and parts; fruit and vegetable products; paper and paper products; and meat products.

3.21 While the figures cited above enable the formation of a general picture of the place of small business in Australian manufacturing industry and probably support the general conclusion that the manufacturing sector is the single sector of most importance to small business, they do not permit more than a superficial assessment of the market position of small businesses in the manufacturing sector.

3.22 Nor do these figures permit any firm assessment of the likely impact of competitive forces on small businesses in the manufacturing sector nor an assessment of whether in the long run the manufacturing sector or particular industries within it will be as important for small businesses as they are today.

Submissions to the Committee

3.23 The Committee received very few submissions which related to problems of small business in the manufacturing sector.

3.24 One was from a small sawmiller allegedly denied access to N.S.W. State forests, one said manufacturers should be allowed to negotiate as a group with monopoly raw materials suppliers another was from a small decorating company which complained of alleged price discrimination and monopolization by its suppliers. A further submission raised the problem of suppliers unable to protect themselves from retailers discounting below "true cost" (see paragraphs 8.43 to 8.49).

SECTION 2 - RETAILING

Statistics

3.25 In 1968/69, there were 91,478 enterprises with less than 20 employees in the retail sector. They accounted for 98.4% of the number of enterprises, 60.7% of employment and 56.1% of value added in this sector.

3.26 In 1968/69, employment in the retail sector by small businesses accounted for 30.5% of total employment by those small businesses included in the ABS statistics. Of total employment

in the retail sector by small firms in that year, food retailing accounted for 53.5% and clothing, fabrics and furniture for another 17.2%.

Submissions to the Committee

3.27 A comparatively large number of submissions relating to the retail sector were received by the Committee, of which roughly one quarter were from trade associations, the remainder were from individual retail enterprises. It is not possible to calculate how many individual retail businesses were represented by those trade associations which made submissions.

3.28 Roughly two-thirds of the submissions complained of unfair price discrimination or differentiation, and roughly one quarter raised some aspect of franchising relationships. These and related matters would appear to be the principal concerns of retailers.

SECTION 3 - SELECTED SERVICES

Statistics

3.29 The Enterprises Statistics for the year 1968/69 published by the Australian Bureau of Statistics relate only to "selected services" and exclude the financial and professional services sectors. The selected services sector contained a very high proportion of small businesses. There were 22,536 firms of less than 20 employees, accounting for 91.2% of total enterprises, 53.2% of total employment and 48.1% of total value added in this sector.

3.30 Employment in this sector constituted 11.0% of total employment by small enterprises. In this respect, the selected services sector is far less important to small firms than the retail sector (30.5% of total small business employment) and only slightly more important than the motor trades sector (10.0% of total small business employment), or wholesaling sector (10.0% of total small business employment). The selected services area includes motion picture theatres; restaurants, licensed hotels, motels and wine saloons; laundries and dry cleaners; and hair dressing and beauty salons.

3.31 Once again, the available statistics are inadequate to permit the formation of any firm conclusions as to the role of small business in this area, and especially as to factors affecting its market position. For this, one would need firm statistics on relative growth rates of particular areas within the services sector, and of small and large business shares of those areas. Despite the lack of comprehensive statistical information it is reasonable to conclude that the selected services sector is a "natural home" for small businesses.

Submissions to the Committee

3.32 The Committee received some submissions relating to the services sector, of which most were from individual enterprises and two from trade associations.

3.33 Both the trade association submissions were from outside the selected services sector (as defined), one relating to the financial sector and the other from a professional body. The submissions from individual enterprises fell into no clear pattern.

SECTION 4 - MOTOR TRADES

Statistics

3.34 In 1968/69 there were 22,167 enterprises of less than 20 employees in the motor trades sector. They accounted for 95% of the total number of enterprises, 60.9% of total employment and 52.1% of total value added in this sector.

3.35 Employment by small enterprises engaged in the motor trades sector accounted for 10% of all employment by small enterprises included in the figures published by the Australian Bureau of Statistics.

3.36 There appear to be no published statistics which provide more recent information on the importance of motor trades sector to small enterprise.

Submissions to the Committee

3.37 The Motor Trades Sector was a major source of submissions to the Committee. We received submissions from the Australian Automobile Chamber of Commerce, the Victorian Automobile Chamber of Commerce, the Motor Traders Association of N.S.W., the Australian Automobile Dealers Association, and the Australian Automobile Dealers Association (South Australian Division).

3.38 The AACC is an industry peak council representing a claimed membership of 16,000 businesses in all areas of the motor trades sector. It is claimed that these businesses employ 180,000, each business, on average employing 7 persons. The submission argued mainly for a franchise termination law and stronger price discrimination provisions. The Motor Traders Association of N.S.W. and the Victorian Automobile Chamber of Commerce are constituents of the AACC and supported its submission. The Australian Automobile Dealers Association represents approximately 3000 new vehicle franchise dealers. Its submission recommended a detailed fair franchising law and in other respects was generally supportive of the AACC's submission.

SECTION 5 - WHOLESALING

Statistics

3.39 The Australian Bureau of Statistics survey cited above found that in the wholesale sector, there were 21,667 enterprises with less than 20 employees in 1968/69. These enterprises accounted for 89.9% of the total number of enterprises, 30.3% of total employment and 26.4% of total value added in this sector.

3.40 Wholesaling accounted for 10% of total employment by small enterprises included in the A.B.S. figures.

3.41 Once again, there are insufficient recent statistics to enable an assessment of the market position of small wholesaling firms or trends within the small enterprise part of this sector.

Submissions to the Committee

3.42 The Committee received several submissions from wholesalers. All complained of unfair price discrimination. Many complained of discriminatory discount practices. One complained of the expenses of sales tax collection. One complained of "unfair" refusal to deal. Of course, the majority of retail submissions have some relevance to wholesale practices.

SECTION 6 - CONCLUSION TO CHAPTER 3

Conclusion

3.43 Using this information it is possible to rank sectors according to the extent to which small business is predominant. Small businesses are most predominate in the motor trades, then retailing, then selected services, then manufacturing, then wholesaling.

3.44 However, the ranking is quite different when sectors are ranked according to their importance to small business, as measured by the proportion of total small business employment they account for. The most important is manufacturing, closely followed by retailing; then significantly less important are selected services, motor trades and wholesaling.

3.45 Apart from resale price maintenance questions very few manufacturers have indicated they are experiencing difficulties with competition or with the competition rules of the Act.

3.46 The principal complaint in the retail sector came from retailers of electrical goods, groceries and pharmaceuticals. In the motor trades, it is those retailers that are franchised to major suppliers that are experiencing difficulties.

3.47 It can be concluded that it is not small business as such that is experiencing difficulty with competition or with the competition provisions of the Trade Practices Act. Rather it is particular categories of small business that are experiencing difficulties. Though these categories do not constitute a major proportion of all small business in Australia, they nonetheless contain a substantial number of small businesses.

3.48 Simply put, these categories of small business are: first, small corner store type retailers (particularly of electrical goods or groceries) who believe their main problems are due to price discrimination and, secondly, franchised dealers

(particularly in the motor trades) whose main problems are claimed to be price discrimination by their suppliers and their lack of bargaining power vis a vis their suppliers.

3.49 Small businesses made other complaints about being required to compete themselves (e.g. by not being permitted to fix prices) and about others with whom they deal not being competitive, or being predatory, but these complaints were not as major as the two categories outlined above.

TABLE I

(see paragraph 3.7)

INCIDENCE OF SMALL BUSINESS IN AUSTRALIAN MANUFACTURING
INDUSTRY

| ASIC Code | Industry Class | % Employment by by Small Businesses | % Employment by Small Establishments |
|--------------|---|---|--|
| 251 | Wood and Wood Products | 64.4% | 77.9% |
| 252 | Furniture and Mattresses | 63.4% | 73.8% |
| 311 | Fabricated Structural Metal Products | 57.0% | 66.8% |
| 242 | Clothing | 56.7% | 62.0% |
| 341 | Leather products | 55.9% | 71.6% |
| 312 | Sheet Metal Products | 51.2% | 51.6% |
| 313 | Nuts, fittings, Handtools & Other Fabricated metal Products | 46.9% | 53.3% |
| 262 | Printing and Publishing | 45.9% | 48.2% |
| 343 | Plastic Products | 43.4% | 47.8% |
| 333 | Industrial Machinery and Equipment | 40.0% | 45.3% |
| 216 | Bread, Cakes and Biscuits | 36.5% | 48.2% |
| 241 | Hosiery and Knitted Goods | 35.0% | 46.8% |
| 243 | Footwear | 34.5% | 42.6% |
| 233 | Other Textiles | 34.0% | 44.6% |
| 322 | Other Transport Equipment | 30.4% | 12.2% |
| 219 | Beverages & Malt | 29.2% | 40.6% |
| 282 | Clay Products | 27.3% | - |
| 215 | Flour, Mill and Cereal Foods | 26.7% | 57.5% |
| 283 | Cement and Concrete Products | 23.3% | 47.7% |
| 331 | Photographic & Scientific Equipment | 22.9% | 37.8% |

INCIDENCE OF SMALL BUSINESS IN AUSTRALIAN MANUFACTURING
INDUSTRY

| ASIC Code | Industry Class | % Employment by by Small Businesses | %Employment by Small Establishments |
|--------------|--|---|---|
| 272 | Soaps, Cosmetics & Other Chemicals | 20.4% | 34.0% |
| 231/2 | Textiles, Yarns and Worsted Fabrics | 19.5% | 28.0% |
| 332 | Appliances & Electrical Equipment | 16.6% | 21.8% |
| 212 | Milk Products | 15.8% | 40.7% |
| 211 | Meat Products | 14.4% | 21.8% |
| 261 | Paper & Paper Products | 13.2% | 25.5% |
| 213 | Fruit & Vegetable Products | 12.4% | 25.4% |
| 321 | Sugar & Other Food Products | 11.3% | 26.7% |
| 271 | Basic Chemicals | 9.5% | 28.1% |
| 292/3 | Non - Ferrous basic metal products | 8.7% | 13.7% |
| 291 | Basic Iron & Steel | 5.1% | 9.1% |
| 221 | Tobacco Products | 1.8% | 2.6% |
| 273 | Petroleum Refining | - | 0% |
| 214 | Margarines, Oils and Fats | - | - |
| 281 | Glass Plate, Bottles etc. | - | 6.4% |
| - | TOTAL | 29.4% | 37.7% |

CHAPTER 4

POLICY AIMS OF PART IV OF THE TRADE PRACTICES ACT

Introduction

4.1 Competition rules like the provisions of Part IV of the Trade Practices Act and the U.S. Anti-Trust laws may be designed to seek a number of ultimate objectives. These objectives will shape both the specific details of the legislation and particular variations to it, such as we propose in this Report.

SECTION 1 - MAIN AIMS

Promoting Competition

4.2 Some proponents of competition laws see competition as desirable mainly because it limits the accumulation and use of power by individual (large) firms. Although the use of this power might be limited by direct governmental control, competition is seen as preferable because it replaces the direct influence of big business or government with the impersonal dispassionate control of the market. A broader aspect of this claim is the limiting of the "social" power of large firms. The justification for this approach would be the conviction that fragmented economic power with many independent proprietors, rather than economic concentration with power wielded by corporate bureaucrats, is desirable in itself. This assumption is principally structural and ignores how big business performs in terms of efficiency and growth or how it conducts itself in the market place. In our view it would not be appropriate to have laws directed primarily at industry structure. While there might, in certain sectors, be both high concentration and poor firm performance, it is not clear that industry structure is the cause of poor performance, or that any general relationship between structure and performance can be confirmed.

Fair Dealing

4.3 Intuitively the notions that businessmen, in similar situations, should receive equal treatment and that businessmen should deal 'fairly' with consumers are attractive. However the concept of fairness is elusive and not susceptible to objective assessment. 'Fairness' requires subjective value judgements made according to the facts of individual situations. The difficulty of judging business conduct on the criterion of fairness can be illustrated by the example of rationing a commodity in short supply. Suppliers can allow prices to rise to effect the rationing. However those with long term contracts at a low price will complain at having to pay high spot prices. Yet if rationing takes place on the basis of past purchases rather than the market price the efficient expanding purchaser may be held back vis-a-vis a larger declining one and competition among the purchasers is hindered, no doubt to the detriment of the consumer. Fairness resides only in the eye of the beholder and depends on the facts and circumstances of individual cases. Moreover proscribing

business conduct according to a standard of fairness would require the replacement of competition by detailed regulation of individual transactions by either the courts or officials.

Small Business

4.4 The protection of small business as an end in itself would derive justification from the structural assumption that big business is bad (which we do not make) and from the conviction that many competitors, with none large enough to singularly influence prices or output, is desirable for social or political reasons. Such a policy would ignore the other objectives of efficiency of industry or the welfare of consumers and it would probably conflict with the restraints imposed on a small Australian market by minimum scale requirements in many industries.

Welfare of Consumers

4.5 The welfare of consumers is best promoted by industry being responsive to changes in technology and costs and to the diversity of wants of consumers, meeting those wants at least cost. This entails a variety of matters that boil down to desirable economic performance.

4.6 Part V, and related provisions of the Trade Practices Act, prohibit a number of particular practices and gives consumers a number of specific rights against businessmen. As the province of this inquiry is the competition rules of Part IV of the Act and not these provisions they will not be considered here.

Desirable Economic Performance

4.7 Competition laws cannot compel conduct or operate directly on performance or processes. They cannot compel efficiency or growth; rather such laws operate directly on market structure or on business conduct in order to affect processes and performance. Essentially competition laws relate to markets. They can relate to their structure or to conduct of market participants.

4.8 Market structure means those factors external to the firm like the numbers of buyers and sellers and their distribution, the character of demand, production, distribution and marketing and barriers to entry. Conduct on the other hand covers those aspects of the market which are the result of decisions of firms, for example, pricing and marketing decisions.

4.9 Efficiency in economics and in the sense used in discussion of the need for Trade Practices regulation means something quite different from the same word as used by businessmen. Specifically it means a state where no rearrangement of outputs among products and no redistribution of inputs among firms could increase consumer satisfaction without any party being worse off. While complete economy-wide efficiency is impossible to achieve because of "natural" and government

monopolies, and distortions in product and factor input markets, it is useful to apply the concept to individual industries and firms.*

Conclusion

4.10 Competition laws should be directed primarily at the behaviour of firms and secondarily at market structure that is inconsistent with the attainment of efficiency and progress. They should be directed at preventing firms persistently behaving in a manner different from that which a competitive market would enforce on them. They should not be directed primarily at achieving the other goals listed here. These other goals should be subsidiary to and dependent upon what we see as the principal goal which is the promotion of desirable economic performance by firms. Competition laws should not be directed at preserving small business as an end in itself.

SECTION 2 - COMPETITION RULES OF THE TRADE PRACTICES ACT

The aims of the Restrictive Trade Practices provisions

4.11 Some of the competition provisions of the Trade Practices Act have elements that reflect a number of aims.

4.12 For example the aim of protecting small business (as well as promoting competition) underlies sections 46, 49 and 50. Section 49 outlaws systematic price differentiation only when it substantially lessens competition. Its primary thrust is against anti-competitive conduct. Some have argued for its amendment to make its primary thrust the protection of small business. We disagree with this and discuss it in considerable detail below.

4.13 Section 50 is unique. Unlike the other competition rules which relate to conduct, section 50 relates to structure. Simply put, it outlaws mergers where a firm acquires control or domination of a market. It can be argued though that the essential design of section 50 is the prevention of market structures that are antithetical to competition.

4.14 Section 46 relates both to conduct and structure. It outlaws conduct of a firm directed to eliminating or damaging competitors, preventing entry or otherwise preventing others from engaging in competitive conduct only where the firm controls the relevant market.

* This definition does not take account of market restrictions that cannot be removed. The theory of the "second best" deals with the optimum that may be obtained when one takes into account these restrictions. Moreover, the theory of the "second best" undermines the assumption that such optima may, in fact, be achievable and that if they are achieved, they are actually beneficial.

4.15 The remaining competition provisions prohibit conduct either absolutely or if it substantially lessens competition. The categories of conduct prohibited only if the conduct substantially lessens competition in Australian markets are:

- . contracts arrangements or understandings between businesses (section 45)
- . exclusive dealing (section 47)
- . price discrimination (section 49)

4.16 Conduct within these categories is not endemically anti-competitive. On the contrary these categories of conduct are an essential part of trade and commerce and of the competitive process itself. However when conduct such as this creates rigidities in markets that are designed to allow market participants to raise prices or charge more for less - to free themselves from the disciplines of the market - then the conduct works against the attainment of efficiency of firms and efficiency of the economy as a whole.

4.17 The conduct that is proscribed absolutely is so proscribed because it is believed that in the majority of cases such conduct will clearly substantially lessen competition. Such conduct is prohibited absolutely because the certainty and administrative efficiency that is achieved outweighs the difficulties and costs that would be entailed in having to prove anti-competitive effects in each case. In this category fall:

- . primary boycotts (sections 45 and 4D)
- . price fixing agreements (sections 45 and 45A)
- . forcing another person's products (sub-sections 47(6) and (7))
- . resale price maintenance (section 48)

Conclusion

4.18 We consider the thrust of the provisions of Part IV of the Act is primarily against anti-competitive conduct that works against the attainment of efficiency. However we recognise that this thrust is tempered to some extent to protect the market position of small business and promote fairness.

4.19 We endorse this approach and recommend that there be no change to it. Our recommendation regarding the "strengthening" of Section 46 (as detailed in chapter 9) is consistent with this approach. We recommend against amending the Act to give small business a privileged position or to preserve small business for its own sake.

SECTION 3 - UNIVERSAL APPLICATION

Exemptions

4.20 While no submission has been made to the Committee that a particular section of the business community should be exempted from the operation of the competition rules it is important to set out why the Act should apply to the whole business community.

4.21 If particular businesses were favoured with exemption from the competition laws they would be able artificially to increase their market power so as to divert more community resources to them than the market would allow. Moreover, businesses with exemption would be able to prey on other businesses to deny them access to markets or otherwise prevent them from trading freely. We are not saying that businesses would necessarily engage in such conduct but with exemption from the Act there would be no impediment to stop them. Abuse of market power is not only inequitable as between businesses and between businesses and consumers, but it fosters inefficiencies and results in resource misallocation. Those with exemption are freed from the disciplines of the market. So it can be said that exemption would amount to preventing the market doing its job. Because the market mechanism is fundamental to the free enterprise system it is necessary that all business conduct be subject to the free working of market forces which tends to be maintained by the competition rules of the Trade Practices Act.

4.22 We endorsed the Swanson Committee view that the Act should be of universal application at paragraph 2.3 of our Report on the Operation of the Trade Practices Act In Relation To Primary Production in Australia (May 1979). However, we found, as stated in Part 3 of our Report, that there were factors that made primary production unique in Australia and recommended that these factors warranted some special treatment for primary production under the Trade Practices Act. (See paragraph 8 of the Primary Production Report). We do not consider that there is any justification for creating a similar general provision to benefit small business as a whole.

CHAPTER 5
OVERSEAS EXPERIENCE

Introduction

5.1 We examined approaches taken towards small business in the United States, the United Kingdom and Canada. The main emphasis of this study was an examination of the operation of the restrictive trade practices laws of those countries on small business.

5.2 At the risk of some superficiality, we set out here only a brief general statement of the operation of the relevant laws.

SECTION 1 - UNITED STATES OF AMERICA

Introduction

5.3 United States antitrust law has been created mainly by judicial interpretation and expansion of a small number of general legislative provisions. The provisions most relevant to a study of small business are sections 1 and 2 of the Sherman Act 1890, section 2 of the Clayton Act 1914, as amended by the Robinson - Patman Act 1936, and section 5 of the Federal Trade Commission Act 1914.

5.4 The American courts have developed two categories of antitrust violation:

(a) per se violation. This is conduct deemed so anticompetitive that proof that the conduct was engaged in is sufficient to establish the offence, without proof of any other element, including proof of an effect on competition, being necessary. No argument based on public benefit resulting from the conduct will be considered relevant by the courts.

(b) violation subject to the "rule of reason". This is conduct which causes undue limits on competitive conditions. The plaintiff must establish an undue anticompetitive effect before the courts will hold a violation has been committed. Offsetting public benefit aspects of the conduct will be taken into account.

Agreements which Affect Prices

5.5 In the U.S. all arrangements between competitors which affect prices, directly or indirectly, are considered per se illegal. This category includes all contracts, arrangements or understandings between competitors to fix prices, to withhold supplies from markets or to exchange price information.

5.6 In these respects, the U.S. law is very similar to the Australian law as set out in sections 45 and 45A of the Trade Practices Act.

5.7 U.S. antitrust law does not, however, have a provision like subsection 45A(3) of the Trade Practices Act for the benefit of small business which renders recommended price agreements, to which there are 50 parties or more, illegal only if they substantially lessen competition in a market and do not result (or would not be likely to result) in a benefit to the public which outweighs the detriment to the public constituted by any lessening of competition that results (or would be likely to result) from the agreement.

5.8 While the U.S. law with respect to the activities of trade associations is not very clear, it appears a recommended price agreement of this type would be per se illegal in the United States. In this respect U.S. law operates more strictly than does the Trade Practices Act and less leniently to small business.

5.9 With respect to information agreements (contracts, arrangements or understandings between competitors to exchange information as to the prices they charge or have charged or as to their costs) which are potentially capable of restricting competition, the relevant U.S. law is very complex. It appears to us, however, that in this area also, the U.S. law is more strict than Australian law. This appears also to be the case with joint buying and joint acquisition arrangements (subsections 45A(2) and (4)).

Exclusive Dealing and Customer and Territory Restrictions

5.10 Exclusive dealing in the United States (and in Australia) may take one of a number of forms. First, it may comprise an agreement by which one supplier sells his products on the condition that the customer refrains from dealing in the goods or services of competing suppliers. Secondly, the agreement may comprise a requirement contract wherein is contained a condition that the customer buys all his requirements of a particular product from a specified person. Thirdly, the agreement may involve a tying arrangement whereby one party agrees to sell one product, but only on the condition that the buyer also purchases a different (or tied) product. Further it may be constituted by buyers imposing restrictions of this nature on their suppliers. Closely allied with such exclusive dealing arrangements are territorial and customer restrictions.

5.11 Exclusive dealing agreements in the U.S. may be subject to section 3 of the Clayton Act, section 1 of the Sherman Act and section 5 of the Federal Trade Commission Act.

5.12 In respect of the first two categories mentioned above, the exclusive dealing conduct is assessed under the "rule of reason" and will be unlawful where there is proof that the effect of such conduct is either to substantially lessen competition in a substantial share of the market for the product affected, or to create a monopoly.

5.13 This is broadly similar to the Australian approach to this conduct. However, under the Trade Practices Act exclusive dealing, with the exception of conduct involving the forcing of

another's product, is only prohibited if it substantially lessens competition in an Australian market. Moreover, exclusive dealing conduct is authorizable if it results or is likely to result in a benefit to the public outweighing any detriment to the public it causes.

5.14 Territorial and customer restrictions are generally allied with exclusive dealing arrangements. The usual rationale for the imposition of such restrictions is the protection of a distributor's investment in the supplier's product through limitations placed on intra-brand competition.

5.15 In the United States, much argument has centred around whether restrictions of these types, imposed by suppliers on distributors, are per se illegal under the Sherman Act. It has been argued that while the imposition of territorial and customer restrictions on distributors may limit intra-brand competition, it will tend to enhance inter-brand competition. However, the debate now appears to have been resolved by a recent Supreme Court decision which held that such restrictions are not per se unlawful and should be assessed under the "rule of reason".

5.16 This recent development brings the United States approach broadly into line with that taken by the Trade Practices Act. Under the Act, attempts by a manufacturer or a wholesaler to restrict the dealer's sales territory or customers are illegal only if they substantially lessen competition in a market. Furthermore, such restrictions may be authorized if they are in the public interest.

5.17 It is also possible under the Trade Practices Act to gain interim protection for exclusive dealing conduct, other than conduct involving the forcing of another person's goods or services, by lodging a notification of the conduct with the Trade Practices Commission.

5.18 In the U.S. tying arrangements are considered per se violations of section 1 of the Sherman Act if the party imposing the conditions has sufficient economic or market power to appreciably restrain competition in the market for the tied product and a not insubstantial amount of commerce is affected.

5.19 In the U.S., there has been considerable controversy over the per se ruling that the Courts have applied to tying arrangements. It has been argued that this application of the per se rule has resulted in injustices, particularly where considerations of goodwill and economies of merchandising are involved. There is considerable opinion that the tying arrangements need not necessarily involve the predatory monopolistic motives so readily implied by the Courts. However, the general trend has been to suspect a firm's motives in tying arrangements and infer a lessening of competition.

5.20 This approach differs to the Trade Practices Act, where, in respect of tying arrangements, the Act requires proof of a substantial lessening of competition and public benefit aspects of the conduct can be taken into account.

5.21 In general, it seems that the U.S. law on exclusive dealing is stricter than the comparable Australian law, especially taking into account the availability under the Trade Practices Act of the authorization and the notification procedures.

Resale Price Maintenance

5.22 The practice of resale price maintenance is per se illegal under the United States antitrust laws, although a manufacturer may recommend a certain retail price, provided he does not take any positive action through inducement or collusion to enforce adherence to that recommended price.

5.23 This approach to resale price maintenance very closely parallels the approach taken by the Australian law, as expressed in sections 48, 96 and 97 of the Trade Practices Act.

5.24 One difference is that under the American law maximum resale price maintenance is also absolutely prohibited while it is permitted in Australia by paragraph 45(5)(c) of the Trade Practices Act.

5.25 Until 1975, the Federal antitrust legislation exempted from the rules set out above contracts prescribing minimum resale prices for trademarked or branded articles in "free and open competition" with commodities of the same general class, provided such contracts were lawful under a State "Fair Trade" law.

5.26 The exemption was granted by two Acts - the Miller - Tydings Act, passed by Congress in 1937 in response to strong lobbying by retailer groups, and which avoided Presidential veto only because it was tacked on to an appropriations bill, and the McGuire Act of 1951 which clarified the Miller - Tydings exemption following a restrictive interpretation given to it by the U.S. Supreme Court.

5.27 State Fair Trade laws were of two forms. Either they merely allowed the enforcement of resale price maintenance contracts against those who had signed them or they allowed the enforcement of resale price maintenance against all resellers in the relevant State, provided that at least one reseller in that State had signed a resale price maintenance contract with the manufacturer.

5.28 After a long period, marked by the increasing breakdown of resale price maintenance due to competition from resellers located in States without Fair Trade laws, by the striking down by the courts of Fair Trade statutes as unconstitutional and by increasing opposition to resale price maintenance as anti-competitive and inflationary, the Congress repealed the Miller - Tydings and McGuire Acts in 1975 by the Consumer Goods Pricing Act. The long title of which was "an Act to amend the Sherman Antitrust Act to provide lower prices for consumers".

Price Discrimination

5.29 The law primarily regulating price discrimination in the United States is section 2 of the Clayton Act 1914 as amended by the Robinson Patman Act 1936. This amendment, which sought to strengthen the original Act, was passed during the Depression and was aimed primarily at protecting small retailers from the competition of the growing large grocery chains.

5.30 The interpretation of the Robinson Patman Act is bedevilled with difficulties and it is impossible to give a concise summary of the effect of the legislation which accurately conveys the effect of its operation. These difficulties are dealt with in Chapter 10.

5.31 It is sufficient here to set out the main elements of the Robinson Patman Act. While the first limb of that Act prohibits price discrimination "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce" which is a provision not dissimilar to section 49 the second limb goes much further and protects competitors rather than competition itself.

5.32 Under the second limb of the Robinson Patman Act, discrimination in price of goods of like grade and quality is prohibited where its effect may be substantially to injure, destroy or prevent competition with any person who grants the discrimination or knowingly receives the benefit of the discrimination or is a customer of either the person granting the discrimination or of the person knowingly receiving the benefit of the discrimination. This has been interpreted by the United States courts in such a way as to mean that a price discrimination that puts a small buyer at a competitive disadvantage vis a vis a large buyer will in all probability contravene the law, in the absence of a defence. Under the Robinson Patman Act effects of price discrimination in third line markets (that in which buyers from buyers from discriminators sell) and even subsequent markets will be taken into account, while, under section 49, only effects in the markets in which the discriminator or buyers from him sell will be taken into account.

5.33 Moreover section 49 of the Trade Practices Act forbids only price discrimination of such magnitude or of such a recurring or systematic character that it has, or is likely to have, the effect of substantially lessening competition in a market in which the discriminator supplies or the buyers supply goods.

5.34 Amongst the defences permitted by the Robinson Patman Act are two which resemble those under section 49 - that the discrimination is made in good faith to meet competition or that it makes only due allowance for differences in certain costs resulting from the differing methods or quantities in which the goods are sold or delivered to the two buyers.

5.35 In the United States the "cost justification" defence will generally not succeed in the absence of actual cost related allowances. Whereas allowances for likely costs would probably be sufficient in Australia to ground a defence. This is discussed at length in Chapter 10.

Small Business Exemption

5.36 We deal here with the only exemptions from the antitrust laws enjoyed by small business in the United States.

5.37 The Small Business Act 1958 grants an exemption from the antitrust laws to small businesses cooperating to form a joint corporation to obtain for the use of small business concerns raw materials, equipment, inventories, supplies or the benefits of research and development. The exemption applies only where the relevant conduct is approved by the Small Business Administrator, after consultation with the Attorney-General and the Chairman of the Federal Trade Commission, and with the prior written approval of the Attorney-General.

5.38 In addition, it is possible for the President to grant approval to voluntary agreements and programs by small business concerns in pursuance of the Small Business Act, provided the President finds such agreements to be in the public interest as contributing to the national defence. Such agreements are exempt from the antitrust laws.

5.39 Neither of these exemptions appears to be of great practical significance and they have attracted little comment in the United States. Small business does not have a general exemption from United States competition law. Moreover, the United States law does not go as far as Australian law to tailor special provisions for the benefit of small business. (See paragraphs 5.5 to 5.9 for example).

SECTION 2 - THE UNITED KINGDOM

Introduction

5.40 British trade practices law is primarily to be found in the Restrictive Trade Practices Act 1976 (U.K.), which consolidates and extends earlier British legislation in this area. However in July of this year the recently elected Conservative Government introduced into Parliament a bill referred to as the Competition Bill designed to further strengthen the United Kingdom competition legislation.

5.41 Under the Restrictive Trade Practices Act, all restrictive agreements are required to be registered with the Director General of Fair Trading, who must take proceedings before the Restrictive Practices Court in respect of any registered agreement, unless the restrictions contained in it are not of such significance as to require investigation by the Court.

5.42 The Restrictive Practices Court has jurisdiction to declare restrictive provisions contrary to the public interest and must do so unless the parties to the agreement satisfy the Court that the restriction passes through one of the "gateways" set out in the statute and is not unreasonable having regard to the balance between the circumstances set out in one of the "gateways" and any detriment to the public or to persons not party to the agreement.

5.43 Where the Court finds a restriction contrary to the public interest, the agreement is void in respect of that restriction and the Court may prohibit the parties from continuing it and making any new agreement to like effect. Although it might be expected this legislation would be relatively ineffective because restrictive agreements have full force until the Director General brings them before the Court and obtains a declaration that they are against the public interest and because some of the "gateways" are quite widely expressed, the Act has proved quite a strong weapon against the practices it prohibits. The first reason for this is that as long ago as 1959 the British Courts read a general presumption in favour of competition into the Act; unless the parties can show the agreement passes through one of the "gateways" and also passes the balancing test, the Court will hold the restriction contrary to the public interest. The second reason for the effectiveness of the legislation is that so few agreements have managed to run this double gauntlet that many businessmen decided voluntary compliance was easier and abandoned attempts to enter agreements.

Provisions Relevant to Small Business

5.44 Two of the "gateways" for restrictive agreements are designed to allow the use of countervailing power, and, to that extent, are appropriate to a consideration of how the Act affects small business.

The first is contained in paragraph 10(1)(c):

"that the restriction of information provision is reasonably necessary to counteract measures taken by any one person not party to the agreement with a view to preventing or restricting competition in or in relation to the trade or business in which the persons party thereto are engaged."

5.45 The scope of this provision has not yet been considered by the British Courts. Commentators, however have said that the legislation would be extremely difficult to use in practice.

5.46 The second "countervailing" defence is contained in paragraph 10(1)(d):

"that the restriction of information provision is reasonably necessary to enable the person party to the agreement to negotiate fair terms for the supply of goods,

to, or the acquisition of goods from, any one person not party thereto who controls a preponderant part of the trade or business of acquiring or supplying such goods, or for the supply of goods to any person not party to the agreement and not carrying on such a trade or business who, either alone or in combination with any other such person, controls a preponderant part of the market for such goods".

5.47 This defence is aimed at allowing firms to combine to counteract the market power of a preponderant buyer or seller. It has been argued in a number of cases, in one of which it succeeded. Its interpretation and application are still subject to considerable legal uncertainty in the United Kingdom and we found it impossible to assess its usefulness in assisting small business to increase their bargaining power.

Price Fixing and Related Agreements

5.48 All horizontal agreements under which more than one party accepts a restriction (that is, some limitation on his freedom to make his own decisions concerning the prices to be quoted, charged or paid for goods, the processing of goods, or the supply of services) are subject to the Act.

5.49 This covers all formal and informal agreements and the recommendations of trade and services supply associations. Although some categories of restrictive agreement are exempt from the Act, or can be exempted by Order, none of these exemptions appears relevant to the operation of the Act with respect to small business.

5.50 The UK legislation is more strict in this respect than the Australian as it contains no exemption equivalent to subsection 45A(3) (recommended price agreements to which there are at least 50 parties).

Exclusive Dealing

5.51 The UK approach to exclusive dealing conduct is very different from the Australian.

5.52 The Restrictive Trade Practices Act (UK) does not apply to an agreement for the supply of goods or services between two parties only, neither of whom is a trade association or a services supply association, and under which no restrictions are accepted or made other than restrictions by the supplier in respect of the supply of goods or services of the same description or by the acquirer in respect of the sale of goods of the same description or the obtaining of services from other persons.

5.53 Effectively this means that "classic" exclusive dealing agreements under which the buyer agrees not to buy goods from a competitor of the seller or the seller agrees not to sell goods

to a competitor of the buyer, as well as requirements contracts, fall outside the scope of the UK trade practices legislation. Since the Act applies only to two-party agreements in any event and not to classes of agreements made by a particular person, even the aggregated effect of a particular party's exclusive dealing practices on competition is outside the scope of the UK Restrictive Practices Act.

5.54 One qualification to this general immunity of exclusive dealing conduct from UK restrictive practices law should be mentioned. It is possible for the exclusive dealing arrangements of a monopolist, as defined in the Fair Trading Act 1973 (U.K.) to be investigated by the Monopolies and Mergers Commission, following a reference given to the Commission by either the Director General of Fair Trading or the Secretary of State. Use has been made of this provision and some modification of exclusive dealing arrangements in some of the more highly concentrated sectors of the UK economy has resulted.

5.55 On the whole, however, we found that restrictive trade practices law in the UK is considerably less favourable to small business than is the Australian Trade Practices Act in an area of great practical significance to small firms - that of exclusive dealing conduct.

5.56 Outlawing exclusive dealing practices, in the majority of cases, is of benefit to small business and serves to bolster the market position of small business. Larger businesses are prevented from anti-competitively requiring small businesses to accept tying or requirements contracts as a condition of being supplied or allowed to supply. In this respect Australian law favours small business more, and improves its market position more, than U.K. law.

The Competition Bill

5.57 At the time of writing the Bill has been introduced into the House of Commons but has not been passed. The Bill, if enacted, would apply to anti-competitive practices which are defined as "... a course of conduct which ... has or is intended to have or is likely to have the effect of restricting, distorting or preventing competition in connection with the production, supply or acquisition of goods ..." (Sub-clause 2(1) of the Bill).

5.58 It would appear that while this Bill is primarily directed towards exclusive dealing arrangements, practices involving price discrimination and monopolisation which meet the competition test in clause 2 may also be subject to the Bill. Agreements registered or subject to registration under the Restrictive Trade Practices Act 1976 would be excluded for the operation of the proposed Act (Sub-clause 2(2) of the Bill).

5.59 The Bill contains a procedure for a preliminary investigation by the Director General of Fair Trading to establish whether there is a prima facie case. If such a case is established it is to be referred to the Monopolies and Mergers

Commission for further investigation to determine whether the practice is against the public interest. If the Commission determines that a practice is against the public interest the Secretary of State may ask the Director General to seek an undertaking or make an order against the practice.

Resale Price Maintenance

5.60 UK resale price maintenance law is contained in the Resale Prices Act 1976 (UK) which consolidated earlier legislation. In terms, it is almost identical to the Australian law except that provision is made for the exemption of particular classes of goods from the general prohibition on resale price maintenance.

5.61 The Restrictive Practices Court may make an order directing the exemption of a class of goods from the Resale Prices Act if it is satisfied that the particular class of goods passes through one of five "gateways" and that the detriment to the public as set out in the gateway if there were no system of resale price maintenance in respect of the goods outweighs the detriment to the public resulting from the imposition of resale price maintenance in respect of the goods.

5.62 The "gateways" are that, in the absence of resale price maintenance for the goods:

- a) the quality of the goods available for sale, or the varieties of the goods so available, would be substantially reduced to the detriment of the public as consumers or users of the goods;
- b) the number of establishments in which the goods are sold by retail would be substantially reduced to the detriment of the public as consumers or users;
- c) the prices at which the goods are sold by retail would in general and in the long run be increased to the detriment of the public as such consumers or users;
- d) the goods would be sold by retail under conditions likely to cause danger to health in consequence of their misuse by the public as consumers or users; or
- e) any necessary services actually provided in connection with or after the sale of the goods by retail would cease to be so provided or would be substantially reduced to the detriment of the public as consumers or users.

5.63 Two classes of goods have been exempted from the Act - books and prescription medicines.

5.64 In our view these provisions would not appear to greatly improve the market position of small business in the UK. Further comments on resale price maintenance appear in Chapter 8.

Price Discrimination

5.65 There is no general prohibition on price discrimination or other discrimination in terms of trade by an individual enterprise under UK law.

5.66 This general freedom to discriminate in price is tempered by two factors - horizontal agreements by which firms agree to provide goods or services on discriminatory terms are fully subject to the Restrictive Practices Act 1976 (U.K.) and the discriminatory practices of monopolists are subject to investigation by the Monopolies and Mergers Commission following an appropriate reference to it by the Director General of Fair Trading or the Secretary of State.

SECTION 3 - CANADA

Introduction

5.67 Canadian restrictive business practices law is contained in the Combines Investigation Act R.S., c. C - 23, which in its present form is the result of the implementation by way of extensive amendments coming into effect on 1 January 1976 and comprises the first stage of a very extensive review of Canadian competition policy.

5.68 The Bill implementing the second stage of the revised policy, Bill C - 13 (which replaced Bill C - 42) lapsed with the dissolution of Parliament in March 1979 before a general election. It is not known whether the new Government plans to reintroduce the Bill.

5.69 The Act defines a number of offences and makes certain practices subject to review and remedial order by the Restrictive Trade Practices Commission, a quasi-judicial body.

5.70 Inquiries into matters falling within the Act are the responsibility of the Director of Investigation and Research, who then refers the matters to the Attorney-General if action is to be taken in the courts, or to the Restrictive Trade Practices Commission if action is to be taken under its review powers.

5.71 Most of the offences created by the Act may be prosecuted on indictment and carry maximum penalties of up to five years of imprisonment or an unlimited fine at the discretion of the courts, or both. In addition, the courts have power to issue injunctions and orders in respect of most matters. There are no rights of private action under the legislation.

Arrangements Affecting Price or Lessening Competition

5.72 Under sub-section 32(1) it is an indictable offence punishable by fine of up to \$C 1 million, for anyone to combine, agree or arrange with another person:

- (a) to limit unduly the facilities for transporting, producing, manufacturing, applying, storing or dealing in any product;

- (b) to prevent, limit or lessen, unduly, the manufacture or production of a product, or to enhance unreasonably the price thereof;
- (c) to prevent, or lessen unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance upon persons or property; or
- (d) to otherwise restrain or limit competition unduly.

5.73 The word "product" is defined to include goods and services of all descriptions. The phrase "to prevent, or lessen unduly, competition" has been interpreted by the courts in such a way that any arrangement which would if carried into effect, materially interfere with competition in a substantial sector of trade, is caught by the section.

5.74 Since under Canadian competition law price agreements are not automatically illegal, it is possible that recommended price agreements by trade associations of small businessmen would not be caught by the Canadian law. In this respect it appears that Canadian law may be less strict than the Trade Practices Act. It is, however, impossible without a detailed study of the operation of Canadian competition law to compare this with the treatment of recommended price agreements with at least 50 parties under the Trade Practices Act.

Exclusive Dealing Conduct

5.75 The practice of exclusive dealing, tied selling and market restrictions do not constitute offences under the Act. Where, however, any of these practices is engaged in by a major supplier or is widespread in a market and competition is or is likely to be lessened substantially, the Restrictive Trade Practices Commission may order a supplier to cease or modify the practice.

5.76 Canadian law in this area appears to be very similar to that in Australia under the Trade Practices Act, the major difference being that under the Trade Practices Act the practice of forcing another person's goods or services is prohibited irrespective of its effect on competition.

Resale Price Maintenance

5.77 Resale price maintenance of either goods or services is an indictable offence punishable by up to five years imprisonment or an unlimited fine at the discretion of the court or both.

5.78 The substance of the resale price maintenance provisions differs from the Australian law only in that they apply to services as well as to goods and that resale price maintenance agreements between affiliated persons are permitted. The maintenance of a maximum resale price is permitted, as is the setting of a true suggested price, and it is a defence to a prosecution for resale price maintenance that it was to prevent loss-leadering.

Price Discrimination

5.79 Under section 34 of the Combines Investigation Act it is an indictable offence, punishable by 2 years imprisonment, for anyone to be a party to a sale that discriminates to his knowledge, directly or indirectly against competitors of a purchaser of articles from him in that any discount, rebate, allowance or other advantage is granted to the purchaser over and above those available at the time of the sale to competitors in respect of a sale of articles of like quality and quantity, provided such a sale is part of a practice of discriminating.

5.80 The effectiveness of this provision appears to be severely limited. In the first place, proof must be adduced of a practice of discriminating. Secondly, the discrimination must be in respect of similar quantities, which is of no assistance to the small firm whose complaint is that quantity discounts, of which they cannot take advantage are themselves often discriminatory. More generally, the provision is concerned with price discriminations that disadvantage competitors rather than those which lessen competition. In our view, protection of competitors rather than competition is more appropriately dealt with in the context of a monopolization law which is designed to check the abuse of market power. (See Chapter 9).

5.81 Two predatory pricing practices are also forbidden by section 34. It is an indictable offence punishable by 2 years imprisonment for anyone to engage in a policy of selling products in any area of Canada at prices lower than those exacted by him elsewhere in Canada or of selling products at unreasonably low prices anywhere in Canada where the effect or tendency is to substantially lessen competition or eliminate a competitor or where it is designed to have such effect.

5.82 It is an offence under section 35 for a seller to grant a purchaser any allowance for advertising or display purposes that he does not offer on proportionate terms to competing sellers.

5.83 These provisions appear stronger than the equivalent Australian provisions in that practices are forbidden if they affect competitors rather than competition. Very few cases have, however, come before the courts in the 44 years the provisions have been in force and none has resulted in a conviction.

Refusal to Sell

5.84 Where a person willing and able to meet the usual trade terms of a supplier or suppliers is unable to obtain supplies because of insufficient competition and the product is in ample supply and he is substantially affected in his business thereby, the Restrictive Trade Practices Commission may, on application by the Director of Investigation and Research, order that the prospective purchaser be supplied or recommend reductions in customs duties.

5.85 This provision was inserted into the Act as part of the Stage One amendments which came into effect on 1 January 1976 and was designed specifically to assist small business. It is intended to apply whether the person refused supply is established in the market or a potential new entrant. As at March 1979 use of this provision was being contemplated by the Canadian Government as a means of dealing with supply problems experienced by resellers of petroleum products.

CHAPTER 6

AGREEMENTS AFFECTING COMPETITION SECTIONS 45 - 45D

Introduction

6.1 Sections 45 to 45D of the Trade Practices Act are the key regulatory provisions in the restrictive trade practices part of the Act. They prevent market participants insulating themselves from competition by collusive arrangements and by exclusionary conduct. By prohibiting conduct that restricts the free working of market forces, they remove artificial rigidities, encourage rivalrous behaviour and ultimately allow the more efficient allocation of resources.

6.2 Prior to 1977 section 45 dealt with agreements in restraint of trade or commerce. That section was subjected to much criticism largely because of the uncertainty created by the language which had been closely associated with the common law.

6.3 Following the Swanson Committee's review of the Act in 1976 the present sections 45 to 45D, which deal comprehensively with the general area of agreements which substantially lessen competition in a market, were inserted.

SECTION 1 - MEASURES TO ASSIST SMALL BUSINESS

Provisions Inserted in 1977

6.4 When introducing the Trade Practices Amendment Bill 1977, the Minister for Business and Consumer Affairs, drew specific attention to measures which had been incorporated in the amendments for the purpose of assisting small business. The Minister noted that the original Act had given insufficient attention to the problems of small business and, in an attempt to remedy this neglect, a number of concessions were to be allowed. These have now been incorporated in various areas of the section 45 bracket of provisions and, briefly, are:

- (a) the allowance of true recommended prices where there are more than 50 participants and there is no substantial anti-competitive effect (sub-section 45A(3) and paragraph 88(3)(b));
- (b) the permission of agreements relating to collective acquisition and joint advertising schemes (sub-section 45A(4) and sub-section 88(4));
- (c) the general assistance provided by the prohibition on collective primary and secondary boycotts (section 45(2) and section 45D).

6.5 It is felt that these concessions, together with the prohibitions on collusive arrangements contained in sections 45 to 45D have provided a demonstrable measure of benefit to small

businesses. The provisions have operated so as to preclude suppliers from collectively fixing the price of goods supplied to small businesses and have encouraged competition on price. There appear to be many small business sellers who have flourished on price competition. Additionally, it would appear that collective buying groups and joint advertising groups are operating in several industries with success.

6.6 This assistance to small business, through the operation of section 45, has been generally noted in the submissions received by the Committee. While these submissions have tended to support the retention of that section in its present form, they have, however, pointed out areas where problems have arisen. (See paragraphs 6.21 to 6.24 and also paragraphs 12.7 to 12.34).

SECTION 2 - SECTIONS 45 TO 45D

Overview of Sections 45 to 45D

6.7 The prohibitions in sections 45 to 45D fall into four categories:

- (a) contracts, arrangements or understandings containing exclusionary provisions or affecting competition;
- (b) price fixing;
- (c) covenants affecting competition; and
- (d) boycotts.

Contracts, Arrangements or Understandings containing exclusionary provisions or affecting competition

6.8 Section 45 prohibits the making of or giving effect to a provision in a contract, arrangement or understanding which is an exclusionary provision or which has the purpose or effect of substantially lessening competition in a market.

6.9 The purpose of this section is twofold. First it prohibits practices which are considered to be intrinsically anti-competitive such as exclusionary agreements (paragraph 45(1)(a), paragraph 45(2)(a), and sub-paragraph 45(2)(b)(i)). Secondly it operates as a general regulatory provision which is flexible enough to prohibit those classes of conduct not specifically covered by other provisions in Part IV of the Act but which have the effect or likely effect of substantially lessening competition in a market. Such flexibility or breadth is achieved by the combination of "purpose", "effect" or "likely effect" provisions in contracts arrangements and understandings. The limitation provided within the section is that the effect must be a "substantial lessening of competition in a market". This focusses attention on the competitive impact of the practice in question and ensures that the prohibition does not operate too harshly against a wide range of commercial arrangements.

Price Fixing

6.10 Provisions in contracts, arrangements or understandings which have the effect or likely effect of fixing, controlling or maintaining prices between competitors in relation to the acquisition, supply or re-supply of goods or services, are deemed to have the effect or likely effect of substantially lessening competition by subsection 45A(1). Subject to the availability of authorization in specific cases, and to the exceptions listed below, the prohibition on price fixing between competitors is absolute.

6.11 These exceptions are:

- (i) agreements between the parties to a joint venture relating to the selling price of joint venture goods or services (subsection 45A(2));
- (ii) price recommendation agreements, having 50 or more parties, relating to the supply or acquisition of goods or services (subsection 45A(3));
- (iii) agreements on the price to be paid by a collective buying group (paragraph 45A(4)(a)); and
- (iv) agreements relating to the price at which the members of such a buying group will jointly advertise the goods on resale (paragraph 45A(4)(b)).

Covenants Affecting Competition

6.12 Sections 45B and 45C prohibit, and render unenforceable, covenants which have, or are likely to have, the effect of substantially lessening competition. The provisions dealing with covenants were specifically introduced in order to overcome the Quadramain decision where the High Court excluded covenants from the ambit of those arrangements in restraint of trade prohibited by section 45 of the original 1974 Act.

6.13 An exception is made for covenants protecting residential interests (paragraph 45B(9)(a)) and for covenants for the purpose of religious, charitable or public benevolent institutions (paragraphs 45B(9)(b) and (c)).

6.14 Section 45C prevents restrictive covenants from being used for the purposes of fixing, controlling or maintaining prices.

Boycotts

6.15 Sections 45 and 45D contain special provisions designed to prohibit collective boycotts - both primary and secondary.

6.16 Collective primary boycotts occur where the boycott seeks to restrict the dealings of persons, who are in competition with each other, by preventing their dealing with the "target" person

and are prohibited as exclusionary provisions under subparagraphs 45(2)(a)(i) and 45(2)(b)(i).

6.17 Collective secondary boycotts occur where the boycott seeks to restrict the dealings of persons, other than the competing parties, with the "target" person. These are prohibited where they have the purpose and effect or likely effect of causing:

- (a) a substantial loss or damage to the business of the "target" corporation; or
- (b) a substantial lessening of competition in any market in which the corporation supplies or acquires goods.

6.18 The section also prohibits conduct whereby one person, in concert with another, engages in conduct which has the purpose or effect of preventing or substantially hindering a third person from engaging in interstate or overseas trade or commerce. It is a defence if the conduct is authorized or notified to the Trade Practices Commission or if the conduct is engaged in to preserve a business.

6.19 Exemptions apply to avoid the application of the boycott provisions to matters of remuneration, conditions of employment, termination of employment, hours of work or working conditions of employees. (Concerted action by consumers is exempted under subsection 51(2A)).

6.20 Where prohibited secondary boycott conduct is engaged in by members or officers of an employee organisation, special provisions apply in relation to enforcement and remedies. The organisation is liable for damages in the place of its members or officers unless it takes all reasonable steps to prevent the prohibited conduct. Further, pecuniary penalties cannot be imposed on individuals engaging in, or attempting to engage in, secondary boycotts (sub-section 76(2)).

SECTION 3 - GENERAL

Trade Associations

6.21 One matter which was raised in a number of submissions to the Committee concerned the role that is played by trade associations and other similar bodies assisting small businesses. These submissions generally argue that small businesses are, because of their size, lack of market power and comparative lack of expertise, unable to compete effectively with larger enterprises. Further, they argue that if small businesses are to continue as a viable market force in the economy, they must rely heavily on assistance from trade associations. Assistance in such a case would include the development of standard forms of contract, uniform terms of trading, information agreements, codes of ethics and recommended prices.

6.22 It is feared by the authors of some submissions that these beneficial activities of trade associations might be hindered by the operation of the section 45 group of sections.

6.23 It is also argued that the Trade Practices Commission takes too narrow an approach to the meaning of 'public benefit' and places too much emphasis on limitations on short-term price competition. We discuss this matter in Chapter 12 of this Report. Many Trade Associations appear to be unduly worried about obtaining authorization from the Commission for their recommended price agreements.

6.24 Small businessmen need to appreciate that while recommended price agreements involving 50 or more competitors may not contain many public benefit elements nevertheless, unlike price fixing agreements, they do not often have the effect of substantially lessening competition in a market. Accordingly while authorization is not available in many instances; nevertheless the agreements and their implementation will often be perfectly legal.

6.25 Another argument emphasises the unintended effects of the section 45 group of provisions in deterring legitimate business activity due to the uncertainty of small businesses as to what conduct will fall within these provisions. This matter is considered in Chapter 12 of this Report.

SECTION 4 - CONCLUSION TO CHAPTER 6

Conclusion

6.26 It is considered that no change to these provisions is necessary. They are the result of extensive examination by the Swanson Committee and already give special treatment to the conduct of small business and are directed at improving the market position of small business. It is recommended that no change be made to these provisions to afford more lenient treatment to small business.

CHAPTER 7EXCLUSIVE DEALINGIntroduction

7.1 Under the heading "exclusive dealing", section 47 prohibits a wide range of restrictive practices which were formerly prevalent in the distribution and marketing sectors of the economy. Since the practices forbidden by section 47 were ones which were usually imposed by the more economically powerful on those who lacked bargaining power, we expected that section 47 would have been of considerable benefit to small business.

7.2 This expectation has apparently been fulfilled in large part by the practical operation of the legislation. Of the submissions that mentioned section 47 (and they were relatively few in number), all supported the broad thrust of the section, although some raised objections to some comparatively minor aspects of its operation.

7.3 Before discussing these particular criticisms, it is useful to set out here in general terms the scope of the section of its operation.

General Outline of Section 47

7.4 Put in very general terms, the purpose of the first set of provisions in section 47 is, subject to other considerations set out below, to prevent attempts by a supplier to directly or indirectly interfere with the freedom of his buyers to buy from other suppliers or to sell to whom they choose. Conduct falling within the section includes full line forcing (that is where the supplier obliges the buyer to buy a full range of the supplier's goods) requirements contracts (under which the supplier obliges the buyer to purchase all his requirements from the supplier) and the imposition of territorial or customer restrictions on the buyer.

7.5 The section strikes at the substance of the conduct and not at its form. Whether the supplier attempts to impose proscribed conditions on a buyer at the initial stage of negotiation, by way of special allowances, discounts or rebates, by way of special credit conditions, through refusing to supply or refusing to supply on usual terms, through covenants in a lease or through threatening to terminate or fail to renew a lease or licence, section 47 will apply.

7.6 Although it is usually the case that the supplier is the one who attempts to impose exclusive dealing conditions, section 47 applies also to conduct by which buyers attempt to impose restrictions on the economic freedom of suppliers to sell as they wish.

7.7 The legislation recognises that exclusive dealing conduct may in many situations be consistent with competition and not unduly restrictive of economic freedom. For this reason the legislation contains a number of limitations on the scope of the general prohibition of exclusive dealing conduct.

7.8 Exclusive dealing conduct of the kind outlined above is prohibited only if, considered alone or in conjunction with other conduct of the offender and its related bodies corporate, it has the purpose or has the effect or is likely to have the effect of substantially lessening competition in the relevant market.

7.9 Even where exclusive dealing conduct of the type outlined above substantially lessens competition, it may be authorized by the Trade Practices Commission. The Commission is able to authorize conduct if it results or is likely to result in a benefit to the public outweighing the detriment to the public constituted by the lessening of competition flowing from the conduct.

7.10 In addition, such exclusive dealing conduct qualifies for a special form of interim protection from the operation of the Act. By giving notification of exclusive dealing conduct to the Trade Practices Commission under section 93, a corporation gains protection from the operation of the section. The protection remains effective for 30 days after the giving of notice by the Commission that it has found that the anti-competitive effect, or likely anti-competitive effect of the conduct outweighs the public benefit, or likely public benefit flowing from it.

7.11 Third line forcing, a form of exclusive dealing, is treated more stringently. This practice is constituted by a supplier forcing a buyer of his goods or services to also buy the goods or services of another person. It is forbidden regardless of its effect on competition and does not qualify for the protection of the notification procedure. However, it may be authorised on public benefit grounds. This harsher statutory treatment of third line forcing is in accordance with the view of the Swanson Committee that the practice would in virtually all cases have an anti-competitive effect and should only be capable of authorization on public benefit grounds. It is an area of the law which we would hope to review soon.

Discussion

7.12 Some submissions argued that, by striking down many exclusive dealership arrangements, section 47 had unwittingly impeded the access to the market of some small businesses. One argument was that small manufacturers need to be able to offer exclusive dealerships in order to make it worthwhile for dealers to stock their products. In our opinion, where the manufacturer's line of products was as small as this and his market power correspondingly limited, his exclusive dealing agreements would be most unlikely to contravene the Act, as they would not substantially lessen competition in a relevant market.

Conclusion to Chapter 7

7.13 We are firmly of the opinion that by removing restraints in the marketing and distribution systems section 47 has substantially improved the market position of small businesses by increasing their economic freedom. The reduction of restraints

formerly imposed by those with economic power has increased small business opportunities and enhanced small business bargaining power vis a vis powerful suppliers or acquirers.

7.14 As we have said above, those submissions which commented on section 47 for the most part saw it as improving the marketing position of small business. Several submissions did, however, raise one practical difficulty which limits the usefulness of the section to small business. This difficulty arises where a reseller holds his premises on a lease or licence from the supplier. Because such leases or licences are often for short terms and are subject to termination or non-renewal at the discretion of the supplier, a reseller is often reluctant to exercise the freedom that section 47 gives him to purchase supplies from alternative sources, for fear that his supplier/landlord will terminate or fail to renew the lease or licence.

7.15 The amendments to the Act in 1977 which resulted in subsections 47(8) and 47(9) were designed to overcome this problem. However, a problem may still arise where, in order to deal in the products of another supplier, the dealer finds it necessary to make capital improvements of the leased or licenced premises. If his lease or licence is terminated or not renewed by his supplier, the dealer may well be fearful that he will not obtain adequate compensation for such improvements. This fear would tend to inhibit dealers from exercising the freedom section 47 is designed to give them.

7.16 Accordingly, we believe that security of tenure must complement the exclusive dealing provisions in order to ensure their effectiveness. We do not propose to discuss this aspect further here as it is covered in Chapter 11 which contains our recommendations on a law relating to franchising.

CHAPTER 8

RESALE PRICE MAINTENANCE AND RELATED MATTERS

Introduction

8.1 It appears that there is widespread price competition in the retail sector. One result of this is pressure on the profitability of small specialist retailers.

8.2 Some submissions saw this as the result of the ability of large retail chains to obtain volume discounts from their suppliers and use the resulting savings to lower their retail prices. Submissions in this group concentrated on recommending amendments to section 49 to outlaw price discrimination that hurts individuals, to eliminate what was perceived as unfair price discrimination, thus giving the small retailer an equal opportunity to compete in retail price. This matter is dealt with in chapter 10. Some submissions, did however, argue for the removal or the modification of the prohibition of resale price maintenance, either as an alternative to a prohibition of unfair price discrimination, or as an adjunct to such a measure. This issue is dealt with in this chapter.

SECTION 1 - MINIMUM RESALE PRICE MAINTENANCE

The Prohibition

8.3 At present the Trade Practices Act (section 48 and section 96) prohibits the practice of resale price maintenance absolutely. These provisions forbid any attempt by a supplier to directly or indirectly fix a price below which resellers of his product may not sell it. The absolute prohibition is subject to two exemptions, in respect of recommended prices and loss-leader selling. These are discussed more fully below.

8.4 The prohibition does not apply to the specification of a maximum resale price, which is expressly exempted from the Trade Practices Act by paragraph 45(5)(c). (See paragraph 8.24).

Submissions

8.5 Some submissions argued that the practice of resale price maintenance should be permitted. It would then, it is argued, be in the supplier's interest to set a resale price which would guarantee a "reasonable" rate of return to all those who sold his product. Small specialist retailers would benefit through the provision of this guaranteed "reasonable" return and through the elimination of price competition from large retailers.

The Committee's views

8.6 It is accepted that a relaxation of the prohibition on resale price maintenance could benefit small retailers in certain fields but the benefit would be of a short term nature and would

not strengthen the market position of small retailers as much as might at first appear. Moreover such a relaxation of the prohibition would be at variance with the competitive thrust of the Act which we endorse (see paragraphs 4.18 and 4.19).

8.7 However even were systems of effective resale price maintenance to be reintroduced by suppliers, the fixing of the retail price by the supplier would result in greater profit per unit to those resellers who were able to obtain volume discounts and other benefits from the supplier than achieved by the small retailer. The profits so gained would permit greater non-price competition through advertising, better service, free delivery, more advantageous consumer credit, etc. The small retailer would remain at a long term competitive disadvantage.

8.8 Nor would the reintroduction of resale price maintenance necessarily guarantee that suppliers would set resale prices adequate to ensure small retailers, particularly those retailers whose viability is marginal, a sufficient return to ensure their profitability. A supplier's decision to engage in resale price maintenance and set a particular resale price is based on the supplier's assessment of the marketing strategy that best serves his self-interest, weighing the increase in market penetration gained by having a large number of outlets against the loss of consumer sales occasioned by setting a higher retail price. In markets where the supplier faces considerable competition in the consumer market or can achieve high volume through few outlets, the supplier will tend to lower his resale price to the point where his goods are only marginally profitable, if at all, for his smaller, less viable, outlets.

8.9 Indeed, this seems to be the true situation in those retailing sectors which are most in favour of the reintroduction of resale price maintenance. Severe competition for the consumer market between suppliers has resulted in changed marketing and distribution strategies and practices, in which the importance of the role of the traditional specialist retailer has been greatly reduced.

8.10 If resale price maintenance did benefit some small retailers it would benefit them at the expense of a considerable reduction in competition in the retail sector, and amount to a redistribution of income from consumers as a group to retailers as a group. Resale price maintenance would not assist the small retailer unless it was effective in fixing retail prices which were higher than they otherwise would be. To the extent that consumers have to pay higher prices there would be a transfer of income from consumers to retailers as a group. Of this transferred income a large proportion, perhaps even the major proportion, would be reaped by the larger retailers.

8.11 The fixing of retail prices has significant anti-competitive effects. It disadvantages the aggressive and efficient retailer who is prevented from translating efficiencies and economies he has achieved into lower and more competitive

~~prices and disadvantages the new entrant to the retailing market in that he is denied flexibility in his pricing decisions. All participants in the market have less incentive to seek more efficient methods of distribution and traditional inefficient distribution practices tend to persist when prices are fixed. Consumer preferences are less effectively transmitted and price misallocation of resources results.~~

SECTION 2 - PUBLIC BENEFIT AND RESALE PRICE MAINTENANCE

8.12 Some submissions argued that in some circumstances resale price maintenance might be justifiable as being in the public interest. In this section we examine these submissions and give our views.

Preserves Specialist Retailers

8.13 One public benefit put forward consisted of the preservation of a particular sort of businessman - a specialist retailer who is an expert in the goods he sells and is able to give consumers qualified advice on which goods to buy for particular purposes and on their safe and efficient use.

8.14 It is argued that the provision of this qualified advice imposes a cost on the specialist retailer, which he is unable to recoup from the consumer in the absence of resale price maintenance. The consumer will obtain the advice from the specialist retailer and then buy the goods from another retailer who is selling them more cheaply. In the long term, price competition will, without resale price maintenance, force the disappearance of specialist retailers, thus depriving consumers of the benefit of informed guidance on products.

8.15 However the benefit of more adequate consumer information is one which is increasingly available to the consumer from sources other than the specialist retailer - governmental bodies, consumer groups, the media, other retailers and manufacturers.

8.16 Even if this benefit were one that were only available to consumers through the preservation of the specialist retailer by way of resale price maintenance, it would hardly justify the disadvantages to the public in terms of higher retail prices flowing from resale price maintenance.

Ensure Adequate Service

8.17 Another argument advanced in favour of resale price maintenance is that it enables the reseller to provide adequate service facilities.

8.18 It is common for a manufacturer to require his dealers to maintain service facilities and repair free, or at a low charge, goods brought in for service during the warranty period, the reseller being expected to recoup part or all of his costs of providing the service from his profits on the initial sale.

Without resale price maintenance and with strong price competition there will be no margin in the retail price to subsidise repair or servicing costs. Accordingly, it is argued that, resale price maintenance should be permitted so that retail prices are increased to a level that allows servicing and repairing to be done free or well below cost.

8.19 We see little merit, in this argument. We do not see it as a public benefit for repair or servicing costs to be subsidised by retail prices. Consumers should be free to buy goods with or without a servicing or repairing 'package'.

Recommended Prices

8.20 Section 97 provides that a supplier is not guilty of resale price maintenance merely because he uses a true recommended price.

8.21 This reflects a desirable balance between two conflicting interests. On the one hand, it leads to greater price rigidity at the retail level than would otherwise be the case. On the other, it provides small businessmen with guidance in setting prices, and compensates for their lack of resources and expertise in this area.

8.22 Some submissions alleged that a manufacturer's recommended price was occasionally too low to ensure the reseller a "reasonable return on the product".

8.23 It is difficult to see the validity of this argument. Where the reseller is not facing effective price competition, he is under no obligation to comply with the recommendation and may set a higher price if he wishes, if necessary covering the manufacturer's price label with his own. Where the reseller faces effective price competition, he will be unable to raise the price himself in any event.

Maximum Resale Price Maintenance

8.24 Paragraph 45(5)(c) allows a supplier to fix the maximum price at which a reseller may sell products obtained directly or indirectly from the supplier. This conduct is exempt from the Trade Practices Act, whether or not it substantially lessens competition in a market, unless it constitutes monopolization within the meaning of section 46.

8.25 Some submissions argued that small businesses suffered where the supplier imposed a maximum resale price too low to provide the small businessman an adequate return.

8.26 Prohibiting the fixing of maximum resale prices would only benefit those retailers who could increase their prices above the level recommended by their supplier.

8.27 Retailers, who could charge a higher price than that recommended by the supplier in their market would be able to do so either because they provided the consumer with significant

non-price advantages or because they are insulated from market forces by the possession of a monopoly in an exclusive territory, either conferred by the manufacturer or the result of such other factors as distance from other outlets or zoning requirements.

8.28 The ability to fix maximum retail prices is a valuable element in the supplier's market strategy. It must achieve certain volume targets and needs to be certain that its products sell in numbers that make it profitable for it to operate. The ability to fix the maximum price will give it some degree of control over retailers to ensure that its sales targets are met. This would be particularly important for small manufacturers.

8.29 Moreover allowing the fixing of maximum resale prices is consistent with one of the aims of the resale price maintenance law - to benefit consumers through the lowering of prices.

Loss - leadering

8.30 While generally a supplier is prohibited from withholding supplies of goods from a reseller that discounts he may withhold supplies where the reseller discounts below cost (Section 98).

8.31 Under this exception a supplier may withhold the supply of his goods to a person who, within the preceding year, has sold goods obtained directly or indirectly from the supplier at less than their cost to that other person but only where the sale below cost was for the purpose of attracting to the establishment at which the goods were sold persons likely to purchase other goods or otherwise for the purpose of promoting the business of that other person.

8.32 The exception does not apply where the sale below cost was a genuine seasonal or clearance sale of goods that were not acquired for the purpose of being sold at that sale or where the sale below cost took place with the consent of the supplier.

8.33 The relevant cost to the reseller may include delivery charges, but does not include any proportion of the reseller's overheads.

8.34 The Act does not prohibit selling below cost nor does it require the supplier to withhold supply to a reseller who is selling below cost it merely permits the supplier to withhold supply in certain circumstances if he wishes.

8.35 A substantial number of submissions urged that loss-leadering should be prohibited by the Trade Practices Act. All of these saw the abolition of loss-leadering as going some way towards reducing what was perceived as excessive and unfair price competition. In many instances it was not clear that cases of alleged loss-leading were in fact the result of a firm reselling goods below cost to it, rather than merely passing on savings in costs gained through bulk purchases.

8.36 The arguments advanced in favour of a prohibition on loss-leadering parallel those advanced for resale price maintenance. Some submissions said loss-leadering was an unfair competitive practice and its abolition would enhance the profitability of the small retailer. The arguments advanced above against resale price maintenance as a means of protecting small retailers apply equally here and need not be repeated.

8.37 In addition, it is argued that loss-leadering smacks of deception of consumers, who are lured into the loss-leader's store by an artificially low price on a particular good and then buy other goods which are not competitively priced. We do not accept this argument. The deceptive practice of bait advertising is prohibited by section 56 which adequately protects consumers.

8.38 The other main argument against loss-leadering to some extent contradicts the first - that consumers associate quality with price and the manufacturer ought to be able to protect himself against his product gaining a low quality image because of loss-leadering by a reseller.

8.39 This argument is not convincing and, in any event, the argument would seem to apply only to products which are consistently loss-leadered. However loss-leadering appears not to be practised continually with particular goods. On the contrary retailers vary the goods which they loss-leader.

8.40 The present section 98 permits a manufacturer who is aggrieved by loss-leadering below cost to withhold supply from offending resellers and in our view this provision is sufficient to protect the legitimate interests of a manufacturer.

8.41 Indeed, it could well be argued that on the general ground of the promotion of competition, it is difficult to see why the manufacturer should be permitted to achieve the enhancement of his product's image at the expense of the retailer's freedom to adopt the pricing policy he deems most suitable for the advancement of his own business.

8.42 It seems unlikely that loss-leadering of one particular product by a particular reseller would often occur on a sufficiently consistent basis so as to undermine its general acceptability. Termination of supplies in retaliation for loss-leadering could merely provide a convenient excuse for action which is really based on the reseller's general low-pricing policy.

Resale Price Maintenance to Protect Small Manufacturers

8.43 It was also put to us that the prohibition on resale price maintenance should in some way be relaxed to allow manufacturers to protect themselves from retailers who sell the manufacturers goods at low prices so causing other retailers to decline to stock the manufacturers goods. The concern of the manufacturer is that this causes sales in his products to drop.

8.44 We felt some sympathy for small manufacturers in situations like this but consider it would not be possible to amend the resale price maintenance provisions to allow them to influence a retailer who discounts without, in effect, repealing the prohibition of resale price maintenance.

8.45 We explored the possibility of allowing a manufacturer to cease supplies to a retailer who sells goods below his "true costs" (at present he may only withdraw supplies if a retailer sells below invoice cost within the preceding year - sub-section 98(2)).

8.46 However, we found the concept of "true cost" most elusive.

8.47 Every retailer will have different overheads and thus no one percentage mark-up would be applicable to all retailers. Nominating any one percentage would be arbitrary.

8.48 It would be no more satisfactory to insert the term "true cost" in the Act, undefined, leaving it to the parties to establish what "true cost" is in each particular case in the Court. This is because, necessarily, it must be up to a retailer to assess the "true costs" of his handling each item he sells. Accordingly his "true costs" will be whatever he determines his "true costs" to be.

8.49 If a workable formula for calculating "true cost" had been available to us we would have given serious consideration to recommending some change to implement its use, provided we were not adversely affecting price competition: for example by introducing a back door means of price fixing by retailers. To date no such workable formula has become available and this leaves us in the position where we do consider price competition to be essential to the competitive process and feel that the prohibition of resale price maintenance is vital in preserving price competition. Accordingly no change to the resale price maintenance provisions is recommended (at least until a workable formula is produced to us).

SECTION 3 - CONCLUSION TO CHAPTER 8

Conclusion

8.50 We consider the prohibition of resale price maintenance fundamental to the fostering of price competition and in line with the competitive thrust of the provisions of Part IV of the Act.

8.51 After examining the arguments against the prohibition of resale price maintenance we are of the view that none of the arguments warrant the relaxation of the prohibition.

CHAPTER 9ABUSE OF MARKET POWERSECTION 1 - MONOPOLIZATIONIntroduction

9.1 The only provision of the Trade Practices Act that deals solely with abuse of market power is section 46 (Monopolization). This provision outlaws specific conduct directed at preventing others from engaging in competitive behaviour. Unlike the competition provisions discussed in Chapters 6, 7, 8 and 10, it does not prohibit conduct on the basis of its effect on competition and it does not prohibit particular conduct in general. Rather it prohibits a particular person engaging in particular conduct.

9.2 For a corporation to be subject to section 46 it (together with any related corporation), must be in a position substantially to control a market for goods or services in Australia. This includes a company which by reason of its share of the market or its share of the market combined with its access to technical knowledge, raw materials or capital, has the power to determine the prices, or control the production or distribution of a substantial part of the goods or services in that market (sub-section 46 (3)).

9.3 In order for a contravention to occur, the corporation must take advantage of its position in the market for the purpose of:

- (a) eliminating or substantially damaging a person, being a competitor of the corporation in that market or in any other market;
- (b) preventing the entry of a person into any market; or
- (c) deterring or preventing a person from engaging in competitive conduct in any market.

Swanson Committee

9.4 In making its recommendations on the 1974 Act the Swanson Committee noted that submissions made to it accepted the concept underlying the provisions of section 46 dealing with monopoly power which go, not to the creation and continued existence of monopolies, but to the abuse by monopolies of their power in relation to competitors. The Committee considered that in Australian conditions, at that time, this system of dealing with monopolies was appropriate.

9.5 The Committee, however, recommended that section 46 should be amended to provide that:

- . an intent to monopolize is required (purposive test) and

- monopolization does not occur by reason only of investment in new capital and equipment.

9.6 Following these recommendations the Act was amended in 1977 to make it clearer that only purposive conduct by a market-dominating concern comes within the prohibition.

Competition Policy and Abuse of Market Power

9.7 As stated in Chapter 4, the primary thrust of the competition provisions of the Act should be towards efficiency. However there should be protection of small firms from the predatory conduct of other firms with any substantial degree of market power to support such conduct, irrespective of their size. Whilst small business preservation is not necessarily a desirable economic end in itself it may well be desirable for social, economic or political reasons. Without some protection firms possessing substantial market power may well be able to insulate themselves from competition from smaller firms by driving them from markets or by preventing them from entering markets. The diminution of competition consequent upon small businesses being denied the opportunity to compete may well work, in the long term, against efficiency because the firms with market power would eventually be free of the disciplines of the market place.

9.8 Small firms are an important source of innovation; indeed experience overseas and in Australia has shown that small firms are often more innovative than larger firms. Small firms should not be prevented from entering markets or expanding. They should not be at risk of being blocked or driven out by existing firms. Existing firms should not be able to freeze market forces and to arrest structural adjustment by removing firms they find troublesome. Small firms are a vital source of competition and keep large businesses "on their toes". It is obviously public policy that they should not be removed from the market place by the predatory abuse of economic power.

SECTION 2 - UNITED STATES EXPERIENCE

Introduction

9.9 The competition laws of other countries typically do not penalize the mere presence of "monopoly" power. They are, however, often wary of the attainment of such power and have certainly prohibited its abuse. It is useful, in this context, to examine briefly some of the issues raised by the interpretation of section 2 of the Sherman Act, as they demonstrate some of the basic problems associated with this type of legislation.

Intent to abuse "monopoly power"

9.10 The Sherman Act is not directed against the existence of a monopoly but against monopolization, conduct involving the intentional use or acquisition of market power to deter, damage or eliminate competitors. This was described in the 1955 Report

of the US Attorney-General's National Committee to study the Anti-Trust Laws as "Monopoly power plus an element of deliberateness".

9.11 It is clear from US Court interpretation of Sherman Act section 2, that intent or purpose (the terms are used synonymously) is an element of the offence created by the section.

9.12 What is not clear is the means of proving the necessary intent when considering the unilateral conduct of a monopolist. The issues were relatively clear-cut in Standard Oil Co. of New Jersey v US 221 US1 (1911) where the Court stated that the evidence "gives rise to the prima facie presumption of intent and purpose to maintain the dominance over the industry, a presumption made conclusive by the defendant's conduct". The Court explained that the position of market dominance had not been obtained by "normal methods of industrial development" but by conduct which necessarily involved the intent to drive the others from the field and exclude them from the right to trade.

9.13 The distinction between normal and predatory business practices is still an integral part of U.S. monopolization law, but not all cases are as clear-cut as Standard Oil.

9.14 The Court in US v Aluminium Company of America 148 F2d 416 (1945) (Alcoa) was not troubled by the requirement of "intent" and gave a finding that Alcoa had a monopoly of virgin aluminium ingot. Here, without overtly predatory conduct but by making reasoned business decisions in anticipating increases in demand for the product, Alcoa had doubled and redoubled its production capacity before other firms had entered the field. By 1939 Alcoa held 90% of the market.

9.15 In Alcoa the Court dismissed the need to show intent. It said "to read monopoly as demanding any specific intent makes a nonsense of it for no monopolist monopolises unconscious of what he is doing. Here, Alcoa meant to keep, and did keep, that complete and exclusive hold upon the ingot market with which it started". Thus once monopoly power is established, the onus lies on the defendant to prove that it is irremediable or the inevitable result of superior skill as a defence.

9.16 However, in US v Grinnell Corp 384 US 563 (1966) the Supreme Court found the defendants had satisfied the test for unlawful monopolization which was defined as monopoly power plus "the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident" (page 571). It may be that the possession of monopoly power is not presumptively unlawful, but rather that the degree of intent required to be proved varies inversely with the degree of monopoly power enjoyed by the defendant. In practice the Courts have paid little more than lip-service to the requirement of intent.

SECTION 3 - ELEMENTS OF SECTION 46

"For the purpose" element

9.17 In section 46 of the Trade Practices Act, the insertion of "for the purpose of" in the 1977 amendments clearly imports an element of "deliberateness" into the section.

9.18 What does "intention" or "purpose" mean? The word "purpose" is defined in the Shorter Oxford English Dictionary as "that which one sets before oneself as a thing to be done or attained; the object which one has in view". The word "intention" may be understood to cover results which may reasonably flow from what is deliberately done. However the presumption that a person intends the natural consequences of his act could allow a Court to draw inferences from a person's conduct as to what he intended to achieve by his conduct.

9.19 When there is no direct evidence as to purpose, the courts will have to rely heavily on inferences drawn from the actual consequences of the defendant's conduct. It is not possible to indicate the extent to which the courts will draw such inferences. Each case will depend upon the evidence before the courts, but a finding of "purpose" (as enunciated in section 4F) is an essential element of any contravention.

9.20 The Trade Practices Commission in its submission argues against the retention of the "purpose" element in section 46 (Page 37 of its submission).

9.21 We agree with the Commission that the purpose element is very difficult to prove in the context of "economic" legislation like the Trade Practices Act. However, we are concerned that removing the purpose element altogether could give the provision a very wide application and bring within its ambit much legitimate business conduct. It is also a fundamental aim that competitive conduct should not be outlawed. In view of our recommendation that the ambit of section 46 be extended so that it will more clearly prohibit predatory conduct by firms with a substantial degree of market power we perceive that there is a need to place some limit on the application of the section.

9.22 It is only purposive misuse of market power and not inadvertent conduct or efficiency inspired conduct that should be at risk. Accordingly, we recommend that the purpose element should remain because we consider it is fundamental to a provision dealing with misuse of market power.

The "substantially to control a market" element

9.23 In our view, unilateral predatory conduct should clearly be brought within the scope of section 46 if it is engaged in by any firm abusing any substantial degree of market power. The present words "substantially to control a market for goods or services" have on one view of their definition as set

out in sub-section 46(3) been written down so as effectively to lower the threshold of firms which are subject to scrutiny under Section 46 to include most firms in particular markets which do have substantial market power. However, we have the clear impression that many people, including some who seek to enforce the Act, tend to interpret the words and their definition as only proscribing purposive conduct by the market leader. If this interpretation were correct the section would not be effective to curtail the predatory actions of other powerful firms, in a market, which are directed at smaller firms. In any event we think that these doubts as to the limited class of firms to which section 46 has application are the main reason why the section has not been the subject of much litigation.

9.24 We think that if the words "in a position substantially to control a market for goods or services" were replaced by the words "that has a substantial degree of market power" the direction of the section's thrust would be clearer. We would also recommend certain other consequential changes and an amendment which would make it clear that it is not normal or even fierce competitive rivalry between firms of comparatively equal strength which it is sought to contain but rather the predatory acts of powerful firms against smaller firms.

9.25 If the changes we suggest are made section 46 should be less ambiguous and should clearly be able to be used by victimised smaller firms in preventing predatory conduct engaged in against them by medium as well as large firms, whilst at the same time ensuring that normal competitive behaviour, particularly between firms of equal market power, is not affected.

9.26 We considered and discarded the idea of importing into the section the theoretical economic test of market power - whether a firm can raise its prices without losing a significant portion of its volume of sales. In present times with institutional wage fixing and price approval by bodies external to firms, prices regularly (and sometimes uniformly) increase. This could give the impression that particular firms can "determine" the prices when they "pass on" wage increases, for example, and adoption of this test as the threshold might not take due account of these institutional rigidities in the market. In any event we were reluctant to recommend major structural changes until the present wording, with our recommended amendments, has been more thoroughly tested.

The Words "taking advantage of the power"

9.27 In our view these words mean "use market power"; that is, the overt deliberate exercise of market power. To avoid confusion and misunderstanding we recommend that the word "use" replace take "advantage of" (see our draft legislation at paragraph 9.36).

SECTION 4 - PRICE DISCRIMINATION AND ABUSE OF MARKET POWER

Introduction

9.28 On the material put to us, section 49 (price discrimination) has been misunderstood and misinterpreted. The situation has not been helped by the contentious and difficult history which the Robinson Patman Act has had in the US; even now no case law exists in Australia, nor are principles of application available so that confident assertions may be made about the operation of the section.

9.29 We agree with the Trade Practices Commission when it says "It is necessary to bear in mind that the perception of the law among businessmen is often the decisive consideration because of its effect on their conduct long before any questions of litigation arise." (Paragraph 4.83 Trade Practices Commission Fifth Annual Report 1978/9).

9.30 The material available to us suggests that the flexibility of pricing is impaired by the operation of section 49 and certain rigidities are introduced both by the section and the uncertainties of its application. Some of this material was put to the Swanson Committee and it saw this as a reason for its repeal. We agree with the Swanson Committee's view expressed at paragraph 7.21 that section 49 has had a detrimental effect. (see Chapter 10).

9.31 We also consider it a misconception to regard section 49 as a provision designed principally to assist small business. Rather it is a provision designed to protect competition which incidentally and only rarely protects firms from some discriminatory pricing conduct. As stated in chapter 10 we do not think section 49 should be amended to bring it closer to the US Robinson Patman Act (and hence protect competitors). However, adoption of our recommendation, should have the effect of ensuring the regulation under section 46 of much predatory price discrimination that small business seeks (and in the past has usually failed) to have regulated under section 49.

SECTION 5 - CONCLUSION

Conclusion

9.32 In the Committee's view, an amendment to the Act consistent with our terms of reference is available which would make it clear that section 46 proscribes certain predatory conduct which is objectionable to small businesses thereby improving their market position without derogating from the thrust of competition which the Act seeks to preserve.

9.33 Our suggested amendment is designed to ensure the prevention of conduct which has the purpose of eliminating competitors or preventing entry. The purpose element should be retained in order to prevent incidental elimination or entry prevention being prohibited. Moreover, the threshold test should be amended so as to make certain that the provision applies to all firms that have a substantial degree of market power.

9.34 The market position of small business would be improved upon adoption of our recommendation because:

- (a) small businesses will more readily perceive that this section rather than section 49 is designed to protect them from predatory price discrimination, price cutting and other conduct amounting to abuse of power.
- (b) section 46 will regulate the predatory conduct of a wider class of the more powerful firms.
- (c) the effect of only focusing on the behaviour of firms which have greater market power than the alleged victim ought to make it clear that the section is aimed at the abuse of market power rather than the acquisition of market power.
- (d) the changes are not radical so that their introduction should not cause confusion and small business and the Commission should be able to make better use of the section now that its meaning (hopefully) has been clarified.

9.35 The provision would not have application to legitimate business conduct, for example to large firms reflecting economies of scale or other efficiencies in their trading activities nor would it have application to fierce competitive conduct between small firms which have comparable market power. We think that the effect of the suggested sub-section (2A) will be that people will concentrate on the converse of the permitted conduct when analysing whether a firm and its conduct are caught by sub-section (1).

Proposed Amendment

9.36 We recommend that section 46 be amended along the following lines.

SECTION 46. Abuse of Market Power

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

(2) If -

- (a) a body corporate that is related to a corporation has, or two or more bodies corporate each of which is related to the one corporation together have a substantial degree of market power; or
- (b) a corporation, and a body corporate that is, or two or more bodies corporate each of which is, related to that corporation, together have a substantial degree of market power

the corporation shall be deemed for the purposes of this section to have a substantial degree of market power.

- (2A) Sub-section (1) does not apply to conduct to the extent that that conduct affects a person whose market power in a relevant market is not substantially less than that of the corporation.
- (3) A reference in this section to a corporation or other body corporate having a substantial degree of power in a market includes a reference to a corporation or other body corporate, as the case may be, having, by reason of its share of that market, or its share of that market combined with the availability to it of technical knowledge, raw materials or capital, a substantial degree of power in respect of a substantial part of the goods or services in that market.
- (4) A reference in this section to having a substantial degree of power in a market shall be construed as a reference to having a substantial degree of market power either as a supplier or as an acquirer of goods or services in a market.
- (5) Without extending by implication the meaning of sub-section (1), a corporation shall not be taken to contravene that sub-section by reason only that it acquires plant or equipment.
- (6) This section does not prevent a corporation from engaging in conduct that does not constitute a contravention of any of the following sections, namely, sections 45, 45B, 47 and 50, by reason that an authorization is in force or by reason of the operation of section 93.

9.37 We believe this amendment to section 46 would considerably improve the market position of small business.

SECTION 6 - REFUSAL TO DEAL

The Problem

9.38 While not a predominant complaint of small business in Australia, a number of those that made submissions said that their position in the market was adversely affected by their

inability to obtain supplies or markets due to others refusing to deal with them.

9.39 While there is no specific refusal to deal law in Australia (as there is in Canada and a number of European countries) suppliers (and in some cases, buyers) are prohibited from refusing to deal with others if the refusal involves conduct categorised as exclusive dealing, resale price maintenance, primary or secondary boycotts, monopolization or agreements that are substantially anti-competitive.

9.40 However, in respect of a straight out refusal to deal (not involving the abovementioned matters as such) we gave consideration to a general law that would require dominant or powerful firms not to unreasonably withhold supplies or not to unreasonably deny markets to small business. However, we soon became convinced that any such requirements would have serious implications and could not be introduced without a substantial debate.

9.41 We were not convinced that any workable solution is available and thus we were not able to give this subject greater consideration at this time without jeopardising the timing of the whole of this Report.

9.42 It was put to us that in modern times there is a good case for the law requiring the economically strong to deal with the weak upon reasonable terms. Indeed, many of our recent consumer protection laws have been based on just this premise (see the extension to the definition of "consumer" by the Trade Practices Amendment Act 1977).

Conclusion

9.43 We make no recommendation in respect of refusal to deal law. However we consider that this matter should be the subject of public debate.

SECTION 7 - GENERAL PROHIBITION OF HARSH UNCONSCIONABLE OR UNFAIR CONDUCT

9.44 The Committee notes with interest a submission from the Law Council of Australia in which it is argued that business would benefit from a general prohibition of harsh, unconscionable or unfair conduct irrespective of whether or not the conduct involved injury to competition or abuse of market power.

9.45 As indicated in Chapter 4 of this Report, we endorse the aim of Part IV of the Act - being to promote efficiency through the maintenance of the competitive process.

9.46 We would see a law prohibiting "unfair" business conduct as going further and not being compatible with the provisions of Part IV because the provisions regulate conduct according to the competitive effect of the conduct and not, as a law based on "fairness" would, on its morality. We also see it as having a very wide impact beyond the present boundaries of Parts IV and V.

9.47 However, we feel there is great merit in exposing the proposal of the Trade Practices Committee of the Law Council of Australia for debate and discussion and consider it a worthwhile area for the Government to keep under active examination.

CHAPTER 10

PRICE DISCRIMINATIONSECTION 1 - OVERVIEW OF AUSTRALIAN PRICE DISCRIMINATION LAWPrice Discrimination Law Pre 1974

10.1 Under the Trade Practices Act 1965 the seeking or inducing of favourable terms or prices was made an examinable practice under paragraph 36(1)(a) and the engaging in price cutting, by a person in a dominant market position, with the object of substantially damaging the business of a competitor or preventing a possible competitor from entering the market, was made an examinable practice under sub-section 36(2).

10.2 The net effect of the 1965 Act's provisions was to inhibit a person who enjoyed a substantial degree of market power from using that dominance against, or to the detriment of, competitors in a particular market. The first provision was aimed at anti-competitive conduct of purchasers while the second applied to both suppliers and purchasers who had the requisite degree of market power and used that power for the purpose of eliminating or preventing competition.

10.3 It is difficult to gauge the effectiveness or adequacy of these provisions at this late stage. There were no reports of any action being taken under paragraph 36(1)(a) during its operation. However, an extract from the Third Annual Report of the Commissioner of Trade Practices (1970) may give some indication as to how the provision was viewed:

"My Office has had no complaints from suppliers about threats or promises from a powerful buyer; presumably suppliers are glad to have the business. The smaller competitor of the powerful buyer is hardly in a position to complain either. He does not know what pressures, if any, the powerful buyer has used on the supplier. He may know that he is not able to buy as well, but probably accepts that the reason is the smaller size of his orders. The section leaves the supplier free to give discriminatory terms if he wishes".

10.4 The two provisions were repealed when the current Trade Practices Act came into operation in 1974.

Trade Practices Act 1974

10.5 The Trade Practices Bill, introduced into Parliament in late 1973, contained what has become the present day section 49. This particular section attracted much comment during the passage of the Bill, in Parliament as well as from academics, lawyers and the business community.

10.6 The section had its origins in United States legislation, particularly the Robinson Patman Act. This statute has been severely criticised since its introduction (see paragraphs 10.86 to 10.93 below) and its amendment or repeal has been advocated increasingly by a number of U.S. authorities, including the

Department of Justice. By way of contrast Canada has recently enacted (or re-enacted) a similar law (see paragraph 5.79).

10.7 The tenor of reaction to the introduction of section 49 was expressed by Professor Stephen Breyer, Professor of Law at Harvard Law School, in an article in the Australian Law Journal, January 1977. As Breyer put it:

"The American statute has been criticised with virtual unanimity by economists and academic anti-trust experts as impeding, rather than promoting, competition. The Federal Trade Commission in recent years has curtailed its enforcement of this statute, and, there is now a strong move afoot to repeal it. Under these circumstances one must wonder whether the differences in the wording in the Australian version (s.49) are sufficient to overcome the American difficulties." (page 36).

10.8 Breyer recounted some of the economic objections to laws against price discrimination in the following terms:

"Unjustified price discounts came to be offered by firms in concentrated industries. Economic theory suggests that firms in such industries often do not compete in price, rather they tend to fix prices above competitive levels, fairly secure in the knowledge that each firm will forego the short-run competitive advantages of a price cut for fear that all its competitors will rapidly match its lower price, preventing it from attracting new customers." (page 37)

Breyer developed the general proposition from this analysis that -

"the more concentrated the industry in an economy, the more harm that can be done by a rule against price discrimination. For these reasons, a strict interpretation of s 49 is likely to prove particularly harmful in Australia. Since Australian industry is highly concentrated, the net effect of preventing price discrimination is more likely to be uniformly high prices than uniformly low ones." (page 37).

It is significant that the material which came before the Swanson Committee, and that which is being put before us, tends to confirm this outlook.

10.9 During the passage of the Trade Practices Bill through Parliament in 1973 and 1974, doubts were constantly raised as to the appropriateness of the discrimination provisions in an Act designed to improve and maintain competition in the Australian economy:

"We do not believe that this legislation, as it is now proposed will serve as an anti-inflationary measure. Indeed, the general thrust of the prices discrimination

provisions runs counter to these anti-inflation, keeping prices down, concepts. Indeed, if one has a look at the prices discrimination provisions, one sees they will require the supplying of goods on the same terms and conditions to all outlets, with some exceptions...it will have the contrary effect of reducing competition to the general level of some other inefficient supplier". (Mr. Sinclair; House of Representatives Daily Hansard 7 November 1973 at page 2919).

10.10 Notwithstanding the strong criticisms voiced, section 49 was retained, although with some amendments to the original draft which did not affect the substance of the provision.

The Provisions of Section 49

10.11 Section 49 of the Trade Practices Act prohibits discrimination by a corporation, in trade or commerce, between purchasers of goods of like grade and quality. The discrimination must be in relation to either:

- (a) the prices charged for the goods;
- (b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of the goods;
- (c) the provision of services in respect of the goods; or
- (d) the making of payments for services provided in respect of the goods.

10.12 Discriminatory conduct will be caught by this provision only where it is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods. The relevant market is that in which the corporation supplies goods (the primary market) or those purchasers supply goods (the secondary market). (Sub-section 49(1)).

10.13 The section provides for two defences to discriminatory conduct:

- (a) where the discrimination makes only a reasonable allowance for the differences in cost of manufacture, distribution, sale or delivery resulting from differing places to which goods are supplied to the purchasers; methods by which goods are supplied to the purchasers; or quantities in which the goods are supplied to the purchasers; (paragraph 49(2)(a)) and
- (b) where the discrimination is constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier. (paragraph 49(2)(b)).

10.14 A person who, in trade or commerce, induces or attempts to induce a corporation to discriminate in a manner prohibited or who enters into any transaction that, to his knowledge, would result in his receiving the benefit of a discrimination that is prohibited will also come within the conduct prohibited by section 49. (sub-section 49(4)).

The Swanson Approach

10.15 In 1976, the Trade Practices Act Review Committee ("Swanson") recommended the repeal of the section. In so recommending, the Committee noted the widespread criticisms against section 49 and was persuaded that the section may not be operating in a way which is conducive to the maintenance and development of a free and fair market in Australia. The Committee reported:

"...this section of the present Act drew more criticism in submissions than any other." (paragraph 7.1).

"At the time of its introduction the section was widely regarded as being designed to advantage small businesses especially small retailers. Yet all submissions from small business interests, with two notable exceptions, thought the section had either worsened the relative position of small business or not assisted them in any way." (paragraph 7.2).

"The criticisms tended to be of a general nature. Only a few submissions alluded to specific situations to show how the section affected those situations, notwithstanding that many problems which arise are clearly pragmatic market place difficulties. Many submissions said it has introduced an unsatisfactory price rigidity into the 'market place' in that it operated to prevent price flexibility which is at the very heart of competitive behaviour." (paragraph 7.3).

"The Committee considers that in the Australian context the conduct of a large buyer who is endeavouring to secure price cutting in his favour, whether it be discriminatory or not, may be more pro-competitive than anti-competitive. Indeed, such price cuts as a large buyer is able to obtain can trigger off competition from rival suppliers or can trigger off competition in a market, where other forces are unlikely to produce active competition." (paragraph 7.20).

"...the prohibition on price discrimination in Section 49 has, in our view, operated substantially to limit price flexibility. The Committee believes that in the Australian context, section 49 has produced such price inflexibility that the detriment to the economy as a whole from the operation of the section outweighs assistance which small business may have derived from it. It is price flexibility which is at the very heart of

competitive behaviour. The Committee thus recommends that section 49 should be repealed." (paragraph 7.21) (Trade Practices Act Review Committee, August 1976).

Post "Swanson"

10.16 At first, the Government accepted the Committee's recommendation that section 49 be repealed. When introducing the Trade Practices Amendment Bill (in which this repeal was proposed), the then Minister for Business and Consumer Affairs, Mr. Howard, said:

"...the prohibition has worked to inhibit price flexibility and has not encouraged competition...in fact the Review Committee stated that this law has actually been used as a pretext to abolish discounts and effectively raise prices."

(House of Representatives Daily Hansard, 8/12/1976).

10.17 The first amending Bill lapsed with the prorogation of Parliament in February 1977 and when another Bill was introduced in May of that year, the provision repealing section 49 had been deleted. The reason for the retention of the provision was expressed, in the Minister's Second reading speech, as being in the interest of assisting the competitive position of small business.

Enforcement

10.18 Section 49 creates a prohibition of conduct for which the benefit of the authorization process is not available. The supplier must assess whether the proposed conduct amounts to discrimination in the terms of the Act and, if so, whether it will have the effect of substantially lessening competition.

10.19 Contravention of section 49 gives rise to liability for pecuniary penalties, injunctions and ancillary orders. Such conduct may also be the subject of civil actions for damages by those who have suffered loss or damage as a result of a contravention of that section.

10.20 The Trade Practices Commission has indicated that section 49 is an area which it left largely to private action prior to 1977. In that year, however, the Commission announced its intention to develop a program to monitor the existence and effect of price discrimination in a number of selected industries. The Commission has dealt with the topic of price discrimination at length in its (1979) Fifth Annual Report.

"There have been no Commission proceedings in Court, and no private actions have come to hearing. The Commission has received since the Act commenced some 180 complaints about alleged price discrimination, with well over half coming from individual small businesses who typically believe that a larger outlet nearby is getting a better deal from a common supplier. Often the suspicion of the

better deal in purchase is brought about by the larger outlet selling at lower prices. The complaints have come from the full range of typical small businesses. Sometimes quantity discounts do not appear to be out of line with likely economies of fewer deliveries and larger drops per delivery. Sometimes the particular market appears to be such that competition is unlikely to be substantially lessened which is a requirement before the section is breached. Most of the complaints were not taken any distance because on the facts available there appeared to be no chance of their coming within section 49. Some were really complaints about the presence of competition."

SECTION 2 - WHAT IS PRICE DIFFERENTIATION

The nature of Price Differentiation

(For the purposes of the ensuing discussion, a distinction has been drawn between economic price differentiation and the conduct which is governed by section 49 of the Trade Practices Act. The latter is referred to as price discrimination.)

10.21 "Economic" price differentiation like price discrimination occurs where transactions in respect of goods of like grade and quality occur at different prices, and where the differences in price do not correspond with differences in the cost of supplying the buyer in relation to each of those transactions. For example, the sale of goods of like grade, quality and quantity of equal cost at different prices is price differentiation, as is the sale of goods of like grade, quality and quantity of differing costs at the same price. Further economic price differentiation, unlike price discrimination occurs where a corporation sells at the same price to all buyers, regardless of cost differences in distribution, delivery and so on. This conduct would not be in contravention of section 49 even though it would amount to economic price differentiation.

10.22 Economic price differentiation like price discrimination may be initiated by sellers or induced by buyers. In either case, the firm which differentiates or the firm which benefits from the differential treatment may gain a distinct advantage over its rivals. However price differentiation can play an important role in the stimulation of effective competition.

10.23 In most cases a seller can profitably engage in price differentiation where three conditions are satisfied:

- . the seller has some degree of market power;
- . the seller is able to segregate its customers into distinct groups (either into groups with varying reservation prices or groups with different price elasticities of demand); and
- . the opportunities for resale by low priced

customers to high priced customers (known as arbitrage) can be constrained. (The resale of personal services, such as insurance, to make an arbitrage profit is virtually impossible. The services industries thus lend themselves particularly well to price differentiation. On the other hand, as goods can usually be sold, transported and resold, arbitrage would be more easily practised. Therefore, at least in theory, it would appear that the possibilities for price differentiation are more limited).

Types of Price Differentiation

10.24 A number of common practices are set out below in order to further illustrate the type of conduct characteristically involved in economic price differentiation. (It should be noted that much of this conduct would not constitute price discrimination prohibited by section 49).

10.25 Quantity discounts may be given. For example the discount may be determined by the amount that is bought in a single transaction. Where this practice continues without any restriction, an advantage will accrue to the purchasers of larger quantities. It may disadvantage smaller competitors who do not have sufficient resources to purchase and store in bulk. Such discounts typically are graduated or scaled, i.e. as the number of units purchased increases, the unit prices charged are lowered.

10.26 Volume discounts, on the other hand, have no necessary relationship to the actual number of units purchased in a particular sale. A volume discount is an allowance or rebate calculated as a percentage of unit value of all purchases made over a specified period. Such discounts would be of most benefit to purchasers who regularly purchase from the same source and might be loosely viewed as a concession on the part of the seller for the support he has received from the purchaser over a certain period of time.

10.27 Another form of differentiation arises when the seller compensates a buyer for some service or value received by the granting of an allowance or other benefit which would otherwise represent an expense to the seller. This type of functional discounting occurs commonly where the burden of warehouse storage or delivery is shifted from the seller or producer to the purchaser.

10.28 Locality differentials occur where a seller charges lower prices in particular areas, nominated by him, for his own reasons, while he continues to maintain higher prices in other areas.

Price Differentiation and Competition

10.29 Price differentiation can have important effects on competition. Depending upon the type of differentiation

involved, and the manner in which it is practised, it may strengthen competition or weaken it. Unsystematic price differentiation can be pro-competitive in a number of ways. It can encourage more experimentation in pricing. Sellers are reluctant to engage in such experimentation if such changes have to be implemented in every geographic market area. Sellers are more willing to experiment if changes are restricted to test-markets where rival or consumer reaction can be accurately gauged without the possibility of serious detriment to the seller's overall sales.

10.30 Another pro-competitive effect is the tendency of unsystematic price differentiation to undermine oligopolistic pricing disciplines. (This is particularly relevant for the Australian economy). In this case, suppliers may grant secret, differential price concessions to a few aggressive buyers and sooner or later, often through the efforts of buyers to extract similar concessions from other or additional suppliers, these price concessions become known. Other suppliers then try to match, or undercut, these prices. As price concessions spread, the overall prices to all buyers are eventually reduced. Thus all buyers benefit and if their market is competitive the savings are passed on to the ultimate consumer.

10.31 Price differentiation can also have anti-competitive effects, particularly where it is systematic. Bearing in mind that a differentiator must possess some degree of market power, systematic price differentiation may be used by firms to entrench their positions of market power by creating strong buyer-seller ties and raising barriers to the entry of new competitors.

10.32 This may be achieved in a number of ways. Discounts or other preferences may be granted so as to give the differentiator's regular customers a cost advantage over rival firms. Alternatively, a firm can make full use of its market power and charge higher prices in areas where it has power while accepting very low rates of return in areas of competition, thereby making it very difficult for new entry and effective competition of rivals.

10.33 In the latter situation, price differentiation may easily move toward the fine boundary which separates it from predatory price differentiation. The line between pro-competitive and destructive predatory price differentiation is seldom clearly defined as much will depend upon the intention or motive of the differentiator and how the differentiation alters market structure over time. These in turn are difficult to identify with precision. Businessmen will also be wary of the use of predatory tactics which, of their very nature, entail high costs offset only by the uncertain prospect of actually succeeding.

Conclusion

10.34 It would appear, therefore, that price differentiation may be desirable or undesirable, depending upon its effects on competition. Generally unsystematic price differentiation which

is pro-competitive by encouraging price experimentation and maintaining price flexibility is desirable and should not be discouraged. However, systematic price differentiation may have on occasion anti-competitive effects. It may be used to preserve and strengthen a monopoly position, to tie buyers together with sellers giving discounts for concentrated purchases or make entry into segments of a market difficult or impossible.

10.35 Any policy adopted should therefore be one in which the desirability of pro-competitive price differentiation is recognised and it is encouraged to function as part of the essential mechanism of price competition. At the same time, anti-competitive price differentiation which serves as an exploitation of market power or amounts to a predatory practice should be eliminated.

SECTION 3 - TRADE PRACTICES ACT POLICY AND SECTION 49

Introduction

10.36 As set out in Chapter 4 we see that the immediate objective of the competition rules of the Act is the minimisation of conduct which works against the efficient allocation of resources. The general principle adopted is that it is the market place which allocates resources and not sectional interests. We think the primary thrust of any price discrimination law should be towards the promotion of efficiency in firms through the elimination of anti-competitive behaviour. While a price discrimination law may be directed at protecting small businesses this should not be at the expense of efficiency.

The Elements of Section 49

10.37 A summary of the section together with methods of its enforcement has been given above. It should be remembered that section 49 does not prohibit all price differentiation. This was noted by the Swanson Committee. The Committee listed seven requirements, laid down by the section, which must be proved before price differentiation will be unlawful. These are:

- (a) the discrimination must apply only to goods and not services;
- (b) the goods must be of like grade and quality;
- (c) the discrimination must be of a recurring and systematic nature;
- (d) the discrimination must have the effect of substantially lessening competition;
- (e) the market must be one in which either the supplier sells (primary market) or the customer sells (secondary market);
- (f) the discrimination makes more than reasonable allowance for the difference in the cost of manufacture, distribution, sale or delivery; and

- (g) the discrimination must not be an act in good faith to meet a competitor's price. (Trade Practices Act Review Committee Report: paragraph 7.8).

Effect on Competition

10.38 Section 49 prohibits unlawful price discrimination, by a seller, and the inducement of discrimination by a buyer, where such discrimination has or is likely to have the effect of substantially lessening competition in either of two markets - the primary market, that of the seller and his competitors, and the secondary market, that of the seller's customers.

10.39 The section is normally not concerned with damage to an individual competitor only. Damage to competition is required in either of these markets, each taken as a whole, before the discrimination is prohibited. For this reason, it is possible, and consistent with the thrust of the section for a competitor occupying a small share of a large market, to be completely eliminated by means of discriminating conduct, because that discrimination may not be of such magnitude or of a recurring or systematic character which would be sufficient to have the likely effect of substantially lessening competition in the whole of the relevant market.

10.40 This requirement of damage to competition and not to individual competitors highlights a major difference between section 49 and section 2 of the U.S. Robinson Patman Act. (The development of U.S. price discrimination laws are dealt with in more detail below). The Robinson Patman Act goes beyond damage to the market as a whole and makes unlawful any discrimination which is likely "to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination". The U.S. law is directed to detriments suffered by individuals as well as to the state of competition. For this reason, the U.S. law probably has a more drastic effect on business practices than does the Australian law.

Primary Market Damage

10.41 Where a seller uses his ability to discriminate in price for the purpose of eliminating a competitor, it is viewed as an abuse of market power which is intended to cause a reduction in competition. This can be illustrated by the well known practice in which a seller, with some market power in one market subsidises price cutting in other markets by maintaining high prices or raising prices in the market he controls. It is often the case that where a competitor engages in predatory pricing he sells below cost (while other markets are higher priced to support the other loss).

Secondary Market Damage

10.42 Section 49 is also concerned with the effect of discrimination by the sellers of goods on competition in the market where their purchasers supply goods. To fall within the

prohibition, a discrimination must have the effect or likely effect of substantially lessening competition in that market. The discrimination covered may be either one which was initiated by a seller or one which has been induced by a purchaser.

Seller Initiated Discrimination

10.43 In practice, this could only be effectively done by a firm which is a powerful seller to the relevant competing purchasers in the market. Unless a seller enjoys such power, disfavoured customers will move to the seller's competitors in search of better prices with the result that the discriminating seller may lose those customers altogether or may remove its original preferential prices.

10.44 Where discrimination is initiated by a powerful seller, competition in the secondary market will be substantially impaired only where the purchaser receiving a preferential price is a substantial seller in its market. Any discrimination favouring a purchaser which is not itself a substantial seller will tend to improve its competitive position and thus enhance competition in that market.

Purchaser induced discrimination

10.45 A large purchaser will use its power to cause discriminatory pricing in its favour. Such market power often arises from the size of that purchaser's share of the market. It may also derive from the demonstration, by a purchaser, of his potential for expansion to a seller which offers that seller increased market opportunities in the future.

10.46 Sub-section 49(4) imposes a legal restraint on such conduct. That sub-section prohibits a purchaser from knowingly inducing or attempting to induce a corporation to unlawfully discriminate or to knowingly enter into any transaction which would result in its receiving the benefit of an unlawful discrimination.

10.47 The scope of sub-section 49(4) is limited by the requirement that sub-section 49(1) must be violated before the buyer is liable. That is except in the case of an attempt, a seller must have engaged in discriminatory conduct prohibited by that sub-section and all the elements of a seller's contravention must be established before the buyer can be liable.

10.48 Section 49 prohibits price discrimination only when such conduct has a substantial anti-competitive effect. To remove that requirement in an attempt to strengthen section 49 to further assist small business would run the risk of outlawing competitive conduct. Allegations of this kind against price discrimination laws such as the Robinson Patman Act have been made by many authorities including the Swanson Committee.

10.49 There also appears to be another way in which buyers are favoured under this sub-section. Whereas all of a seller's

discrimination is taken into account in determining whether it has the effect or likely effect of substantially lessening competition, a contravention by a buyer depends on a contravention by a single seller and it is not possible to aggregate all the discrimination induced by one buyer from several sellers of goods. Where a major retail store induces discrimination from several small suppliers, the effect may be to substantially lessen competition but without the buyer contravening sub-section 49(4) because no single seller discriminates in a manner prohibited by sub-section 49(1).

Section 49 and other Pro-Competitive Measures

10.50 While section 49 would appear to be consistent with the general policy of the Trade Practices Act, the operation of that section has achieved results which are not easily reconciled with other specific measures adopted under the Act.

10.51 After section 49 came into operation, in February 1975, the following, possibly short-term, effects upon price levels in various industries were noted. Either:

- . discounts were eliminated altogether, with uniform prices becoming the pre-discount level, the consequences being a net price increase; or
- . discounts were eliminated altogether but uniform prices were set at a level to provide the seller with the same net return; or
- . discounts were largely eliminated for the small, medium and medium to large enterprises with discounts being available only to large and very large enterprises, often on a secret basis.

10.52 These results relate directly to business practices and reactions. A further relevant factor is an apparent inconsistency in the Act relating to the "meeting competition" test.

10.53 Paragraph 49(2)(b) of the Act provides that sub-section 49(1) does not apply to a discrimination if the discrimination is constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier. This is seen as an attempt by the Act to allow certain discriminatory pricing in response to competitive forces. However, in order to act in good faith, a seller would have to establish that it had a reasonable belief as regards the existence of a competitive offer together with the level of that offer.

10.54 How does a seller establish and verify these two beliefs? One solution is for it to make enquiries with its competitors, a course which may raise difficulties under section 45 of the Act. Any discussions between competitors as to prices may provide evidence of collusion as to prices. While it could be argued that non collusive enquiries would assist in maintaining high levels of price competition and perfect information, it would almost be impossible accurately to indicate at what stage, if any, these enquiries become price fixing discussions.

Possible Administrative Assessment of Price Discrimination by the TPC

10.55 Consistently with our view that misunderstandings and misconceptions about section 49 may lead to price rigidity and that pricing strategies, which are not anti-competitive should not be impeded by the Act, we canvassed the possibility of introducing some form of notification or other administrative procedure to reduce business uncertainty as to the effect of section 49.

10.56 Our inquiry into this subject was based upon the premise that most price differentiation conduct by firms will not substantially lessen competition and so will not be unlawful. Given this, a major disadvantage of any administrative procedure for the review of price differentiation conduct is that it will be heavily over-used by businessmen, who, as previously noted, appear to be uncertain of the section's effect. This would result in a major diversion of the resources of both businesses and the Trade Practices Commission into both using and administering any procedure adopted.

10.57 Unlike the other types of conduct for which administrative procedures are available under the Act, price discrimination conduct generally consists not of one agreement or act, but of a pattern of conduct usually extending over a considerable period of time. This characteristic of price discrimination is reflected in the wording of section 49 which is addressed to price discrimination "of such magnitude or ... of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition...". Even were these words to be deleted from the section, price discrimination conduct would very rarely be anti-competitive unless it in fact had these characteristics.

10.58 For this reason, adequate administrative assessment of price discrimination conduct would not be possible unless the applicant supplied the Trade Practices Commission with very detailed and comprehensive information as to its pricing policies and strategies.

10.59 Moreover, the Commission would face a much more difficult task in assessing whether the conduct has or is likely to have the effect of substantially lessening competition in a market than it presently faces in assessing the anti-competitive effect of conduct falling within sections 45, 45D or 47 for which administrative assessment is currently available. Conduct of these latter types will generally be anti-competitive because it decreases price competition or raises barriers to entry. Each of these effects will be easily foreseeable and have a relatively obvious adverse effect on competition. Price discrimination, on the other hand, will usually have substantial anti-competitive effects only if it makes entry or continuance in a particular market unprofitable for participants disadvantaged by the discrimination. Adequate assessment of whether this is likely to occur as a result of particular price discrimination conduct

would require detailed investigation of the pricing structure in a particular market. Obviously, such investigations would impose a substantial burden on the resources of the Trade Practices Commission. We doubt that such a use of resources would be warranted. These very same difficulties are a substantial argument for repeal of section 49.

10.60 While the Commission already faces this burden in relation to its task of enforcing section 49, enforcement is concentrated on those areas where there appears to be substantial price discrimination. It is our expectation that, were an administrative procedure introduced for price discrimination, the Commission would have to deal with a very large number of applications and that this would require a significant increase in the Commission's resources.

10.61 Another significant disadvantage of any form of administrative procedure is that businesses would be required to give advance warning of their pricing strategies to their rivals. This in itself could result in a considerable lessening of the price flexibility which as the Swanson Committee correctly says is at the very heart of competitive behaviour.

10.62 Even if applications were to be confidential, and this would represent a departure from the present principle of openness underlying adjudication procedures, a lessening of price flexibility would also occur if the proposed administrative procedure were restricted to proposed conduct, since the applicant would not feel free to differentiate his prices until the Commission had granted approval, which for the reasons noted above could take a considerable time. To allow the proposed procedure to apply to conduct which is already being engaged in is to run the risk of a substantial lessening of competition occurring while the Commission is assessing the application.

Conclusion

10.63 These general difficulties would seem to preclude the establishment of any form of authorization, notification or other workable administrative procedure for price discrimination conduct. We further note here our view that, should any such procedure be adopted, it would be inappropriate to require public benefit aspects of the conduct to be taken into account, as is the case under the present authorization and notification procedures provided under the Act. Where price discrimination conduct results or is likely to result in a substantial lessening of competition, it will so rarely result in an offsetting benefit to the public that the costs to industry and Government involved in allowing attempts to justify such conduct considerably outweigh the benefits which might flow from the very occasional justification of the conduct which might occur.

SECTION 4 - THE DEVELOPMENT OF U.S. PRICE DISCRIMINATION LAW

Introduction

10.64 Arguments put forward by small business interests indicate that they view section 49's retention as vital for their survival

and that the section should be "strengthened" so as to allow, at least initially, some equality between competitors regardless of their respective market share and power.

10.65 The origin of this line of argument can be traced back through the history of the United States Robinson Patman Act and it would be appropriate to now deal with the U.S. approach to price discrimination.

10.66 Price discrimination was initially dealt with by Section 2 of the Clayton Act 1914 which required a showing of effect upon competitive conditions generally in the line of commerce and market territory concerned as distinguished from the effect of the discrimination upon immediate competition with the grantor or grantee.

10.67 The provision permitted unlimited price discrimination if based on volume discounts or made in good faith to meet competition. This liberal approach, in the view of some people, indicated a further failure to foresee the growth of chain stores and other large concentrations of buying power and the use of that power to compel preferential price treatment endangering the survival of independent local merchants.

10.68 During the currency of the Clayton Act, however, the focus of concern with price discrimination changed considerably. In the 1920s and early 1930s the growth of chainstores, together with the accumulation of massive buying power, brought about increasing concern and demands for the protection of smaller businessmen. Particular attention was then directed at conduct which injured purchaser competition and the need to protect the ability of individual small businesses to compete with chainstores in local markets.

10.69 The provisions of the Clayton Act were found to be deficient. They were not adequate to cope with such discriminatory practices as "special discounts", brokerage payments, advertising and promotional allowances as well as other preferential treatment not conferred upon smaller purchasers.

10.70 In 1926, the Federal Trade Commission was directed by the U.S. Senate to make a comprehensive investigation into chainstores. This investigation resulted in the preparation of a total of 34 reports. The final report in this series was presented to the Senate in 1934. It recommended that the law be amended to facilitate measures which would correct the imbalances and abuses arising out of the chainstores' explosive development.

10.71 The Great Depression shook people's faith in free enterprise and competition and inspired a number of Government moves towards direct regulation rather than competition. For example, the Robinson Patman Act, which was introduced after the 1934 Report, was not the sole legislative response to the development of chainstores. Other Government attempts to curb chainstore growth and power included:

- . the National Recovery Administration (1933 to 1935) - consisting of codes which imposed stringent regulation on the distribution process;
- . Fair Trade Laws - allowing State Governments to authorise, by Statute, resale price maintenance (these laws allowed agreements between suppliers and distributors which prescribed minimum prices for resale of trademarked or branded commodities); and
- . Chainstore tax laws - which were passed by a number of States. (A proposal for a Federal chainstore tax, put forward by Congressman Patman was defeated);

Of these adopted measures, only the Robinson Patman Act remains.

The Robinson Patman Act

10.72 The Robinson Patman Act came into force on 19 June 1936 and amended section 2 of the Clayton Act. It contained an elaborate set of provisions which were designed to give effect to the Federal Trade Commission's recommendations mentioned above.

10.73 Section 2 of the Act imposes civil prohibitions and is divided into six parts. The main provisions of those parts are, briefly:

- . Section 2(a) prohibits persons engaged in commerce from, either directly or indirectly, discriminating between different purchasers of commodities of like grade and quality where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with the customers of either of them. Defences are provided by the section where otherwise unlawful price discrimination can be cost justified or where the discrimination results from a changing condition affecting the market for the goods or their marketability.
- . Section 2(b) sets out the burdens of proof in defending a violation. It provides that after a plaintiff has made out a prima facie case the defendant must then rebut the presumption of illegality. It also provides that a price discrimination is not unlawful if it is made in good faith to meet the equally low price of a competitor.
- . Section 2(c) prohibits the seller from paying brokerage fee, commission or an equivalent to a buyer or buyer's agent. A buyer is similarly

precluded from accepting such brokerage fees or commissions.

- . Sections 2(d) and 2(e) are closely related and prohibit a seller from granting discriminatory allowances (2(d)) or services and facilities (2(e)) to a buyer, unless such assistance is made available to other competing buyers on proportionally equal terms.

- . Section 2(f) provides that it is unlawful for any person to knowingly induce or receive a discrimination in price which is prohibited by the section.

10.74 In addition to the above provisions, section 3 of the Act, a criminal provision, declares that it is unlawful for a seller to provide certain secret allowances to a buyer. It also prohibits territorial price reductions or sales at unreasonably low prices where the seller's purpose is to destroy or eliminate competition.

Enforcement

10.75 The Federal Trade Commission is the principal agency responsible for the enforcement of the Robinson Patman Act. It has extensive investigatory powers and, where it appears that formal proceedings would be in the interest of the public, may issue a complaint and conduct a hearing. Where a decision is against a respondent, the Commission may issue an order to cease and desist. (Such an order is similar to an injunction and remains in force indefinitely). Where a violation occurs, the respondent may be prosecuted for civil penalties. The Commission also encourages compliance with the Act by a number of informal means including advisory opinions and by a consent settlement procedure.

10.76 The number of complaints brought by the Federal Trade Commission has declined in recent years.

10.77 A breach of section 3 of the Act gives rise to a criminal offence and the enforcement of this provision falls within the responsibility of the Department of Justice. This section has rarely been invoked.

10.78 In addition to enforcement by Government agencies, private actions may be brought under the Act. This has been encouraged by the United States Congress which has provided that a successful litigant may recover treble damages for damages resulting from a violation. This incentive combined with the U.S. practice of allowing counsel to work on a contingency fee basis has led to an excessive number of private actions based on the Robinson Patman Act.

SECTION 5 - ROBINSON PATMAN AND SECTION 49 OF THE TRADE PRACTICES ACT

Introduction

10.79 Most commentators have noted that section 49 is based on the Robinson Patman Act, although a number of significant changes were made in an attempt to avoid criticisms which had been expressed in respect of the United States legislation. However, the complexity of section 49, together with the lack of Australian judicial authority, has resulted in many local businessmen placing heavy reliance upon the interpretation of the United States Act.

Interpretation

10.80 The United States approach is, we believe, relevant to the interpretation of section 49. However, business reaction following that section's introduction indicated that perhaps not enough attention has been paid to the basic, deliberate differences between the two price discrimination provisions.

10.81 The decisions of the United States Supreme Court are influenced by attempts of the judiciary to give effect to broad political considerations. That Court will refer to legislative debates to construe the intention of the legislature. In contrast, Australian Courts have consistently refused to make use of the Hansard record. It is thus a question of some conjecture as to how much weight the Australian Courts ultimately will give to decisions of the United States Supreme Court which, although dealing with similarly worded legislation have gone behind the language used in the statute and have taken account of congressional intention and aspirations.

10.82 This Congressional intent was formed prior to, and during the depression era of the 1930s. The Robinson Patman Act was enacted to protect small business against the increasing growth of chainstores as an expression of this intent. There was at that time, a great deal of sentiment in favour of the small independent retailer and many thought that such retailers were in great danger of disappearing from the distribution line altogether. The following quotes give an indication of the feeling which prompted the enactment of Robinson Patman:

"You know there is a certain sentiment and romance about the corner or crossroads grocery store. There formerly, and there now, exists the spit and whittle club. You know, where the boys gather around the stove in the winter, sit around its red-hot fire, chew tobacco, spit on the bowl and listen to it sizzle, and settle the problems of the Nation, and the problems of the community".

(Remarks of Rep. Nichols: 80 Cong. Rec. 8134 (1936))

"The result is, I believe it is the opinion of everyone who has studied this subject, that the day of the independent merchant is gone unless something is done and

done quickly. He cannot possibly survive under that system. So we have reached the crossroads; we must either turn the food and grocery business of this country - now, that is just one division - we must either turn the food or grocery business of this country over to a few corporate chains, or we have got to pass laws that will give the people, who built this country in time of peace and who saved it in time of war, an opportunity to exist - not to give them any special rights, special privileges, or special benefits, but just to deny their competitors the special benefits that they are getting, that they should not be permitted to have."

(Hearings on H.R. 8442, H.R. 4995, H.R. 5062 before the Committee on the Judiciary of the House of Representatives 5, 74th Congress, 1st Session (1935) p.p.5 -6).

10.83 On the other hand, Australian Courts construe the intention of the legislature from the words of the relevant statute. In this case, it is suggested that the relevant legislative intent is to reduce the level of conduct in Australian industry which works against the efficient and economic allocation of resources (See paragraphs 4.10 et seq). Any interpretation of section 49 should, therefore, be undertaken within the context of this policy.

Differences

10.84 Section 49 has a number of fundamental drafting differences, when compared with the Robinson Patman Act, which should give it a more limited operation. These are noted briefly below:

Injury to Competition

Section 49 prohibits price discrimination which has or is likely to have the effect of substantially lessening competition in a market. On the other hand, the Robinson Patman Act prohibits price discriminations which may substantially either:

- . lessen competition;
- . tend to create a monopoly in any line of commerce; or
- . injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.

The first two tests of illegality, which were contained in the original section 2 of the Clayton Act as passed in 1914, involve adverse competitive impact upon the total relevant market, whereas the third test which was added by the Robinson Patman amendment in 1936, focuses upon the probable adverse impact on particular competitors.

• Per se rule

All items of discrimination in section 49(1) are conditioned by reference to the impact on competition in a market (they are not per se illegal).

Unlike the Trade Practices Act, conduct violate of paragraphs 2(c), 2(d) or 2(e) of the Robinson Patman Act is per se unlawful without the need to show competitive injury. Under these paragraphs, moreover, the "cost justification" defence is not available. However, the "meeting of competition" defence does apply.

• Burden of proof

In regard to buyer liability for inducing or receiving a discrimination under section 49, a buyer who is relying on the "cost justification" or "meeting competition" defences has to prove that it was reasonable for him to rely on these exceptions (sub-section 49(5)). However, the Robinson Patman Act appears to require the plaintiff to prove that the buyer knew that the "cost justification" and "meeting competition" defences were not available.

• Likelihood or possibility

The Robinson Patman Act requires that the effect of the prohibited price discriminations "may be substantially to lessen competition or to injure, destroy, or prevent competition". The U.S. Court has decided that the above provision does not require that the discriminations must in fact have harmed competition, but only that there is a reasonable possibility that they "may" have such an effect (FTC v. Morton Salt Co. 334 US 37 (1947)). Section 49 uses the word "likely". It is suggested that this word requires a higher degree of certainty than does the United States Act's provisions. "Likely" would not be equivalent to a "reasonable possibility that it may".

10.85 Despite these differences the Robinson Patman Act can provide a valuable guide to the effect of possible changes to the Australian provisions. Accordingly we now proceed to discuss recent developments in the United States.

Recent Developments

10.86 The effectiveness of the Robinson Patman Act has been the subject of controversy since its enactment and has recently been the subject of detailed reports by at least four United States Government Bodies.

10.87 Serious doubts about the Robinson Patman Act's consistency with the policies in favour of competition embodied in the anti-trust laws were raised by two investigations of the anti-trust laws in 1968 and 1969. Following the release of the reports of these investigations (the White House Task Force Report on Anti-Trust Policy (Neal Report) in 1968 and the President's Task Force Report on Productivity and Competition 1964 (Stigler Report) in 1969) the U.S. Congress set up a special Ad Hoc Subcommittee (which was chaired by Congressman Wright Patman) to study small business and the Robinson Patman Act in 1970.

10.88 This Subcommittee's Report on "Recent Efforts to Amend or Repeal the Robinson Patman Act" was completed in 1976. The Subcommittee found that:

"The unfounded, erroneous and unjustified allegations made against the anti-trust laws in general, and against the Robinson Patman Act specifically, have had the ill effects of confusing citizens and governmental officials and misleading them into the belief that those laws against price discrimination practices destructive of competition are anti-competitive and undesirable and should be repealed."

10.89 It recommended that the Robinson Patman Act should not be repealed, emasculated or weakened in any way, it should not be amended and that the appropriate Departments and agencies should fully and effectively enforce the provisions of the Act. ("Recent Efforts to Amend or Repeal the Robinson Patman Act - A report of the Ad Hoc Subcommittee on Anti-Trust, the Robinson Patman Act and Related matters of the Committee of Small Business", (U.S. Government Printing Office), 1976 pages 120 - 123).

10.90 The Report, however, has been subjected to criticism on a number of grounds. In particular, three members of the Ad Hoc Subcommittee, in an attachment to the main Report, expressed serious reservations which colour the overall value to be placed on the Subcommittee's work. The three members said:

"We have serious reservations concerning certain findings, conclusions, and recommendations, and we do not believe adequate testimony was developed at the Ad Hoc Subcommittees so as to enable the Ad Hoc Subcommittee to render a fair, objective or impartial report ..."

10.91 The three members related how the Ad Hoc Subcommittee had failed to achieve objectivity by failing to give opponents of the Act the proper opportunity to appear before its public hearings and on how the report concentrates on misstating the Administration's position. They called for a further "objective investigation of the Robinson Patman Act."

10.92 The most recent review of the Robinson Patman Act was concluded by the U.S. Department of Justice in 1977. The Act was condemned as having failed to achieve any aims set for it by its

authors in 1936. The Department urged a fundamental weakening of the Act to shift the burden of proof that a given price discrimination was unrelated to cost from the defendant to the plaintiff. It also suggested that discrimination be considered harmful only where there is a proven systematic discrimination in favour of large purchasers.

10.93 Specific weaknesses of the Robinson Patman Act were highlighted by the Report:

- . It has done little to save American consumers from the rise of supermarkets by preserving a nation of small shopkeepers;
- . It has actually harmed competition by imposing rigid pricing in industries where companies in oligopolistic markets are happy to invoke Robinson Patman (by private action) against a price-cutting competitor rather than try to match his prices. Fear of such private actions has inhibited price cutting;
- . Some companies have actually invoked Robinson Patman, as a reason for swapping price information in a way that clearly breaches the earlier anti trust acts, claiming that they need the information to prepare the competitive response defence against Robinson Patman suits that might be brought against them;
- . Ascertaining the costs attributable to specific customers have proved to be difficult, as has the task of defining what products are of "like grade and quality" particularly following the introduction of cheap "own-brand" goods by large chainstores.

SECTION 6 - SMALL BUSINESS AND PRICE DISCRIMINATION

Introduction

10.94 Pricing problems experienced by small business often stem from an inequality in bargaining power as between small business and medium and large business. However, a price differentiation mechanism will provide a structure whereby the individual trader can increase his own purchasing power. This mechanism which provides for the availability of discounts, graduated in accordance with purchasing power, gives small businesses a strong inducement to gain the benefit of the higher discount levels thereby increasing their ability to compete with larger businesses in the market.

10.95 This increased competition is then reflected in the passing of cost savings down the chain of distribution to end-consumers with a resultant lowering of prices as the competition increases.

10.96 In practice, such a mechanism may not be beneficial to all business. It may be difficult, if not impossible, for a small business handling large numbers of diverse and differentiated products to purchase in sufficient quantities to achieve higher discounts. This may be due to:

- . a lack of, or lack of easy access to, capital for such purchases;
- . lack of bulk storage space; or
- . insufficient funds for advertising of discounted goods.

10.97 Such traders, however, often do not rely heavily on scale discounts to enable them to compete effectively. Their continued existence largely depends upon their lower overheads combined with the wide range of stock or specialized forms of stock together with the personalized service, including extended trading hours which they are able to offer to their customers.

Section 49 and Small Business

10.98 The reaction of business following the introduction of section 49 has been noted above. (paragraph 10.7 et seq). This reaction has had two effects on small business in general. First through the elimination of many discounts, a number of small businesses have been placed upon a similar purchasing level to that of many medium and large businesses. Such equalization, however, has been to the detriment of those other enterprises, and, in addition, could have deprived some small businesses of the growth incentives otherwise available through scaled discounts.

10.99 Secondly, small businesses which rely heavily on the personalised and specialised services they can offer to customers for their continued existence as competitive firms may have been insulated from competitive forces, at the expense of other potentially more competitive firms.

10.100 The aspect of section 49 which has been stressed in this Chapter is that the prohibition cannot be invoked unless there has been substantial damage to competition in a market. Section 49, is not, and should not, be viewed as a charter for the preservation of small business. This is so, particularly in cases where such small businesses are inefficient (i.e. economically inefficient as opposed to technically inefficient) and where their disappearance from the market would not make it less competitive. In fact, there are circumstances in which the market position of individual traders may be damaged while real and continuing competition itself is actually increased with benefits ultimately flowing to the consumer.

10.101 This approach to small business recognises the fact that the U.S. Robinson Patman Act was specifically enacted with the social goal of protecting the independent small businessman from

the competition of large businesses. It also accepts the recent findings and conclusions of the U.S. Department of Justice investigation into that Act. In this specific regard, the Department's conclusion is relevant:

"Robinson Patman is ineffective when evaluated both in terms of its narrow, protectionist objections, and in terms of its benefits to the welfare of society as a whole. The greater the business community's compliance with Robinson Patman, whether as a result of voluntary action or rigorous public or private enforcement, the greater the Act's deleterious impact upon competition. However, and this is the anomaly inherent in the law, it cannot be said that an increase in compliance produces a corresponding increase in protection for small business. For...Robinson Patman is largely irrelevant to the survival, success or failure of the small business class in the long run. Rather, the forces of consumer choice and the market remain determinative of success and failure. At the same time the Act has not shown itself to be capable of promoting the anti-trust goals of continued competitive vigor and low prices. In fact, the Act is regulatory in nature and its enforcement is based on a series of faulty presumptions. The other anti-trust laws are capable of protecting against genuine predation, and the ingenuity of those small businessmen who are aggressive and competent will ensure the maintenance of a strong small business sector".

(Department of Justice Report page 250)

Section 45 and Price Discrimination

10.102 It has been argued that the repeal of section 49 might enable somebody who has been adversely affected by price discrimination, in circumstances where the amended section 46 would not apply to use section 45 to obtain relief.

10.103 It should be pointed out that there is no express provision in the Act at present which would prevent such a person using section 45 for that purpose, and thus avoiding the more restrictive provisions of section 49. A strong argument against this proposition would be that the scheme of the Act clearly requires that sections 45 and 49 do not overlap and thus that such a complaint should be brought under section 49.

10.104 We are not unduly concerned by the spectre of numerous price discrimination complaints being brought under the provisions of section 45 which proscribe anti-competitive conduct. In the first place the complainant would need to establish a particular contract or combination of contracts which were having the requisite anti-competitive effect and secondly, the amendment which we propose to section 46 would provide a simple avenue for redress for predatory price discrimination.

10.105 There is no evidence from present experience to suggest that the provisions of section 45 which proscribe anti-

competitive conduct are having or would have the unintended effect of limiting economically desirable price differentiation.

Conclusion

10.106 As stated in the conclusion to Chapter 3, in the main there are two categories of small business that are experiencing difficulties with economic price differentiation or price discrimination conduct. These are "corner store" retailers and retailers in the motor trade (particularly petroleum retailers).

10.107 It is important to note that the factors that led to price differentiation are not identical for the two categories. In the petroleum retail sector there was significant price competition. The major oil companies competed with each other and with "independents", selectively subsidising prices to individual petrol retailers. Moreover, their market strategy included selling directly to the public through sites operated by commission agents. These sites were often high volume self service sites that marketed petrol priced below full service sites. Moreover, independent groups of retailers bought spot cargoes at prices that allowed them to undercut the oil company lessee dealers. The picture in 1979 however has changed dramatically. Due to price fixing and output restriction conduct of OPEC countries and the conduct of oil companies there is no longer an "oversupply of petrol" situation and accordingly price differentiation and discounting are now minimal.

10.108 However the "corner store retailers" problems are more deepseated. Essentially their problems stem from the large "discount" stores and "chain stores" growing at their expense.

10.109 Section 49 prohibits price discrimination where it has the effect or likely effect of substantially lessening competition in either the primary market or the secondary market. The section is one of the measures adopted under the Trade Practices Act in pursuit of its overall objective, which is the reduction of the level of conduct in Australian industry which works against the efficient and economic allocation of resources. In our view it is not a provision designed specifically to assist small business and it would not be appropriate to amend it to make it a provision to prohibit price discrimination that disadvantages individuals. Such price discrimination is but one manifestation of abuse of market power and should be regulated under the general provision section 46, as we suggest it be amended.

10.110 The section recognises that price discrimination has both pro-competitive and anti-competitive aspects and attempts to encourage full and free competition between competing suppliers and buyers while at the same time curbing excesses and abuses which will substantially impair competition. This goal of section 49 is consistent with the general thrust of the Act and its realization would result in some improvement of the market position of small business.

10.111 It is our conclusion, however, that section 49 is not capable, in practice, of having the effects sought, because of

doubts by business as to its interpretation, as well as inconsistencies with other provisions in Part IV of the Act. Its anticompetitive inflationary effects are undesirable. These difficulties cannot be overcome by redrafting the section.

10.112 It follows that in reviewing section 49, we have come to the inescapable conclusion that we must recommend that it be repealed. Our difficulty has been to reconcile this firmly held view with our Terms of Reference; which require us to explore avenues for the improvement of the market position of small business. Because section 49 is believed to be of some benefit (albeit minimal) to a section of small business; some might see it as inconsistent with our terms of reference for us to recommend its repeal in this Report (where we are asked to advise on measures designed to improve the market position of small business).

10.113 It is clear, however, that our proposed amendment to section 46 would be of considerable assistance to small business. We are of the view that there would be a nett benefit to small business if section 49 were repealed, at the same time as section 46 were strengthened, as we suggest. It should be noted that section 49 in its present form is not seen by the majority of small businesses as having been of any real assistance to them. It has largely failed small business because its thrust is against anti-competitive conduct and not against predatory conduct that hurts particular competitors. Our overall task is to advise government as to the best means that are available to it, for the effective working of the Act and accordingly, in the context of a strengthened section 46 and for the reasons we have stated; we recommend that section 49 be repealed.

CHAPTER 11

FRANCHISING

Introduction

11.1 It became apparent quite early in our deliberations that a significant range of small business was concerned about problems related to the general topic of franchising. Accordingly, the Committee raised this particular question with the Minister who subsequently publicly announced that the Committee would be specifically considering matters relating to franchising and the possible introduction of a franchisee protection law into Australia.

11.2 As a style of business, franchising has been fast growing and now is firmly entrenched in Australia. In 1978 it accounted for 18.9% of small non-manufacturing firms in Australia. We are indebted to the Bureau of Industry Economics for some statistics in this field, which dissect by type of industry the percentage of non-manufacturing firms engaged in franchising.

Franchising in small non-manufacturing firms, Australia : 1978

| Industry | Percentage of firms engaged in a franchised activity. |
|--|---|
| Accommodation | 11.3 |
| Building | 8.9 |
| Road transport | 7.4 |
| Motor trades | 57.1 |
| Retailing : 1) Beverages, food & tobacco | 10.2) |
| 2) Clothing, fabrics, furniture, household appliances and hardware | 20.2) 17.9 |
| 3) Other retail | 31.9) |
| Wholesale distribution | 33.9 |
| Travel agents and real estate agents | 10.2 |
| Personal services | 5.2 |
| Total | 18.9 |

Source: Bureau of Industrial Economics Submission.

Debate about Regulation of Franchising

11.3 The debate over and subsequent enactment of the exclusive dealing provisions of the Trade Practices Act 1974 were significant recent events in a continuing debate about possible regulation of the franchise relationship. The issues started to crystallise and possibly for the first time in Australia some exactitude was given to defining the range of problems which can flow from such relationships.

11.4 However, this chapter is not concerned about the possible exclusive dealing aspects of a franchise relationship; we deal with that in Chapter 7. The importance of mentioning them here is merely to note that the exclusive dealing provisions of the Trade Practices Act caused debate to focus more precisely on the problem aspects of the franchise relationship which fell outside of that Act.

11.5 The Swanson Committee in 1976 devoted an entire chapter of their Report to the problem of a termination of a franchise after the franchisee has built up the business. No immediate action was taken by the Government in respect of the views of the Swanson Committee - but the debate did not die away.

11.6 Recently the debate has surfaced strongly and publicly in relation to the retail petroleum business. The last few years have seen dramatic changes in that business. Those changes may be characterised, simplistically, as a shift to less numerous but higher volume service station outlets, particularly in urban areas. One aspect of this change has involved the termination by oil companies of many retail service station "franchises" - either because of an intention to close that site altogether or an intention to develop the site for higher volume, faster throughput, company operations.

11.7 On 30th October 1978 the Minister for Business and Consumer Affairs, The Hon. Wal. Fife M.P., announced that the Australian Government was examining a law whereby retail petroleum dealers would have a right to compensation for unjust termination or non-renewal of their "franchise", a right of assignment of that "franchise", and certain pre-entry rights to the disclosure of information concerning the "franchise".

11.8 The oil industry problems at a retail level in Australia, however, sparked Government interest in what was happening in franchising generally, and also (particularly in the oil and automotive industries) in the United States of America. The result was a report commissioned by the Government dated 28th February 1979 by a Study Group led by Sir Robert Cotton - as to U.S. developments. That Study Group particularly considered the U.S. Petroleum Marketing Practices Act 1978 - a franchise protection statute for the petroleum marketing industry - but it also looked to more general developments in the U.S.

11.9 On 23 October 1979 Mr. Fife announced that the Government had decided to prepare draft franchise legislation for the petroleum retail industry. In his announcement Mr. Fife said:

"The franchise law is intended to ensure equitable treatment for lessee and licensee petroleum dealers. The draft Bill will provide for payment of compensation to franchisees for unjust termination of a franchise or unreasonable refusal to renew a franchise. It will also give franchisees rights to continuation of supplies, without discrimination, in the event of any shortage and

rights of assignment of their franchises. The bill will also provide for full disclosure of relevant information to incoming franchisees."

11.10 This Committee considers that before the Government enacts a franchise law for the retail petroleum business, it should consider the views in this Report on a more general franchise law.

11.11 There is no doubt that the general trend in the U.S. in recent times both at federal and state government level has been for greater government involvement in the franchise relationship by means of special statutory provisions, largely directed to maintaining a "fair" position for the franchisee.

11.12 We have already noted the interest the Committee found in the topic of the regulation of franchising. We draw particular attention to the comments on the subject by the Bureau of Industry Economics in its submission which, together with some other submissions, are separately published with this Report.

Definition of a "Franchise"

11.13 The concept adopted by the Committee is that of a continuing commercial relationship whereby one party (the franchisor) grants to another party (the franchisee) the right to conduct a separate business which is, however, indelibly and publicly linked with the identity of the franchisor. The link to the franchisor will always involve the licensing of the use of a relevant trade mark or name, and/or user of particularly distinctive shapes or colours if they are not a registered mark. The Committee does not wish to cover "loose" commercial relationships, not reduced to written form.

11.14 However, the Committee considers that for the purposes of developing law with respect to "franchise" relationships, certain exclusions are appropriate. These exclusions relate to situations in which the potential franchisee is required to make minimal (or no) capital or like contribution to the franchisor, where there is an employment or partnership relationship, or where the licensing involved is not multiple.

11.15 There are also a number of variable features common to the franchise relationship which are not essential pre-conditions. For example, a franchise may involve total conformity to a marketing plan prescribed by the franchisor, or it may involve the use of real property owned by the franchisor or it may involve a contract of supply, or purchase, from or to the franchisor by the franchisee.

11.16 The types of franchise relationships that exist have been analysed in the Swanson Report and the Bureau of Industry Economics and the Trade Practices Commission submissions to this Committee. We have nothing further to add to those analyses.

Advantages of Franchising

11.17 The franchising system has often been commended, and rightly so in our view, because it has frequently enabled the development of small business under circumstances where the only other option was direct operation by bigger business (i.e. in competitive terms, franchising has lowered barriers to entry in some industries). The positive, and continuing, contribution of franchising to small business must never be overlooked in assessing the need for legislation relating to franchising.

11.18 The positive contribution which franchising has made to strengthen the small business base in the United States has been recognised by the U.S. Small Business Bureau; "... the evidence to date establishes that franchisees have a good chance to survive and prosper in a highly competitive economy. We believe that appropriate franchise operations provide healthy competition for vertically integrated organisations." (The Growth and Importance of Franchising. Its Impact on Small Business" 12 Antitrust Bulletin (1967) pp 1191-1210).

11.19 In a study based on 1000 completed questionnaires from franchisees in the fast food, convenience grocery and laundry/dry cleaning franchising industries, the nett effect of franchising on the creation of new business was estimated to be 52%. In other words, if franchising did not exist 52% of franchisors would not be self employed (see "The Socio-Economic Consequences of the Franchise System of Distribution" Hunt - Journal of Marketing July 1972 p.32).

11.20 There is a lower failure rate in franchised business. One common explanation for this is that franchisors impose superior management techniques on franchisees (in particular financial management) because franchisors commonly supply the franchisor vital goods or services and also commonly take a fee on turnover. The franchisor therefore has a vital interest in ensuring that the franchisee keeps tight and accurate financial records.

11.21 A survey conducted by the University of Newcastle in 1973 revealed that the following benefits were derived by franchisees from franchising agreements:

| <u>Type of Benefit</u> | <u>Percentage of Total Responses*</u> |
|---|---|
| Free advertising and/or display material | 34.5 |
| Free advice and assistance with operation of the business | 20.1 |
| Exclusive market made available by franchisor | 5.7 |
| Special quantity discounts or rebates on purchases from franchisor | 31.8 |
| Loans from franchisor at a low rate of interest | 4.9 |
| Other benefits | 2.9 |
| | 100.0 |

* There were 375 respondent small firms, of which 197 derived more than one benefit.
(Source: B.L. Johns, W.C. Dunlop and W.J. Sheehan Small Business in Australia. Problems and prospects, Allen and Unwin, Sydney, 1978).

11.22 For the franchisor, the franchising system can provide a lower cost means of distribution. Few franchisors actually own their distribution outlets (a notable exception is often the retail petroleum business). Industrial problems of employees are minimized - the self employed do not usually strike, or even necessarily seek higher wages. Commercially the business risk is widely spread and the minor irritants of business life (local government, community support, workers compensation, tort and other legal claims etc.) are all left to the franchisee.

Matters for Possible Legislative Action

11.23 The principal problems of small business with the franchise relationship are:

- . adequate disclosure of relevant information by the franchisor to the franchisee before entering the relationship,
- . the rights of the franchisor to terminate the relationship, and the right of the franchisee to compensation for unjustified termination, and
- . right of assignment of a franchise.

11.24 The Committee is effectively asked by its terms of reference whether any changes should be made to the Trade Practices Act so as to deal with these problems.

11.25 We note at the outset the procedural problem raised by the Commission in its submission that any possible legislation relating to franchising should be separate from the Trade Practices Act. We respectfully disagree with that proposition. The Trade Practices Act stands for freedom to do business - franchise rules must always seek to be consistent with that principle. If the two are separated, in different Acts, the pressure to retain consistency of principle is lost. The Committee considers this a major problem of economic regulatory legislation today. Common principles are lost or conveniently overlooked; detail breeds more detail; separate administrative empires develop without regard for each other or the overall effect on the country.

Prior Disclosure

11.26 This has been an area of prime concern in the U.S. with the result that by 1978 (the latest year for which compendious information is available) 16 U.S. states had general disclosure laws and 8 U.S. states had specific laws requiring disclosure to petroleum franchisees.

11.27 Pressure for action in the US on state legislatures substantially died away after the Federal Trade Commission issued a Trade Regulation Rule on "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (43 FEDERAL REGISTER 59614, 21 December 1978, effective 21 October 1979).

11.28 There are several issues involved here. Fraud is an issue of concern - see paragraph 1.14 of the Trade Practices Commission's Fifth Annual Report concerning the problems of unscrupulous promotions. It would not be the only reason, however, for the Committee suggesting any alteration to the law at this stage. Of equal if not greater importance in the long term, so far as small business is concerned, are the questions of accurate knowledge about the persons selling the franchise and the commercial viability of the franchise being sold. Both these are necessary for a firm foundation for a long term business investment. The Committee became aware, for example, that "franchise opportunities" were being marketed in Australia on the basis that a significant sum was to be tendered "up-front" (say 25%) before the prospective franchisee was permitted even to see the details of the terms and conditions of the franchise.

11.29 It is a long standing practice of many substantial franchisors, in the business in the long term, to provide considerable information to prospective franchisees about the franchise business - to ensure that the persons who become their franchisees are induced to be there on a long term basis also. There is no commercial advantage, in the long term, in having an unstable, constantly changing number of franchisees. The Committee understands it has become a matter of course for such franchisors to provide potential franchisees with an accurate assessment of the particular franchise business. Candour is in the interests of all in those situations.

11.30 The problem comes with less substantial franchisors either in terms of financial resources or in terms of experience with the franchise in question. Such franchisors have in the past been responsible for numerous failures, taking with them a raft of equally naive, innocent small businessmen.

11.31 No law can, or should, act to prevent the holding or seeking of high aspirations, however unlikely to be satisfied. However, it has been a long standing philosophy of free enterprise government that it is a legitimate role of government to provide, or cause by law to be provided, an accurate informational framework within which individual aspirations are formulated. Thus, for example, the Companies Act does not directly regulate who can or cannot lend money to a company but requires a company making a public invitation for loan finance to make various disclosures in a public prospectus about the business of the company and its management.

11.32 The Committee can see very little difference between the objectives of company law in this regard and the objective of providing potential franchisees with relevant information.

11.33 We were heartened to find that this conclusion was widespread among persons the Committee dealt with in relation to this matter. Full disclosure of relevant information was seen, not as a restriction on business, but a common sense and firm basis for doing business within the peculiarly close relationship of a franchise.

11.34 We note the guidelines of the Trade Practices Commission as to disclosures to persons in connection with home operated business (Information Circular No. 10) and the full disclosure requirements of the US Federal Trade Commission which are now in force in the United States (see paragraph 11.27 above).

11.35 The Committee also notes, with particular concern, the problems that have recently been disclosed in litigation about section 59 of the Trade Practices Act. Section 59 is the only section of the Act which presently deals directly with invitations to enter into business opportunities. The problems were demonstrated by the case Thompson v. Mastertouch T.V. Services 1978 ATPR 40-076 where statements about a business which was being offered for sale proved to be widely inaccurate to the point of being ridiculous. The Court found that Section 59 of the Trade Practices Act did not, however, apply to the particular situation. The lesson of the case is that a realistic franchise disclosure law must, if it is to be of use, impose a positive obligation on the vendor of the franchise to disclose all relevant facts, and to clearly identify any matters which form part of a sales promotion for the franchise and which are his own opinions or are not based upon fact.

The Substance of Disclosure

11.36 Three matters are of prime concern to a person contemplating purchasing a franchise

- the terms and conditions of sale of the "franchise"
- the background of the franchisor and its chief executives, and
- facts relevant to the viability of the business including its possible term of existence.

These are the matters that are focussed on with particularity by the Federal Trade Commission rules and Trade Practices Commission Guidelines, and also by this Report.

11.37 An example of matters that could fall within the above mentioned paragraph, within a stricter regulatory framework, including government licensing and document lodgment procedures is given by the Californian Franchise Investment Law, Corporations Code, sections 31000 through 31516. The Committee does not, in this Report, examine such a stricter form of regulatory framework, concentrating instead upon the (hopefully) prophylactic effects of mandatory disclosure rules, backed up by unjust termination remedies.

Termination of a Franchise

11.38 The Swanson Report saw the termination of a franchise as a central question. At paragraph 5.4 of their report they raised the spectre of a franchisee having invested substantial sums and performed the contract of franchise properly receiving little or no compensation for his investment at the end of the franchise period.

11.39 The Trade Practices Commission, in its submission, saw this matter as central not only to issues of fairness between the franchisor and the franchisee but more importantly as to the inhibiting effects on competition flowing from the imbalance of bargaining power between the franchisor and franchisee. The Commission identified the matters which surround tenure as highly significant - such as potential loss of goodwill, inadequate knowledge as to contractual rights and general fear of confrontation.

11.40 As the Committee understands it, the Commission identified the above matters as being particularly relevant to franchise situations. They considered that "clogs" on the whole process of competition were created by small business being in that sort of position and they supported a law which sought to stabilise the relationship and to reduce the importance of those factors to the conduct of the small business franchise.

11.41 The Committee does not wish to inhibit free flowing contractual relationships designed by particular persons to suit particular situations. However, the Committee does feel that it would be of significant advantage to small business franchisees if the legislature could spell out a "shopping list" of factors that would enable franchise relationships to be terminated, on the basis that termination outside those factors is compensatable. A clear, and in the opinion of the Committee, highly desirable, precedent to be followed in this regard are the provisions on termination in the U.S. Petroleum Marketing Practices Act 1978.

Right of Assignment of a Franchise

11.42 Naturally, the small business franchisee, would wish to be able to get back his investment in a franchise (investment both in terms of capital and human effort) by its sale to a new franchisee.

11.43 Such a policy, however, directly conflicts with the policy of respecting the property rights of the franchisor. In particular, property rights in trademarks and tradenames relevant to franchise situations can be highly valuable, and that value in most cases has come about because of diligent (and usually expensive) marketing by the franchisor.

11.44 The Committee notes that these conflicting considerations in relation to goodwill were the subject of discussion in the Cotton Report [(see paragraphs 145 to 155 of that report); paragraph 11.8 supra].

11.45 The Committee considers that it would be appropriate for the law to favour such assignments, provided equity can be done between the franchisee and the franchisor. However, we very much doubt that this would be the effective position if the legislature were to adopt a recommendation that a franchisee has a right to assign his franchise subject to the consent of the franchisor, which consent is not to be unreasonably withheld.

11.46 Accordingly the Committee, in its conclusions, makes certain recommendations as to the method of apportioning any goodwill between the franchisor and the franchisee upon termination of the franchise. It is our view that those same considerations should govern an apportionment of goodwill upon assignment of the franchise. On the basis that these recommendations are designed strictly to assist small business franchisees, the Committee makes no recommendation for recovery by the franchisor of negative goodwill.

Conclusion

11.47 The Committee recommends that the Trade Practices Act be amended so as to introduce a new Part VA, dealing with the protection of franchisees. In our view, such a law should -

- . require a franchisor (and, in the case of a franchisee assigning the franchise, require a franchisee) to disclose certain matters to an incoming franchisee - (see section 2 of the draft legislation at paragraph 11.51 for a detailed description of the matters the Committee would see disclosed in pursuance of this obligation);
- . that the law provide a "shopping list" of situations which would permit a franchise relationship to be terminated or not renewed by the franchisor; termination or non-renewal outside of those situations would render the franchisor liable for damages for unjust termination or non-renewal;
- . that a franchisee be permitted by law to assign his franchise to another person, subject to the consent of the franchisor, which consent shall not be unreasonably withheld;
- . that in both the assignment and the termination or non-renewal situations there be an apportionment of any goodwill between the franchisor and the franchisee on the basis of the principle of fair apportionment having regard to the relative inputs of the franchisee and franchisor, both of capital (including general marketing costs which the franchisor may have incurred to promote the tradename, etc.) and labour, so that any goodwill is apportioned having regard to that relationship.

11.48 The Committee also worked on more precise terms for the above recommendations. At the same time it was aware that the Government was also working on similar proposals, in the context of the petroleum industry. The Committee believes that its specific proposals, below, would work more generally than in just the petroleum industry, but if the Government were to adopt them they should merge the petroleum proposals into the general ones.

11.49 We considered the possibility that the law should provide for a minimum franchise period - possibly a minimum period of one year for the first or "trial" franchise, and three years for every franchise granted thereafter. The Committee considers that more harm than good would arise from providing a minimum franchise period - the more direct problem is not a minimum period but the terms and conditions for termination and non-renewal.

11.50 Consistently with our recommendation that any court of competent jurisdiction have jurisdiction over Part IV, we recommend that any such court have jurisdiction in respect of this proposed franchising law.

Proposed Franchising Law

11.51 The following outline draft encompasses our recommendations; the draft is intended to be used for the purposes of more precise debate and also as possible drafting instructions for Parliamentary Counsel -

PART VA

FRANCHISEE PROTECTION

1. Definition

- (1) "Franchise" means any continuing commercial relationship whereby a person ("the franchisee") supplies or seeks to supply goods or services which are identified by a trademark, service mark or trade name, under license from another person ("the franchisor") and the franchisor exerts or has the right to exert such an influence over the business affairs of the franchisee that the business of the franchisee is publicly and substantially identified with the franchisor or the business of the franchisor.
- (2) "Franchise" does not include:-
 - (i) an arrangement where there is no writing evidencing material terms of the arrangement;
 - (ii) any relationship of employment or of partnership;
 - (iii) trademark, etc. licensing between franchisor and franchisee where that license is a single license and no similar licences in respect of carrying on business in Australia have been given to any other person; or

- (iv) an arrangement whereby the franchisee is not required to make a payment at any time (described in any manner) of at least \$500 as a condition of entering into the continuing commercial relationship.

2. Pre-franchise Disclosure

- (1) All information required by this section to be provided by a potential franchisor must be provided:-
 - (a) accurately and clearly in a single document;
 - (b) without any other promotional material;
 - (c) at least three (3) days before the entering into of any contractual obligations related to the franchise;
 - (d) together with a statement of the rights and obligations of the franchisor and franchisee under this Part.
- (2) Prior to the creation of any franchise and the payment of any consideration in respect thereof the prospective franchisor must disclose to the prospective franchisee the following information:-
 - (a) the name and registered office of the franchisor and the name and registered offices of all related corporations;
 - (b) the business name, if any, under which the franchisor conducts business;
 - (c) the trademark, trade name or service mark which identify the goods or services to be supplied by the prospective franchisee;
 - (d) the name of each of the directors at that time of the franchisor, if the franchisor is a corporation, and the names of the chief officers of the company, including the officer responsible for any franchise marketing;
 - (e) the business experience during the past five years of each of the abovementioned persons;
 - (f) the business experience of the franchisor, including the length of time the franchisor:-

- (i) has conducted a business of the type to be operated by the franchisee;
 - (ii) has offered or sold a franchise for such business; and
 - (iii) has offered or sold franchises in other lines of business - together with a description of such other lines of business;
- (g) As to:-
- (i) the franchisor;
 - (ii) any related company the affairs of which are relevant to the franchise; and
 - (iii) every director and senior officer of the franchisor;
- a statement of any:-
- (iv) criminal convictions, other than traffic offences;
 - (v) liability (either from final judgment or settlement out of court) in civil actions involving allegations of fraud, embezzlement, fraudulent conversion, misappropriation of property, or breach of the Trade Practices Act; and
 - (vi) current litigation, either of a criminal (not including traffic offences) or a civil (not including domestic or family matters) nature pending before any court;
- (h) for all the abovementioned persons, disclosure as to whether they have been declared bankrupt or entered into any arrangement with their creditors pursuant to the Bankruptcy Act or Companies Act in the past seven years;
- (i) a factual description of the franchise arrangement about to be entered into and a statement as to how the franchisor envisages the arrangement will operate in practice;
- (j) a statement as to any payments the franchisee must make (and to whom they must

be made) in order to commence the franchise operation and a full statement of all payments that the franchisee will be required to make during the term of the franchise, so far as the franchisor is aware that those payments will be required to be made;

- (k) a statement as to any person with whom the franchisee will be required to do business under the franchise;
- (l) a statement as to any goods and services that the franchisee will be required to acquire from the franchisor or from any other particular person;
- (m) where a similar franchise in the same locality has been operated in the past by another person, a statement of the business history of the operation of that franchise so far as the franchisor is aware;
- (n) details of any financing being offered to, or required to be taken by, the prospective franchisee;
- (o) limitations in the franchise as to:-
 - (i) goods or services which may be offered for sale;
 - (ii) customers to whom goods or services may be offered; or
 - (iii) geographic area in which goods or services may be offered (and if there are limitations as to geographic area, whether exclusive territory will be granted by the franchisor or not);
 - (iv) any other business which the franchisee may participate in;
- (p) the extent of personal participation required by the franchisee;
- (q) the terms and conditions of the prospective franchise as to termination and renewal;
- (r) the rights of the franchisee to assign the franchise business;
- (s) details of the total franchise operations of the franchisor;

- (t) the total number of franchises operated by the franchisor during the past financial year, together with the number of similar businesses conducted by the franchisor itself, and the following information about the first mentioned franchises, namely:-
 - (i) the five franchises most nearly geographically located to the franchise in contemplation;
 - (ii) the number of similar franchises voluntarily terminated or not renewed by franchisees during the last preceding year;
 - (iii) the number of similar franchises which the franchisor terminated or refused to renew during the last financial year and a short statement of the reasons for the refusal or termination;
 - (iv) the franchises re-acquired by the franchisor during the last financial year and the consideration paid by the franchisor;
- (u) details of any site selection procedures involved with the franchise including description of the usual periods of time taken in the execution of those procedures;
- (v) training offered or required by the franchisor to be undertaken by the franchisee;
- (w) a statement of the current financial position of the franchisor for the most recent financial year, prepared in accordance with accounting principles usually adopted in Australia.

3. Franchise Pre-Assignment Disclosure

- (1) All information required by this section to be provided by a franchisee seeking to assign his franchise (in this section called the "assignor") must be provided in the form, and within the time periods, outlined in sub-section 2(1), as if those provisions applied, mutatis mutandis, to such assignor.
- (2) Prior to the assignment of any franchise and the payment of any consideration in respect thereof,

the assignor must disclose to the prospective incoming franchisee (in this section called the "assignee") the following information:

- (a) all information disclosed to the assignor in pursuance of these requirements, at the time he became a franchisee, together with a statement of any material changes to that information or information to the same effect as required by section 2 in respect of a franchisor allotting that franchise at the time of the proposed assignment;
- (b) the name and registered office of the assignor and of all related corporations;
- (c) the name of the directors and senior officers of the assignor;
- (d) a statement of all payments that the assignor is required to make to the assignor upon the assignment of the franchise, together with a statement of any payment that the assignee may be required to make to the franchisor;
- (e) a statement of the trading position of the assignor, with respect to the franchise to be assigned, including audited profit and loss accounts and an audited balance sheet, for the previous three years or such lesser time as the assignor may have operated the franchise.

4. Termination and Non-Renewal by the Franchisor

- (1) A franchisor may not terminate a franchise except as provided in this section.
- (2) A notice under this section must:-
 - (a) state the ground relied on; and
 - (b) state the facts and circumstances relied on in respect of the ground relied on.
- (3) A franchisor, on giving thirty (30) days notice to the franchisee, may terminate a franchise on any of the following grounds:-
 - (a) a reasonable belief of fraud or criminal conduct by the franchisee relevant to the operation of the franchise;
 - (b) continuing physical or mental disability on the part of a franchisee (being a natural

person) or, where the franchisee is a body corporate, the Managing Director, which prevents the continued operation of the business of the franchise;

- (c) failure by the franchisee to pay promptly to the franchisor all sums due under the franchise;
 - (d) wilful adulteration, or misrepresentation of the goods or services the subject of the franchise arrangement;
 - (e) substantial breach by the franchisee of any law relevant to the operation of the franchise; or
 - (f) breach by the franchisee of a reasonable and substantial obligation of material significance to the franchise.
- (4) A franchisor, on giving 180 days notice to the franchisee, is also entitled to terminate or fail to renew a franchise if:-
- (a) continuation or renewal of the franchise is likely to be uneconomical to the franchisor, provided that no act or omission of the franchisor caused, or substantially contributed to, such likelihood; or
 - (b) the franchisor bona fide decides to withdraw from the particular market area of the franchise operation for legitimate business reasons.

5. Right to Assign

- (1) A franchisor shall not unreasonably withhold his consent to an assignment of the franchise by the franchisee.
- (2) Upon an assignment the assignee shall assume the benefits and take over such of the obligations of the assigning franchisee as is required by the franchisor.

6. Supply Protection

- (1) The termination of the supply of the goods or services, the subject of the franchise, to the franchisee, or the substantial under fulfilment of the franchisees requirements of those goods or services, shall be deemed, for the purposes of this Part, to be a termination of the franchise.

- (2) In proceedings under this Part in respect of a failure of a franchisor to supply any goods or services pursuant to the franchise to the franchisee, a franchisor shall not be taken to have terminated the franchise by failing to supply if failure to supply is due to the inability of the franchisor to obtain supplies of the goods or services in question.
- (3) If the franchisor is unable to meet all the franchisee's requirements for goods or services then the franchisee may obtain supplies of goods or services from any person and such conduct shall not be taken to be a breach of franchise and may not be used as a ground for the purposes of section 4.

7. Uniform apportionment in times of shortage

- (1) Where the franchisor is unable to meet all requirements of its franchisees for goods or services to be supplied by the franchisor, or at its direction, pursuant to the franchise then the franchisor shall equitably apportion supplies of those goods or services between those franchisees having regard to both the normal requirements of those franchisees (over past 2 years) and the total requirements of all franchisees as a proportion of total sales of goods or services of that kind.
- (2) Where the franchisor is a competitor of any of its franchisees or it supplies any other person then each retail establishment operated by the franchisor shall be regarded as a separate franchise for the purposes of this section and shall not be advantaged over the franchisors franchisees.

8. Pecuniary Penalties

- (1) If the Court is satisfied that a person:-
 - (a) has contravened a provision of section 2;
 - (b) has attempted to contravene such a provision;
 - (c) has aided, abetted, counselled or procured a person to contravene such a provision;
 - (d) had induced, or attempted to induce, a person, whether by threats or promises or otherwise, to contravene such a provision;

- (e) has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of such a provision; or
- (f) has conspired with others to contravene such a provision;

the Court may order the person to pay to the Commonwealth such pecuniary penalty (not exceeding (blank) in the case of a person not being a body corporate, or (blank) in the case of a body corporate, in respect of each act or omission by the person to which this section applies) as the Court determines to be appropriate having regard to all relevant matters including the nature and extent of the act or omission and of any loss or damage suffered as a result of the act or omission, the circumstances in which the act or omission took place and whether the person has previously been found by the Court in proceedings under this Part to have engaged in any similar conduct.

9. Orders

The Court on application of:-

- (a) the Minister;
- (b) the Commission; or
- (c) any other person;

may

- (d) grant an injunction restraining a person from engaging in conduct that constitutes or would constitute a breach of a provision of this Part;
- (e) award compensation to a franchisee for unlawful termination or failure to renew a franchise and in considering the amount of compensation to be awarded in respect of any item of goodwill shall have regard to the contribution of both the franchisor and the franchisee in the development of that goodwill;
- (f) declare that a termination is of no effect;
- (g) order that the notice periods provided for in section 4 may be shortened where it is fair and equitable to so order and where continuation of the franchise would be likely to lead to substantial damage to the business, the reputation or the property of the franchisor;

- (h) declare that consent to an assignment of a franchise was unreasonably withheld.

10. Jurisdiction

The Court for the purposes of this Part is any court of competent jurisdiction.

11. Savings of Other Laws and Remedies

- (1) Nothing in this Part is intended to exclude or limit the concurrent operation of any law of a State or a Territory.
- (2) Except as expressly provided in this Part nothing shall be taken to limit restrict or otherwise affect any right or remedy a person would have if this Part had not be enacted.

CHAPTER 12PROCEDURES AND REMEDIESIntroduction

12.1 In previous chapters of this Report, the operation of the particular provisions of the Act has been discussed and amendments suggested which would have the general effect of improving the market position of small business.

12.2 Our task would be incomplete, however, without a consideration of how best the ancillary provisions of the Act should be designed to ensure the Act is practically useful to small business.

12.3 Small businesses, as has been noted, typically have strained management resources, few or no internal specialists, and rarely have the financial resources to make much use of external sources of professional advice.

SECTION 1 - SMALL BUSINESS COMPLIANCE WITH THE ACTRisk Taking

12.4 It has been put to the Committee that small businesses by their very nature are disadvantaged in complying with the Act in two major ways. In the first place, their comparative lack of internal specialists and market power forces them to rely heavily on cooperative action to achieve results that a large business can achieve unilaterally. To this extent, their conduct is more likely to be subject, at least at first glance, to those provisions of the Act which prohibit agreements which substantially lessen competition (the section 45 group of provisions). In very many cases, the agreements reached by small businesses, in the context of a trade association, will not have or be likely to have the effect of substantially lessening competition and so will not contravene the Act. However, the fear of inadvertent contravention may well be a potent force inhibiting the legitimate cooperation of small businesses.

12.5 In the second place, the very disabilities that make cooperation necessary mean that small businesses are less able than large firms to assess whether their proposed conduct is likely to contravene the Act.

12.6 While many submissions received by the Committee revealed a thorough understanding of the operation of the Act and of its limitations, others revealed a fundamental misunderstanding of the nature of the competition provisions of the Act and evidenced a considerable overreaction to its perceived strictness. It was not uncommon for the Act to be criticised for prohibiting conduct upon which it had no actual effect.

12.7 In some cases, these misconceptions as to the operation of the competition provisions seem to have been instrumental in discouraging small businesses from engaging in conduct which is legitimately open to them. This was particularly the case with respect to the various forms of trade association activity.

12.8 An agreement between the members of a small trade association, or one composed of very small businesses, is, all other things being equal, less likely to substantially lessen competition. By the same token, the burden of obtaining proper advice will be relatively heavier on the parties, as will the effect of any penalties incurred. Hence, there will be a greater disincentive to entering into any particular agreement due to an inability to assess the risk being taken with any confidence.

Conclusion

12.9 In practice, we feel the difficulties are not experienced nearly as often now in as acute a form as the above discussion would suggest.

12.10 The adverse effects of uncertainty are most commonly alleged to occur with respect to recommended price agreements. We have discussed the operation of the relevant provisions of the Act elsewhere in this Report and do not propose to cover this ground again. We note, however, that the argument is equally valid with respect to all contracts, arrangements or understandings which are capable of falling within section 45.

12.11 As the basic problem is one of small business uncertainty as to the effect of the provisions of the Act and particularly as to what will substantially lessen competition in a market, it is not one which lends itself to easy solutions. Hopefully the improved communication which we advocate (paragraph 12.25) will help small business.

SECTION 2 - THE COMPETITION TEST AND THE PUBLIC BENEFIT TEST

The competition test

12.12 No submission against the competition test (substantially lessening competition in an Australian market) was made to the Committee. This was the subject of exhaustive examination by the Swanson Committee and we make no recommendation about its alteration.

The public benefit test

12.13 A number of submissions were, however, made to the Committee about the public benefit test. Not against the test itself but rather on how the Commission has interpreted it in particular circumstances.

12.14 Consideration was given to particularizing matters to which the Commission should have regard when assessing public benefit in small business adjudication matters. This was rejected not only because it is impossible to define legislatively a small business matter but it would not be satisfactory to provide legislatively a shopping list of matters to be had regard to. If the shopping list were too narrow then factors important to particular cases could be ignored and if it were very long it would add nothing to the matters that are at present embraced in the broad term "public benefit".

12.15 In our report on the Operation of the Trade Practices Act in relation to primary production in Australia, we considered the general test of "public detriment" to be the appropriate test and we listed a number of factors that were peculiar to primary industry that should be taken into account when considering "public detriment".

12.16 However we do not recommend the insertion of a "shopping list" for small business adjudication for the reasons set out above.

SECTION 3 - ADMINISTRATIVE PROCEDURES

Clearance

12.17 We gave consideration in some detail to the reintroduction of a clearance procedure for small business agreements and initially found the concept of a clearance procedure which would be of limited availability and restricted to proposed conduct quite attractive.

12.18 It soon became clear that it is not feasible to design a workable procedure which can be restricted to small business and still not have other undesirable effects on the effectiveness of the Trade Practices Act.

12.19 In reaching this conclusion, we found the reasoning which influenced the Swanson Committee to recommend the abolition of the clearance procedure more than persuasive. Briefly these reasons were that the availability of the clearance procedure acted as a disincentive to businesses to assess their own conduct against the standards of the Act, that anti-competitive conduct tended to persist until clearance had been decided, and that administration of the procedure diverted the limited resources of the Commission from enforcement to administration.

12.20 We consider that the argument based on the strain on the Commission resources is probably less relevant today because business, as a whole, now has a greater understanding of the Act.

12.21 Limiting a clearance procedure to proposed conduct only would tend to overcome the second difficulty seen by Swanson - the persistence of anti-competitive conduct until clearance was denied.

12.22 However, we found it impossible in practice to design a provision that would limit access to a clearance procedure only to agreements all the parties to which are small businesses. Even if a satisfactory definition of "small business" for these purposes could be devised, and we have argued elsewhere that it cannot, it would be difficult to prevent other businesses that are not party to the cleared agreement from obtaining the benefit of the clearance.

Conclusion

12.23 Like the Swanson Committee, we recommend against the reintroduction of a general clearance procedure because that would frustrate the objective of the Act being self-enforcing and would mean the Trade Practices Commission would be involved in many business decisions and the procedure would also benefit large businesses.

12.24 We do not, therefore, recommend the adoption of either a general clearance procedure or a small business clearance procedure.

SECTION 4 - SMALL BUSINESS AWARENESS

12.25 One suggestion which would seem to offer positive benefits to small business is to provide them with more adequate information as to the operation of the Act.

12.26 Under paragraph 28 (1)(a) the Commission presently has as one of its functions, the function:

"(a) to make available to persons engaged in trade or commerce and other interested persons general information for their guidance with respect to the carrying out of the functions, or the exercise of the powers, of the Commission under the Act."

12.27 The Commission has in fact, within the confines of its available resources, always advised small business on its responsibilities under the Act and small business familiarity with the Act does appear to be increasing.

Conclusion

12.28 We recommend, however, a formal commitment on the part of Government, through agencies like the Department of Business and Consumer Affairs, the Department of Industry and Commerce and the Trade Practices Commission, in co-operation with small business agencies and trade associations to advise small business on the Trade Practices Act.

12.29 In making this recommendation the Committee is mindful that these agencies may not give legal advice. Nevertheless the Committee believes that the provision of information and advice on the Act, particularly tailored to small business situations, would greatly assist small business to assess whether or not their conduct was consistent with the Trade Practices Act and greatly assist small business to use the Act.

SECTION 5 - PROTECTION OF WITNESSES

12.30 Many of the substantive provisions of the Act are designed to protect small businesses from the anti-competitive conduct of large businesses.

12.31 In practice, however, persons engaged in small businesses are often deterred from exercising their rights under the legislation by fear of reprisals from larger corporations in the industry.

12.32 Section 36A of the Crimes Act 1914 (CTH) provides:

"36A A person who -

- (a) threatens, intimidates or restrains;
- (b) uses violence to or inflicts an injury on;
- (c) causes or procures violence, damage, loss or disadvantage to; or
- (d) causes or procures the punishment of,

a person for or on account of his having appeared, or being about to appear, as a witness in a judicial proceeding shall be guilty of an indictable offence."

Conclusion

12.33 We see merit in the Commission's recommendations that the existing protection from intimidation afforded to witnesses in Court proceedings by this provision be extended to protecting witnesses who give evidence or information to the Commission, in relation to its investigations that do not result in Court proceedings and in relation to its adjudication investigations.

SECTION 6 - ACCESS TO LOWER COURTS

12.34 At present the Federal Court of Australia has exclusive jurisdiction over all proceedings for enforcement and remedies under Part VI of the Trade Practices Act. It has been suggested to us that small business would benefit by being able to have access to the simpler procedures of the smaller State Courts should they wish to use the provisions of the Act to protect their position.

12.35 In our view, there is little justification for preventing actions under the Act involving restrictive business practices and consumer protection breaches from being instituted in lower courts. However, we do accept that the law would tend to be more consistent if appeals from these courts were to be brought in the Federal Court.

Conclusion

12.36 The Government should give serious consideration to amending the Act to allow magistrates courts and District Courts or their equivalent in the States to have jurisdiction to decide cases brought under Part IV and Part V of the Act. The Federal Court would retain its present jurisdiction and also hear appeals

from these courts. In our view, any disadvantages which might arise out of the inconsistent decisions which could occur initially are far outweighed by the benefits to small businesses, consumers and other less powerful litigants who would thereby obtain ready access to the Courts.

SECTION 7 - CLASS ACTIONS

12.37 The class action is essentially a procedural device which brings together a number (often a large number) of individual claims against a common defendant for decision in a single adjudication. The proceeding is primarily justified by the existence of questions of fact and law that are common to both the claim of the individual plaintiff and the claims of those persons whom he represents - the class members. In this context, it should be noted that the class action could not, and should not, succeed if the separate claims are not soundly based both in fact and in law i.e. unless the individual claims are otherwise triable separately.

12.38 The question of class actions and their possible introduction into the Australian Courts has been the subject of a detailed investigation by the Australian Law Reform Commission since 1977. In June of this year, the Commission issued a Discussion Paper on this topic to promote discussion and elicit comment. This work follows a similar investigation and a Report by the South Australian Law Reform Committee in 1977. In its Report to the South Australian Attorney-General, that Committee recommended that class actions be introduced in South Australia and produced a draft Bill. It is understood that no further action has been taken on that Committee's recommendations pending the outcome of the Australian Law Reform Commission's Report.

Conclusion

12.39 As has been noted, the Australian Law Reform Commission's work in this area has not yet been completed. It is considered, therefore, that it would not be appropriate to make any recommendation in this regard at this time. This issue warrants further investigation when the Australian Law Reform Commission reports.

SECTION 8 - ASSISTANCE FOR ENFORCEMENT

12.40 The Trade Practices Committee of the Law Council of Australia raised a number of important issues in a detailed submission to the Committee including the following:

"FURTHER RECOMMENDATIONS REGARDING ASSISTANCE FOR ENFORCEMENT

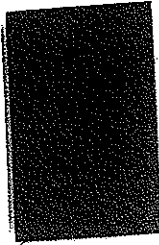
39. The greatest impediment facing small business in seeking to ensure fairness in competition in trade or commerce is the cost of conducting court proceedings. A significant contribution that can be made by the

Government towards the development and maintenance of free and fair competition in the Australian economy, with particular emphasis on the improvement of the market position of small business in Australia, is the financial contribution that the Government can make towards the enforcement of the law by the Trade Practices Commission and the ready grant of legal aid in deserving cases, without unduly restrictive "means tests" upon applicants. A small business should not be required to jeopardise all its resources when taking on a large and wealthy company which is claimed to be guilty of unfair conduct or unlawful price discrimination or misuse of market power.

40. Accordingly we recommend that more funds should be available to the Trade Practices Commission for law enforcement purposes; legal aid should be far more readily available to private litigants; pecuniary penalties ordered by a court and Trade Practices Commission costs recovered after successful proceedings should not go to consolidated revenue but to the Commission for enforcement purposes, such amounts not being taken into account in determining the Commission's annual budget."

Conclusion

12.41 We recommend the adoption of the suggestion that more legal aid be made available to small businesses involved in litigation under the Trade Practices Act.



R79/832 Cat.No.79 2085 0