

COLLECTIVE BARGAINING: THE DAWSON REVIEW'S ASSISTANCE PACKAGE FOR BUSINESS CARTELS

JOHN KENCH*

I INTRODUCTION

The Dawson Committee's recommendations to make certain types of collaborative conduct by rivals subject to the general competition test represents a significant shift in competition policy. By removing the current inflexible *per se* prohibitions on primary boycotts of suppliers and buyers, joint venture price-fixing and third line forcing, the door will be wide open for business rivals of all sizes to undertake collaborative action against large suppliers and large buyers.

The Committee has said that it may be in the public interest to enable small business to negotiate effectively against big business by combining to reach the right level of countervailing power. Collective bargaining, as one form of collaboration by rivals, is singled out for special encouragement by these substantive amendments.

In the parlance of competition law, 'cartels' will be able to form and cooperate openly. This is an interesting solution to potential misuse of a substantial degree of market power. It will place the onus on buying or supplying cartels to discipline misuse of market power directed at them by their powerful opposite numbers. There is no assistance for the direct rivals of powerful businesses.

There are no recommendations for special treatment of the 'small business sector' *per se*, consistent with the Committee's opening recommendations about uniform application of the *Trade Practices Act 1974* (Cth) ('Act').¹ In the pursuit of countervailing power, if the Committee's approach is correct, businesses of all sizes should be enabled to combine.

Procedural amendments to the current authorisation process and introduction of a qualifying small business notification are small parts of this business package. The significant downgrading of the legal status of the prohibitions is the major development. All of these changes should correspondingly downgrade the administrative and enforcement role of the Australian Competition and Consumer Commission ('ACCC').

* Partner, Blake Dawson Waldron.

1 Committee of Inquiry for the Review of the *Trade Practices Act*, Parliament of Australia, *Review of the Competition Provisions of the Trade Practices Act* (2003) 36.

The small business collective bargaining notification, with all of its imperfections, continues this policy shift. By giving the ACCC only 14 days to consider a notification, the Committee is saying that for defined individual small business transactions of only \$3 million each, the ACCC should be pragmatic and let them go ahead without too much detailed investigation.

By changing the rules to encourage more collaboration, the Dawson Committee has passed the competition risk assessments to the participants. This may produce better market outcomes in lieu of exit through failure or merger.

II UNILATERAL POWER VERSUS COLLABORATIVE POWER

Submissions by the ACCC and small business groups to the Dawson Committee did not persuade the Committee to make any recommendations to change the major unilateral conduct rules. As the Federal Government has accepted the Committee's recommendations, the current position is that there will be no change to s 46 and no additional prohibition on price discrimination. The outcome of appeals in current s 46 litigation may lead to reconsideration. Opposition parties and small business groups will continue to press for amendments to s 46. The Senate has announced an inquiry.

III ENCOURAGEMENT FOR ALL CARTELS

The fundamental change is to downgrade collaborative conduct of groups of buyers or sellers, under s 45 of the Act as per se contraventions, and make them subject to, or defensible under, the general competition test.

These recommendations place the onus on groupings of small, medium and large businesses to do more to redress their respective power imbalances with large suppliers or large buyers. Potential groupings will be no different to a trade union acting on behalf of employees attempting to create a bilateral monopoly in negotiations with an employer, or duopolistic or oligopolistic cartels seeking to act as a monopoly.

The Committee's recommendations represent a significant shift in competition policy.

IV THE ROLE OF COLLECTIVE BARGAINING

On the topic of collective bargaining, the Dawson Committee made the following opening observation:

In some industries a number of competing small businesses must bargain with big business. Individually, the small businesses may lack bargaining power and so may seek to join together and bargain collectively, thereby exercising a degree of countervailing power to that of big business. Collective bargaining at one level may lessen competition but, at another level, provided that the countervailing power is not excessive, it may be in the public interest to enable small business to negotiate more effectively with big business.²

These remarks underpin not only the Committee's recommendations on collective bargaining but also the other proposed amendments to s 45. They contemplate that small businesses should be enabled to seek the right level of aggregated collective bargaining power – 'not too little and not too much'. In the absence of combination, an individual small business would continue to be a 'price taker'.

Dictionary definitions of 'countervailing power' refer to a position of equal effect, power or influence against an opposite number. Just like Miss Goldilocks in the pursuit of a personal solution to her needs, there are many dimensions as to when the balance is 'just right' and is neither under-, nor over-, cooked. As in the tale, the answers may only be known in hindsight after experimentation when the opposing forces have run their course of collective bargaining.

Economic theory does not predict a precise outcome from the collective bargaining process because there may be a substantial range of possible outcomes depending on the short, medium and long term objectives of the bargaining sides. Additional uncertainty emerges from the reliance placed on each side's negotiating skills. In common with all cartel arrangements, there is the added prospect of 'cheating' by cartel members. Thus, consequences may not be known for some time.

Rather than be at loggerheads with each other, bilateral monopoly may result in higher prices for consumers. Each side may recognise the position of the other as being complementary, and not combative. They may negotiate to share the possible monopoly profits.

V PROCUREMENT AND SUPPLY COLLABORATION

There will be many procurement and supply transactions as inputs move from raw material suppliers to manufacturers of outputs for wholesale and retail distribution to consumers.

The upstream market power of each firm in the production and distribution chain as an acquirer of inputs will be substantially affected by its market profile as a downstream supplier of outputs. The larger the downstream share, the larger the procurement volume. The larger the procurement volume, then generally the buyer may expect to receive more favourable buying terms and conditions from its suppliers. These extra benefits may be used in various ways to fund internal and external growth, including low price strategies to win business away from its

2 Ibid 115.

downstream competitors. The more a firm grows its downstream share, the more it can request even more favourable terms from its suppliers.

Individual and combined market share and market concentration at each of the functional levels will affect the likelihood that a proposed joint procurement or supply collaboration will create or increase market power.

Other things being equal, the individual and combined market shares will indicate the scope and extent by which the members of the collaborative group must restrict, or threaten to restrict, their respective order quantities to achieve the desired effects in the relevant market. The smaller the individual and combined shares held of the total market, the greater the output restriction needed to produce a given price increase (or buying reduction to produce a given price decrease). An output (or buying) restriction by this group will not be a credible threat and the greater the difficulty of maintaining group solidarity in the face of the other side's threats to deal with other businesses outside the group. By comparison, a bargaining group of all available buyers or sellers will only need to make small reductions to produce a desired result when negotiating with an opposite side.

Independent competition between firms will usually drive them to achieve internal efficiencies that might be brought to bear against each other. There may be real limits on how far a firm can generate significant efficiencies on its own. Collaboration may eliminate independent striving for efficiencies but may offer superior joint efficiencies by combinations of resources and skills. This may result in even lower prices and improved quality, services and innovation over the single firm result. Collaboration-led efficiencies may enhance competition by permitting some higher cost firms to become more effective lower cost rivals.

A comparison needs to be made of likely efficiency gains using the 'future with and without test', noting that efficiencies may be difficult to quantify and verify, and any cost savings arising from any anti-competitive output (or buying) restrictions will be excluded. There will also be inquiry as to whether the joint efficiencies could be obtained by some less restrictive means. The resulting efficiencies arising from the collaboration need to be measured alongside the perceived anti-competitive detriments, and a determination made as to whether any part of superior net benefits from the efficiency gains are passed through to the other side.

If the collective bargaining group is successful, this may only attract new entry. The new entrants may also wish to join in collaborative behaviour in due course as their independent entry may result in prices falling to pre-collaboration levels.

VI PROCUREMENT COLLABORATION

The textbook view of monopsony power is the incentive or ability of a buyer profitably to seek to depress prices charged by a supplier below the competitive level for a significant period of time, and thus depress the supplier's output. In practice, a monopsonist may be more likely to use its position to threaten to

reduce its level of purchases so as to drive down the supplier's prices. This is done with the aim of having the supplier sell more product to the powerful buyer at lower prices than before.

Defining buying power is not easy. One suggestion of retailer buying power is the definition in the draft paper of the Organisation for Economic Co-Operation and Development ('OECD') Secretariat for the OECD Roundtable on 'Buying Power of Multiproduct Retailers', July 1999:

[A] retailer has buying power if, in relation to at least one supplier, it can credibly threaten to impose a long term opportunity cost (ie, harm or withheld benefit) which, were the threat carried out, would be significantly disproportionate to any resulting long term opportunity cost to itself. By disproportionate, we intend a difference in relative rather than absolute opportunity cost, eg, Retailer A has buyer power over Supplier B if a decision to de-list B's products would cause A's profits to decline by 0.1 per cent and B's profits to decline by 10 per cent.³

(In the final OECD paper, this was replaced by an unhelpful definition of 'the ability of the buyer to influence the terms and conditions on which it purchases goods'.⁴)

The goal of buying collaboration is to jointly purchase or coordinate individual purchases of inputs so as to exercise monopsony power, or duopoly or oligopoly power depending on the comparative strength of the remaining firm or firms standing outside the group.

Some aspects of these collaborations may be pro-competitive due to cost reductions and efficiency gains through resource sharing. Each member of a large buying group may have to make, or threaten to make, only small output (or buying) restrictions by way of contribution to a large aggregate group restriction. As the opposite side loses its bargaining power through its corresponding declining ability to switch or threaten to switch to other possible buyers outside the group, the potential for anti-competitive harm will rise as assessed by the 'future with and without test'. Whether the resulting harm to individual suppliers or buyers is detrimental for consumers will very much depend on the peculiar facts and circumstances of each market, as the conduct sets off actions and reactions in response to the collective bargaining conduct.

By operating at lower unit costs than their rivals, members of a large buying group may each increase their profits and make further investments to increase their sales at the expense of their rivals. With growing sales they may claim even better terms in the next round of negotiations.

A Impact on Other Buyers Outside the Buying Group

Depending on their relative size, another buyer may seek a comparable deal within a range that reflects its size. A weaker buyer may be charged more by a supplier seeking to recover its losses from its dealings with the buying group. This will put the weaker buyer at a further disadvantage, in addition to the

3 OECD Secretariat, 'Buying Power of Multiproduct Retailers' (Paper presented at the OECD Roundtable on Buying Power of Multiproduct Retailers, July 1999).

4 'Buying Power of Multiproduct Retailers' (2000) 2 *OECD Journal of Competition Law and Policy* 167.

mounting advantages to the buying group as it grows its volume. A relatively large buyer will not want to pay more than the buying group. The supplier may encourage the further growth of this buyer so as to reduce its exposure to the power of the buying group.

B Impact on the Large Supplying Firm

There may be no harm done to a large supplier with a substantial degree of market power. It may benefit from the efficiencies of dealing with a single buyer. Discounts, allowances and benefits may be justified by economies of scale or scope, the 'security' of a large order, or cost justifications that directly relate to the level of output being purchased. A large supplier may increase its output and in fact be better off, at the risk of attracting new rival supplier entry in the long run.

If the outcome is that the supplier's total revenue equals or exceeds its total variable cost, it will have an operating loss equal to its fixed costs. It may be better off not producing at all and will have no incentive to invest in products, services and innovations and it may delete weak brands.

If a large supplier exits, and the buying group continues to drive hard bargains, there may be an incentive for other suppliers also to leave and apply their resources to the next best alternative. Suppliers may continue to withdraw until the prices offered by the remaining suppliers rise to enable them to recover all of their costs. It will not be in the interests of the bargaining group to harm a large supplier to such an extent that it raises their own buying costs.

C Impact on Downstream Consumers

Consumers should be better off when the buying group has no downstream selling power and members compete against each other downstream to grow their respective businesses. Lower input prices to the buying group's members should lower their respective downstream marginal costs and these savings should be passed through to consumers in the form of higher output at lower prices. This should occur in the absence of illegal collusion, merger or further collaboration.

VII SUPPLY COLLABORATION

Suppliers may respond to large buyer power by merger or through collaboration.

A large enough collaboration amongst supply rivals may give them the incentive or ability profitably to raise prices above, or reduce output, quality, service or innovation below, the prevailing market circumstances that would have applied without the collaboration. They may wish to act as a monopolist if all firms are represented, or as a duopoly or oligopoly depending on the comparative strength of the remaining firm or firms that are outside the group.

Supply collaboration may involve agreements, either exclusively or non-exclusively, to make, sell, distribute, promote or license the supply of goods or

services that are either individually or jointly produced. Some aspects of these collaborations may be pro-competitive through cost reductions and efficiency gains, but agreements on price, output and other significant competitive attributes can result in competitive harm through removal of the scope for independent rivalrous action. The goal of the joint monopolist will be to limit output and charge a price above marginal cost, subject to the threat of new entry. The issue is whether the joint monopoly will be stable, as there will be incentives for each to cheat on the agreement especially given the ‘divide and conquer’ tactics that a large buyer may employ to encourage defection.

Supply group collaboration may be pursued to redress the inability of individual suppliers to recover their costs in the absence of collaboration, assuming that there is no or very limited scope to reduce those costs further, or the available market is too small. Elimination of inter-firm competition that might otherwise produce cost savings, at the risk of higher prices to downstream consumers, is always going to be a controversial issue. For example, refer to the Wilkinson report, referred to in the Dawson Review, about collaboration between doctors in provision of medical services to rural communities.

VIII CURRENT PROHIBITIONS AND PROCEDURES ON COLLABORATION

Price-fixing and boycotting by business rivals competing at the same functional level have been outright unlawful, unless authorised, for all size businesses since the commencement of the Act. These are inflexible rules as these forms of collaboration may create or increase market power or facilitate its exercise by the removal of independent decision-making or by combining control over activities

It is only through the authorisation process that a flexible approach is taken. A balancing evaluation is made of the proposed per se conduct taking into account the anti-competitive harm, pro-competitive benefits, public benefits and net overall effects. The analytical method is to forecast the state of competition with the collaborative agreement in place, as compared with the future position without it. The ACCC has authorised collective bargaining arrangements only where there is a clear demonstration of a net public benefit and an absence of less offensive alternative measures.

Outside the authorisation process, the ACCC has devoted considerable litigation and administrative effort to stamp out all cartels and to punish participants of all sizes. Central to this focus has been the ‘per se’ status of the behaviour as being absolutely reprehensible.

IX THE COMMITTEE'S RECOMMENDATIONS ON THE COMPETITION RULES APPLYING TO COLLABORATIVE CONDUCT

A Primary Boycotts

The Committee recommended narrowing the scope of the per se prohibition on an exclusionary provision to apply only to boycotts of actual or potential competitors. For these primary boycotts of competitors, the Committee recommended the introduction of a competition defence that they do not substantially lessen competition.

A primary boycott of a supplier or a buyer will cease being a per se contravention and will only be unlawful if it offends the general competition test in s 45. This change will assist a business cartel in making and delivering credible threats in negotiating procurement or supply contracts. A cartel may assess that its boycotting behaviour in a particular set of circumstances does not have the purpose or effect or likely effect of substantially lessening competition in a relevant market, and if it does, to change the composition and scope of the cartel or seek authorisation or notification.

B Third Line Forcing

The Committee has endorsed the foreshadowed change that third line forcing conduct should cease to be a per se prohibition. This is relevant for members of a collective bargaining group engaging in third line forcing as a means of implementing their collective bargain. Third line forcing will be the subject of a competition test under s 47. It may need to be notified in its own right, unless the new notification for collective bargaining is wide enough to apply to such conduct. The current 14 day procedure for notification of third line forcing has provided the model for the Committee's recommendation for the small business notification.

C Price-Fixing

The per se prohibition on price-fixing by competitors will not apply to a pricing provision for the purposes of a joint venture where the joint venture does not have the purpose or effect or likely effect of substantially lessening competition. Each collective bargaining arrangement should fall within the wide definition of a joint venture in s 4J of the Act. A joint venture is defined as 'an activity in trade or commerce: carried on jointly by two or more persons, whether or not in partnership'.

This amendment will assist a joint venture collaborative group (nee cartel) to make a competition assessment that its conduct is lawful. The group may not qualify to lodge a small business notification, or may not wish to seek authorisation. For the first time, stylising a cartel as a 'joint venture' will confer special status on what otherwise is simply an arrangement by rivals to raise prices or restrict output.

X THE COMMITTEE'S RECOMMENDATIONS FOR NOTIFICATION AND AUTHORISATION

The Committee recommended introduction of a new notification process for defined small business collective bargaining. Notification will confer statutory immunity for (horizontal) collective bargaining arrangements, like the notification process in s 93 for (vertical) exclusive dealing. Only defined small business transactions of \$3 million, variable by ministerial regulation will be capable of being notified. Third parties may make a collective bargaining notification on behalf of a group of small businesses, including cooperatives on behalf of their members.

Notification is intended to be a substantial facilitating resource for negotiation of qualifying small business transactions. Introduction of a notification alternative reflects the ongoing unsuitability of the authorisation route, including possible grant of interim authorisations, to respond to the fast moving nature of most buying and supplying transactions.

Authorisations are likely to continue to be cumbersome, even though the Committee has recommended fee reductions, time limits and prior consultation to improve the authorisation process. The substantive changes to the per se prohibitions may reduce the need for authorisation applications.

If unchallenged by the ACCC within 14 days of filing, notification will enable negotiations to proceed, and agreements to be entered into with statutory immunity from suit by anyone. The Committee observed that the notification process should be provided where the collective bargaining by small business with large business may provide a public benefit. It did not recommend any changes to the statutory tests or any matters to be taken into special consideration in the evaluation of these notifications by the ACCC. Was that an oversight?

As combinations of small businesses, and possibly other sized businesses too, have a reasonable prospect of passing the general competition test, conduct undertaken by them for the purpose of equalising a powerful buyer or supplier could be seen as pro-competitive. Thus, when the ACCC and the Trade Practices Tribunal each evaluates the seriousness of collective bargaining conduct for the purposes of notification, authorisation or general review, this conduct should be distinguished from all other cartel behaviour. If viewed this way, no changes are necessary to the statutory test.

The ACCC will presumably continue to test out the alternative means by which members of the proposed group could reach a comparable result. The problem is that at the moment of filing no-one will be able to predict what the potential harm and benefits may be until the negotiation runs its course and the implications are known for all stakeholders.

The way the ACCC deals with these issues may lead small business cartels to steer away from notification and authorisation and assess their chances on passing the competition test.

A Defined Small Business Transactions

The small business transaction limit of \$3 million is an arbitrary amount. If the principle underlying the Committee's recommendation is sound, there should be no transaction limit at all. There will be many circumstances where a single firm and a potential group of firms in multi-million dollar transaction are each a 'small business' when you compare the substantial degree of market power of their opposite number.

To qualify for notification, potential members of the group, which are at or near the threshold amount, may have to be dropped out of the group. This will defeat the essential reason for the combination in the first place. It is the combined size of its inputs or outputs, which may make its bargaining position respected by the opposite side. Presumably, the protection given by notification will not be lost if by the end of the negotiations the result for a firm turns out to be better than \$3 million. It would be an odd result if a firm were required to turn away part of a transaction so as to stay below the limit.

Disqualified members will not be able to collude lawfully (absent an authorisation) with the group. Their isolation from the group will provide the opposite side with a ready opportunity to employ 'divide and conquer' tactics. Alternatively, disqualified members may wish to be loyal to the group and to see comparable terms.

B The Implications for Large Business on the Opposite Side

While not an eligibility criterion for lodgment of a notification, the nature and extent of the market power of the opposite side's bargaining power will be a factor to be taken into account in the ACCC's evaluation of a notification. The firm on the opposite side may also be able to use the \$3 million limit to its advantage by framing the nature, duration and scope of its offer so as to disqualify many firms from participation in a bargaining group. It could also make changes to the same effect at any time in the bargaining process once it can see the negotiations are leading to its disadvantage. These changes would make the remaining members of the group relatively powerless.

It will also be reluctant to be silent about a pending notification, as it will be concerned about any finding by the ACCC that it has a substantial degree of market power.

Further, the outcome of collective bargaining will have a significant bearing on the issue of whether the large business has, or continues to have, a substantial degree of market power. It is in the hands of the large business to validate or undermine this issue depending on the outcome of the negotiations.

C The Implications for Other Businesses

Small, medium and large size rivals of the collective group may wish to lobby the ACCC in the 14 day period, and afterwards, as to how they may be or have been, disadvantaged by collective bargaining by the small business group.

XI THE ACCC'S DECISIONS ON COLLECTIVE BARGAINING

The ACCC has been supportive of the special position of agricultural collective bargaining groups, as well as collective bargaining groups of independent contractors whose position closely mirrors the position of exempted labour arrangements for groups of employees. By comparison, the ACCC has not supported collective bargaining by the medical profession.

Most forms of collaboration will preserve competition between the group's members in other respects, although there will be some concern the remaining competition is also compromised through association and by enhanced knowledge of each other's affairs. Ironically, a full merger of the parties, that puts an end to all competition between them, might be readily approved.

XII CRIMINALISATION OF CARTELS

While there was no Committee support for different criminal law treatment of small business cartel behaviour, the Committee may have nonetheless created the basis for that to happen. By downgrading the per se status of joint venture price-fixing and primary boycotts of suppliers and buyers a distinction can be drawn between open, meritorious behaviour by small business contributions to pursue countervailing power compared with secret, non-meritorious conduct of larger businesses.

XIII CONCLUSION

The Dawson Committee's recommendations about collaborative conduct, including collective bargaining, have significant implications for competition policy and its administration. Encouragement of more cartel behaviour is a direct consequence of the Committee's recommendations but may not be such a remarkable result given the absence of any recommended changes to the unilateral conduct rules.