

## COLLECTIVE BARGAINING BY BUSINESS: ECONOMIC AND LEGAL IMPLICATIONS

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### I INTRODUCTION

It is sometimes mutually beneficial for businesses to join together through a cooperative or other organisational structure in order to pool their ability to buy or sell goods and services.<sup>1</sup>

Collective bargaining is a particular form of cooperation between businesses that is limited to either buying or selling particular products.<sup>2</sup> According to the Australian Competition and Consumer Commission ('ACCC'), '[C]ollective bargaining involves two or more competitors agreeing to collectively negotiate terms and conditions (which can include price) with a supplier or a customer (the target or counterparty)'.<sup>3</sup>

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1 These types of arrangements are common in many countries. For example, Ace Hardware is a cooperative of independently owned retail hardware stores in the United States. EDEKA is a German supermarket cooperative, Unified Grocers is a retailer owned grocery cooperative in the western United States, while Foodstuffs (New Zealand's biggest grocery distributor) is a retailers' cooperative. These cooperatives all involve 'group buying' but may also involve other functions. For example, Foodstuffs provides grocery wholesaling services to its members, including buying, storage and delivery. The Foodstuffs cooperative also organises joint marketing campaigns for the sale of particular items, although individual members retain the ability to set their own prices at the retail level in most circumstances.

2 The boundary between a 'cooperative', a 'bargaining association' and 'collective bargaining' can be blurred. For example, in the United States, agricultural bargaining associations may take title of member farmers' produce before sale. They may create 'pools' of produce for sale and contracts for sale are between the association and the processor; see United States Department of Agriculture, *Cooperative Farm Bargaining and Price Negotiations* Cooperative Information Report No 26 (1980) ch V.

3 Australian Competition and Consumer Commission, *Assessment: Collective Bargaining Notifications Lodged by PaintRight Ltd*, Notification Nos CB00081–CB0013, 16 September 2009, [1.2].

Collective agreements between competitors are often illegal under competition laws.<sup>4</sup> However, in some jurisdictions, collective bargaining can be exempt from those laws. For example, article 101 of the *Treaty on the Functioning of the European Union* prohibits horizontal agreements that prevent, restrict or distort competition.<sup>5</sup> However, collective agreements between buyers (referred to as ‘purchasing agreements’) can be exempt from Article 101(1) by Article 101(3).<sup>6</sup> Similarly, the European Parliament has recently passed legislation allowing collective bargaining by milk producers, as part of a process for reforming the European Union Common Agricultural Policy.<sup>7</sup>

In the United States, collective bargaining by farmers has limited antitrust immunity under the *Capper–Volstead Act of 1922*.<sup>8</sup> This Act is bolstered by a variety of state laws to promote collective bargaining in agriculture.<sup>9</sup> Less formally, the United States Department of Justice provides on request, a ‘Business Review Letter’ to a collective bargaining group clarifying its antitrust position.<sup>10</sup>

In Australia, agreements between businesses to collectively bargain may be authorised by the ACCC.<sup>11</sup> This exempts them from the operation of section 45 and the cartel provisions of the *Competition and Consumer Act 2010* (Cth) (‘CCA’).

The antitrust evaluation of collective bargaining agreements, in both Europe and Australia, requires an analysis of the costs and benefits of these

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4 Such agreements can be used as part of a cartel to limit competition, eg, by fixing either input or output prices. Peter C Carstensen notes the difficulty in distinguishing between buyer cartels and legitimate buyer groups. ‘Because of the flexibility inherent in the organization of a legitimate buying group, there can be significant difficulty in distinguishing such entities from cartels. ... Thus, many groups of competitors that desire to coordinate their buying activities can with only modest planning create an entity that has the appearance of being a buying group rather than a naked cartel’: Peter C Carstensen, ‘Buyer Cartels Versus Buying Groups: Legal Distinctions, Competitive Realities, and Antitrust Policy’ (2010) 1 *William & Mary Business Law Review* 1, 14–15.

5 *Treaty on the Functioning of the European Union*, opened for signature 25 March 1957, [2012] OJ C 326/47 (entered into force 1 January 1958). [cited as amended]

6 *Guidelines on the Applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-operation Agreements* [2011] OJ C 11/1 (‘*Guidelines on the Applicability of Article 101*’) considers the legality of purchasing agreements in detail.

7 See European Parliament, ‘Parliament Secures More Bargaining Power for Dairy Farmers’ (Press Release, 20120215IPR38106, 15 February 2012) <<http://www.europarl.europa.eu/news/en/pressroom/content>>.

8 7 USC §§ 291–2 (1976).

9 See United States Department of Agriculture, above n 2, ch II for a summary.

10 For recent examples, see R Hewitt Pate, *Re: Business Review Letter Request by The National Cable Television Cooperative, Inc* (United States Department of Justice Antitrust Division, 17 October 2003). <<http://www.justice.gov/atr/public/busreview/201379.htm>>; Christine A Varney, *Re: Business Review Letter Request by Memorial Health, Inc and St. Joseph's/Candler Health System* (United States Department of Justice Antitrust Division, 4 September 2009) <<http://www.justice.gov/atr/public/busreview/249766.htm>>. Business Review Letters can be accessed at <[www.justice.gov/atr/public/busreview/letters.htm](http://www.justice.gov/atr/public/busreview/letters.htm)>.

11 Small businesses may also notify collective bargaining agreements to the ACCC. This is discussed in detail below.

agreements.<sup>12</sup> For example, when considering purchasing agreements the European Commission requires four factors to be satisfied:

1. the agreement creates gains in economic efficiency;
2. restrictions in the agreement must be indispensable to achieving the efficiency gains;
3. the agreement does not bring with it the possibility of eliminating competition in a substantial part of the products in question; and
4. a fair share of the benefits are received by consumers.<sup>13</sup>

Conditions similar to the first three of these requirements must be met for ‘authorisation’ and ‘notification’ in Australia.<sup>14</sup>

At the same time, both competition authorities and independent commentators have raised concerns about the potential anti-competitive effects of collective bargaining. For example, if businesses that are otherwise in competition with one another are able to cooperate for the purposes of collective bargaining, then this may lead to anti-competitive cooperation in their other activities. More subtly, collective bargaining may distort competition in related markets. For example, in the case of a purchasing agreement or a ‘buyer group’, collective bargaining may result in some downstream firms receiving a better deal from suppliers than their downstream competitors. This may undermine the ability of businesses that are not part of the collective bargaining arrangement to compete.<sup>15</sup>

This article analyses both the costs and benefits of collective bargaining by businesses. The aims of this article are threefold:

1. to develop a simple economic framework to analyse the costs and benefits of negotiations between a collective bargaining group on one side of a market and either a supplier or a customer on the other side of the market;
2. to compare the results from this framework with the approach adopted by the ACCC in recent collective bargaining decisions; and
3. to highlight areas of potential concern where the ACCC could focus its attention.

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12 In contrast, in the United States, the *Capper–Volstead Act of 1922* does not require any *ex ante* analysis of collective bargaining associations. It does, however, allow the Secretary of Agriculture to act if he or she has ‘reason to believe that any such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced by reason thereof’: 7 USC § 292 (1976).

13 See *Guidelines on the Applicability of Article 101*, above n 6, 12 [49]. Recent legislation on collective bargaining by milk producers has taken a different approach, directly limiting market shares for individual bargaining groups. ‘To ensure fair competition, the volume of raw milk covered by negotiations between producers’ organisation and processors or collectors may not exceed 3.5 per cent of total European Union output. Nor may it exceed either 33 per cent of overall national production or 45 per cent in states where total production is below 500 000 tonnes’: European Parliament, above n 7.

14 See Australian Competition and Consumer Commission, *Guide to Collective Bargaining Notifications* (ACCC, 2011). We discuss the conditions for authorisation in Australia in detail below.

15 See *Guidelines on the Applicability of Article 101*, above n 6, 45 [203]. Michael A Lindsay, ‘Antitrust and Group Purchasing’ (2009) 23(3) *Antitrust* 66, considers United States antitrust issues relating to buyer groups while Roger G Noll, ‘Buyer Power and Economic Policy’ (2005) 72 *Antitrust Law Journal* 589 provides a useful survey of the relevant antitrust issues and United States cases on buyer power.

The bargaining framework developed in this article is based on the theory of transaction-cost economics and incomplete contracts. In the absence of collective negotiation, individual firms will reach economically inefficient contracts due to bargaining costs.

Collective bargaining allows firms to share these costs, improving the level of negotiation. It can also change businesses' incentives and how they deal with non-contractible decisions. This can lead to more nuanced contracts, in the sense that they better address the specific needs of the firms in the bargaining group. It also leads to contracts that are more complete, in the sense that they cover more future contingencies and encourage investment.

While the gains from collective bargaining arise from improved contract efficiency, it may create economic costs. As already noted, collective bargaining increases the potential for anti-competitive coordination between members of the bargaining group. It may also change the bargaining power of the parties to a negotiation. In this sense collective bargaining may create competitive distortions that favour the bargaining group. Further, while collective bargaining may allow for a sharing of negotiation costs between the members of the bargaining group, it also creates the need for coordination within the bargaining group. This coordination can be costly and may lead to contracts that address the needs of the average member of the bargaining group rather than the needs of individual members. Finally, collective bargaining has implications for businesses that are not part of the bargaining group but compete against the members of the bargaining group. These competitor businesses may be harmed by the activities of the bargaining group.

The remainder of this article proceeds as follows. We consider the Australian law on collective bargaining authorisation and notification in Part II. Then, in Part III, we develop the economic framework to analyse collective bargaining. In Part IV, we use published authorisation and notification decisions to compare and contrast the ACCC's approach with the economic framework. Part V focuses on the four potential costs of collective bargaining summarised above, and the ACCC's approach to these costs. Overall, we conclude that the ACCC is both aware of these potential costs and has highlighted them in specific decisions. However, the ACCC's approach to some of these costs, particularly potential harm to third parties, appears piecemeal. A more systematic approach, possibly through the ACCC providing guidelines to market participants on collective bargaining, could enhance the predictability and transparency of the clearance process.

## II THE LAW

Collective bargaining by businesses that are in competition with each other risk violating either the cartel provisions or section 45 of the *CCA* unless they are

approved by the ACCC (or the Australian Competition Tribunal on appeal).<sup>16</sup> There are two alternative routes for clearance of collective bargaining. First, businesses can seek to have a collective bargaining agreement authorised by the ACCC. In particular, section 88(1A) of the *CCA* states that:

Subject to this Part, the Commission may, upon application by or on behalf of a corporation, grant an authorisation to the corporation:

- (a) to make a contract or arrangement, or arrive at an understanding, if a provision of the proposed contract, arrangement or understanding would be, or might be, a cartel provision; or
- (b) to give effect to a provision of a contract, arrangement or understanding if the provision is, or may be, a cartel provision.

The test applied by the ACCC when considering an authorisation is given in section 90(5A):

The Commission must not make a determination granting an authorisation under subsection 88(1A) ... unless the Commission is satisfied in all the circumstances:

- (a) that the provision would result, or be likely to result, in a benefit to the public; and
- (b) that the benefit would outweigh the detriment to the public constituted by any lessening of competition ...

Alternatively, 'small' businesses may make a collective bargaining notification to the ACCC under section 93AB of the *CCA*.<sup>17</sup> A collective bargaining notification is valid unless the ACCC objects. The test for objection is similar to the authorisation test. For example, under section 93AC(1):

the Commission may, if it is satisfied that any benefit to the public that has resulted or is likely to result or would result or be likely to result from the provision does not or would not outweigh the detriment to the public that has resulted or is likely to result or would result or be likely to result from the

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16 Section 44ZZRD of the *CCA* sets out the definition of a cartel provision. An agreement to form a collective bargaining group that actively engaged in coordinated pricing or contracting with a counterparty and whose members were in competition with each other in an upstream or downstream market, would almost certainly be a cartel provision. Thus, creating a collective bargaining group is likely to breach s 44ZZRF and/or s 44ZZRG of the *CCA*. Breaching these sections of the *CCA* can lead to considerable penalties, including fines of up to \$10 000 000. Similarly, s 45 of the *CCA* limits the ability of businesses to make a contract, arrangement or understanding that would substantially lessen competition.

17 This section was introduced in 2007 following the passage of the *Trade Practices Legislation Amendment Act (No 1) 2006* (Cth). It followed recommendations 7.1–7.4 of Commonwealth, *Review of the Competition Provisions of the Trade Practices Act* (2003) 121 ('*Dawson Report*'). The objective was ostensibly to streamline collective bargaining applications by small businesses. Thus, in her second reading speech, the Minister noted that '[t]he bill will reduce the regulatory burden on small business by introducing a notification process for collective bargaining by small business dealing with large business, as an alternative to the authorisation process': Commonwealth, *Parliamentary Debates*, Senate, 10 March 2005, 130 (Helen Coonan). Collective bargaining notifications are subject to s 93AB(4), which includes a cap of \$3 000 000 on the expected contract volumes for any participant in the bargaining group, with the counterparty, over a 12 month period. The notification process has been relatively 'underused' since its introduction. Caron Beaton-Wells and Brent Fisse, *Australian Cartel Regulation: Law, Policy and Practice in an International Context* (Cambridge University Press, 2011) 296 [8.4.1] discusses this in more detail.

provision, give the corporation a written notice (the *objection notice*) stating that it is so satisfied.<sup>18</sup>

The *CCA* provides limited guidance to the ACCC on the costs and benefits to be considered in reviewing an authorisation application or a notification. Section 90(9A) states that:

In determining what amounts to a benefit to the public for the purposes of subsections (8A), (8B) and (9):

- (a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
  - (i) a significant increase in the real value of exports;
  - (ii) a significant substitution of domestic products for imported goods; and
- (b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

The ACCC states that its approach to benefits and detriments is drawn from the 1994 decision of the Australian Trade Practices Tribunal (now the Australian Competition Tribunal) in *Re 7-Eleven Stores Pty Ltd*.<sup>19</sup> The Tribunal cited an earlier decision, which stated that a public benefit includes ‘anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress’.<sup>20</sup>

Similarly, a public detriment includes ‘any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency’.<sup>21</sup> The Tribunal has noted, ‘something more than a negligible benefit is required before the power to grant authorisation can be exercised’.<sup>22</sup>

The ACCC takes a broad interpretation of costs and benefits, essentially using a total welfare standard. This is consistent with the Tribunal decision in *Qantas Airways Ltd*.<sup>23</sup> In that decision the Tribunal used a ‘form of the total welfare standard’.<sup>24</sup> Similarly, in an earlier decision the (then) Trade Practices Tribunal noted that the term ‘the public’ is wider than simply consumers. Economies of scale and considerable cost saving in the supply of goods and

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18 Less formally, the ACCC states that ‘[a]uthorisation is a transparent process where the ACCC may grant immunity from legal action for conduct that might otherwise breach the [*CCA*]. The ACCC may “authorise” businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment’: Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275* (16 February 2012) [1.4].

19 [1994] ATPR ¶41-357. See, eg, *ibid* [4.14], [4.33].

20 *Re 7-Eleven Stores Pty Ltd* [1994] ATPR ¶41-357, 42,677 (Lockhart P, Members Brunt and Aldrich), citing *Re Queensland Co-operative Milling Association Ltd*; *Re Defiance Holdings Ltd* (1976) 8 ALR 481, 510 (Woodward P, Members Shipton and Brunt).

21 *Re 7-Eleven Stores Pty Ltd* [1994] ATPR ¶41-357, 42,683 (Lockhart J, Members Brunt and Aldrich).

22 *Re Application by Jools, President of the NSW Taxi Drivers Association* (2006) 233 ALR 115, 121 (Finkelstein DP, Members Starrs and Shogren).

23 [2004] ATPR ¶42-027.

24 *Ibid* 42-875.

services may constitute a substantial benefit to the public even though the cost saving is not passed on through lower prices.<sup>25</sup>

A total welfare standard takes a broad and inclusive view of public benefits but explicitly considers that redistributions are not considered benefits.<sup>26</sup>

### III AN ECONOMIC FRAMEWORK TO EVALUATE THE COSTS AND BENEFITS OF COLLECTIVE BARGAINING

In this part, we present a simple economic contracting framework. The framework highlights two potential benefits from the authorisation of collective bargaining. First, authorisation enables members of a collective bargaining group to efficiently share the costs of negotiating and contracting with a counterparty, without breaching competition laws. Second, authorisation can change the incentives of the negotiating parties in ways that enhance the efficiency of the contracting process. We deal with these two potential benefits in turn and also highlight a number of contentious issues that we examine in later parts of this article.

#### A Collective Bargaining and Contracting Costs

Contracts are costly to negotiate and draw up. If two businesses, a buyer and a supplier, negotiate then they will both face a range of negotiation or 'transaction' costs.<sup>27</sup>

These costs will often reflect the complexity of the contract. An individual contract will generally cover a range of terms of supply such as the specific products to be supplied, quantities, prices, the range of quality (ie, any bounds on allowable specifications), and arrangements for delivery and (possibly) return of products. The contract may also cover a range of contingencies, for example, dealing with situations where the buyer (seller) can order (deliver) extra product at short notice or change specifications either temporarily or permanently.

If a group of businesses are all contracting with one counterparty, then there can be economies of scale in terms of transaction costs.<sup>28</sup> The transaction costs

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25 *Re Howard Smith Industries Pty Ltd* (1977) 28 FLR 385, 391. This approach is very different from that used in the European Union. For example, when evaluating purchasing agreements, the European Commission noted that 'cost savings or other efficiencies that only benefit the parties to the joint purchasing arrangement will not suffice. Cost savings need to be passed on to consumers, that is to say, the parties' customers': *Guidelines on the Applicability of Article 101*, 47 [219].

26 See *Qantas Airways Ltd* [2004] ATPR ¶42-027, 42,872. For a general discussion, see Robert R Officer and Phillip L Williams, 'The Public Benefit Test in Authorisation Decision' in Megan L Richardson and Phillip L Williams (eds), *The Law and the Market* (Federation Press, 1995) 157.

27 For a survey of the economic literature on transaction costs, see Oliver E Williamson, 'Transaction Cost Economics' in Richard Schmalensee and Robert D Willig (eds), *Handbook of Industrial Organization* (Elsevier, 1989) vol 1. A classic article in this area is Oliver E Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' (1979) 22 *Journal of Law & Economics* 233.

for each business will be less if costs are pooled and shared. However, in the absence of authorisation, attempts by the businesses to reduce transaction costs by cooperatively bargaining are likely to breach the provisions of the *CCA*.

To see this, consider a group of businesses who compete in a downstream market, but who also buy inputs from the same upstream supplier. When negotiating a contract with the supplier, an individual buyer faces a variety of expenses, such as the cost of hiring lawyers, consultants and other parties to assist with negotiations. Discussions within the business will involve the buyer's staff and take those staff members away from other activities. The more detailed the contract, the greater the negotiation costs. Inevitably, bargaining will stop before a fully contingent contract is agreed upon. Certain factors will either be compromised or will remain unstated in the relevant contract. The negotiated contract will be imperfect, in the sense that not all mutually beneficial opportunities will be exploited in the contract because the negotiation costs outweigh the expected benefits.

If the buyers could negotiate as a group, then many of these costs could be shared. For example, the same lawyers and consultants could be involved in negotiating a contract for the group as a whole (or simultaneously for each member of the group). The buyers could work together to evaluate the relevant contract(s) to determine if the terms and conditions maximise the potential economic gains. Rather than having to formally deal with a range of different buyers and their lawyers, the supplier would have one 'point of contact' for negotiations.

As the buyers share the costs of negotiating specific issues, it is likely that the resulting contract will be more 'complete'.

As a simple example, suppose there is a particular term of delivery that would be preferred by each of the buyers and that differs from the 'default' term preferred by the seller. To make the example concrete, suppose that there are two buyers and the benefit to each of changing the relevant term is \$100. The cost to the seller of changing the term, due to less preferred supply arrangements, is \$80 for each buyer. Overall, there is a potential gain from changing the term of \$20 for each buyer. It would seem obvious that the contract should be changed.

However, suppose that the cost of 'renegotiating' the term is \$25 for each contract. This cost represents the cost of the seller dealing with each of the buyers (and their representatives) individually. Given the total cost of renegotiation for the two buyers (\$50) exceeds the total benefit (\$40), we would expect the default term to remain unchanged.

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28 For a discussion of economies of scale, see Jeffrey R Church and Roger Ware, *Industrial Organization: A Strategic Approach* (McGraw-Hill, 2000) 54. The benefits from businesses pooling and sharing transactions costs in negotiating with counterparties are likely to be greater where the parties to the collective bargaining arrangement are numerous and small, but produce similar products. Thus, in her second reading speech for the introduction of collective bargaining notifications, the Minister for Communications, Information Technology and the Arts noted that '[t]he ACCC has already authorised collective bargaining arrangements, including those by chicken growers, dairy farmers, sugarcane growers and small private hospitals': Commonwealth, *Parliamentary Debates*, Senate, 10 March 2005, 130 (Helen Coonan). Indeed, collective bargaining by agricultural groups is common.



In contrast, suppose that the two buyers could collectively bargain with the seller. In such a situation they can share costs. Such sharing may not be perfect. With a collective bargaining group, the total cost of renegotiating the relevant term may now be \$30. This exceeds the individual renegotiation cost of \$25 each but is less than the total cost of separate negotiation, \$50. The cost of collectively negotiating the changed term is less than the total gain from changing the term, \$40. In this example, we would expect to see the relevant contract term changed under collective bargaining, leading to a \$10 gain, to be shared by buyers and the seller. The renegotiation would not occur in the absence of collective bargaining.

More generally, by using collective bargaining to share the costs of negotiation, we would expect to see contracts that more effectively exploit mutual gains from trade.

In summary, bargaining groups allow buyers and sellers to exploit economies of scale in negotiation to improve contractual outcomes. The gains from these negotiations can then be shared by the buyers and the sellers, so that each party gains from the more economically efficient contracts.<sup>29</sup>

### **B Could the Same Contracting Outcome Be Achieved Without Authorisation?**

Collective bargaining enables businesses to use more efficient modes of negotiating. Authorisation is necessary, not because it changes the way that the businesses could *potentially* negotiate, but rather because it removes legal barriers to the way businesses *actually* negotiate.

In the absence of collective bargaining, alternative ‘negotiation technologies’ may be adopted. In the example presented above, if the seller knew about the size of the potential gains due to the change in the specific term of delivery, then the seller could unilaterally alter the contract so that the efficient term became the default term. More generally, if the seller and individual buyers were able to ‘mimic’ the process of collective bargaining, they could achieve the benefits without requiring authorisation.

However, such alternative solutions are unlikely to be successful. Cartel laws are explicit and attempts by businesses to circumvent those laws, even if for a ‘socially desirable’ end, are likely to meet considerable resistance from regulators and the courts. Indeed, the authorisation and notification processes have been established to create transparent mechanisms for businesses to pursue collective bargaining in those cases where the benefits outweigh the detriment.

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29 The potential savings through collective bargaining can be large. For example, United States Federal Trade Commission and Antitrust Division of the United States Department of Justice, ‘Improving Health Care: A Dose of Competition’ (Report, July 2004) ch 4, 43 refers to a number of estimates of the savings in administrative and other purchasing related costs for hospitals due to collective buying through Group Purchasing Organisations, ranging from \$155 000 to \$353 000 per hospital.

### C Non-verifiable Information and Collective Bargaining

Collective bargaining may also alter contracting in more fundamental ways than simple cost sharing. Contracting will often involve information asymmetries and limitations on the verifiability of information. Buyers and sellers will have private information that affects the efficient contract, but the incentives for each party to truthfully disclose that information will often be limited. Even if the buyer and seller both have the same information, if that information cannot be verified before the court or other appropriate authority, then it cannot credibly be used in an enforceable contract. Consequently, the outcome of the contracting process will not cover all contingencies and will leave certain decisions uncontracted.<sup>30</sup>

Collective bargaining may help improve contracting by changing the available information and how it can be used in contract design.

To see this, consider a simple example of two farmers, *A* and *B*, negotiating the forward sale of their crops to a downstream processor.<sup>31</sup> The output of each farmer will be either of two specifications, *x* or *y*. The buyer slightly prefers specification *x* for processing. However, a key restriction for the buyer is that processing must be calibrated in advance for only one of the two specifications. If the buyer has prepared for specification *x* then crop of specification *y* cannot be used and vice versa.<sup>32</sup>

In the absence of collective bargaining, the buyer will draw up a contract with each farmer. The buyer will set the same crop specification in each contract and, in the absence of any information, this will be for specification *x*.

However, sometimes *x* will not be the optimal choice. In any season, the optimal choice will depend on a variety of factors such as soil temperature, predicted rainfall, soil bacteria and so on. Each farmer can invest time and effort to evaluate the specification that will be best for the processor in a particular season, but such investments do not lead to perfect information and the exact level of investment may not be verifiable by a court. Thus, the buyer cannot enforce a contract requiring that a farmer optimally invest in determining the preferred crop. Further, the conditions across farms may differ. The optimal crop for one farmer may not be the same as the optimal crop for the other farmer in some seasons, reflecting differences in farm location, conditions and previous (often unverifiable) activities by the farmer that affect crop specifications.

In the absence of collective bargaining, the buyer may have little choice than to always require specification *x*. The buyer cannot draw up an enforceable

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30 For a discussion of incomplete contracts see Oliver D Hart, *Firms, Contracts and Financial Structure* (Oxford University Press, 1995); Bernard Salanié, *The Economics of Contracts: A Primer* (MIT Press, 2<sup>nd</sup> ed, 2005). For a highly accessible recent survey of incomplete contracts, see Philippe Aghion and Richard Holden, 'Incomplete Contracts and the Theory of the Firm: What Have We Learned Over the Past 25 Years?' (2011) 25(2) *Journal of Economic Perspectives* 181.

31 The forward sale can occur before the crop is sown and is for future delivery post-harvest.

32 For many food manufacturers, the exact specification of the agricultural inputs is a key element of manufacturing. The 'recipe' used by the manufacturer will require certain mixes of inputs and having the 'wrong' type of input may significantly alter the taste and marketability of the final product.

contract that has each farmer optimally invest in activities to determine the best specification. Further, the seller has a limited ability to use any information provided by a farmer. The seller does not know the extent of any farmer's investigations and the correlation between the information provided by different farmers.

Collective bargaining can alter this situation. When dealing with the farmers as a group, the buyer may find it optimal to delegate the specification decision to the farmers' collective. The farmers as a group can coordinate information collection, monitor that collection, aggregate and interpret the information. As a group, the farmers' incentives can be aligned with both those of the buyer and with each other. The buyer may sometimes have specification  $y$  set and delivered through the process of delegation. But so long as the gains in getting the crop 'right' in some seasons offset any losses where  $y$  is set even though the buyer might prefer  $x$ , the processor and the farmers can be better off. Contracting can be improved by allowing the bargaining group to have 'more input' into the contracting process than would have been possible (or desirable) in the absence of collective bargaining.<sup>33</sup>

In this example, the optimal coordination of activities by farmers may have been possible without authorisation of a bargaining group. However, such coordination would run the risk of breaching the *CCA* and authorisation provides a formal way to protect the farmers from that risk.

In summary, collective bargaining may enable the relevant parties to delegate authority and decision making in a way that improves contracts and would not be possible without coordination between either the suppliers or the buyers. Authorisation removes the legal risk of this coordination, facilitating the ability of one side to optimally 'have more input' into the contracting process.

#### **D Collective Bargaining and Bargaining Power**

Bargaining power will affect the efficiency of contracting. In general, if one party to a negotiation has most of the bargaining power, in the sense that most of the surplus from any negotiation is seized by that party, then this will reduce the incentive for the other party to the negotiation to make mutually beneficial but non-contractible investments.

To demonstrate, consider a simple example where a buyer can undertake a non-contractible investment that costs the buyer \$50 but raises the total surplus generated by the buyer and the seller by \$100. If the buyer has most of the bargaining power – so that any surplus is split 80 per cent to the buyer and 20 per cent to the seller – then the buyer will find the investment profitable. The investment costs the buyer \$50 but the buyer gains \$80 of the additional surplus generated. In contrast, if the seller has most of the bargaining power – so that any surplus is split 20 per cent to the buyer and 80 per cent to the seller – then the

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33 For more discussion on delegation and decision making with incomplete contracts, see Philippe Aghion and Jean Tirole, 'Formal and Real Authority in Organizations' (1997) 105 *Journal of Political Economy* 1; Aghion and Holden, above n 30, provide an excellent discussion.

buyer will *not* find the investment profitable. The buyer's additional share of the increased surplus (\$20) does not justify the \$50 investment cost to the buyer.

More generally, bargaining power on one side of a negotiation can alter the efficiency of that negotiation. However, the optimal split of bargaining power depends on the specific non-contractible activities that parties could undertake and the value of these activities.

Collective bargaining may enhance bargaining power for the parties who join the bargaining group. For example, where accessing an outside option (such as downstream businesses vertically integrating upstream) involves fixed costs, it may be incredible for one buyer to threaten integration. However, a collective bargaining group can share the fixed cost and the threat of a collective group of buyers integrating upstream may be credible.

Changes in bargaining power may simply change the distribution of the surplus generated from bargaining. However, it may also change the incentives for parties to invest in ways that raise the gains from bargaining. For example, Inderst and Wey show how the increased bargaining power of a buyer (in the sense of an outside option becoming more credible) can improve the incentives for the seller to undertake non-contractible investments that lower upstream marginal production costs.<sup>34</sup> In this sense, increased buyer power through collective bargaining may improve economic efficiency and 'keep a seller on its toes'.<sup>35</sup> However, this conclusion will depend on the exact situation under analysis.

The benefits of collective bargaining are likely to be reduced where the counterparty has little if any market/bargaining power. If, for example, a group of suppliers already have numerous similar options for the sale of their product, then collective bargaining is unlikely to change bargaining power. While collective bargaining by sellers might, in these circumstances, lead to gains, it also raises the spectre that the bargaining group will be used to facilitate coordinated conduct, to restrict supply and push up the price paid by each buyer.

### **E Summary: The Benefits of Collective Bargaining**

In summary, the authorisation of a collective bargaining group can enhance economic efficiency in two ways:

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34 Roman Inderst and Christian Wey, 'Countervailing Power and Dynamic Efficiency' (2011) 9 *Journal of the European Economic Association* 702.

35 *Ibid* 703. It can be argued that the original intention of the collective bargaining provisions was to explicitly enhance bargaining or countervailing power. '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': *Dawson Report*, above n 17, 115. 'Effective' countervailing power may imply improved contracting (as discussed here) or a transfer of surplus and profit from the counterparty to the bargaining group (discussed below). The former represents a benefit under a 'total welfare standard' while the latter is simply a transfer and has no weight.

1. Authorisation permits bargaining group members to share the costs of negotiation without making them liable for prosecution under the *CCA*. By sharing negotiation and contracting costs between group members, the collective bargaining group helps parties to negotiate past inefficient take-it-or-leave-it contracts in order to design more complex, mutually beneficial contracts that have fewer economic imperfections. The gains created by more efficient bargaining arise from the economies of scale in negotiations and can be shared by both the collective bargaining group and the counterparty. In other words, both sides to the negotiations can become better off if collective bargaining occurs.<sup>36</sup>
2. Collective bargaining can change the incentives in the contracting process in ways that enhance the ability of parties to undertake non-contractible investments that increase economic surplus. We discussed two channels for this improvement. First, collective bargaining can make delegation desirable where delegation to the group overcomes issues of individual incentives. Second, collective bargaining may alter bargaining power and this can alter incentives to engage in non-contractible investments.

#### IV ACCC EVALUATION OF COLLECTIVE BARGAINING AGREEMENTS

The economic framework presented in Part III is reflected in ACCC decisions on collective bargaining authorisations and collective bargaining notifications.

The ACCC has recognised that a primary source of benefit from collective bargaining is the sharing of the costs of negotiation. For example, when considering an application for authorisation by six coal miners in Queensland's Bowen basin to collectively bargain with the monopoly provider of below rail services, QR Network, the ACCC noted that:

The ACCC considers there are transaction costs (including time related costs) associated with contracting. These transaction costs can be lower where a single negotiating process is employed, such as in collective bargaining arrangements, relative to a situation where a series of individual negotiation processes are necessary. The ACCC considers that to the extent these transaction cost savings do arise they are likely to constitute a public benefit.<sup>37</sup>

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36 RBB Economics, 'The Competitive Effects of Buyer Groups' (Economic Discussion Paper No OFT863, Office of Fair Trading, United Kingdom, January 2007) ch 3 <[http://www.oft.gov.uk/shared\\_of/economic\\_research/oft863.pdf](http://www.oft.gov.uk/shared_of/economic_research/oft863.pdf)> provides a detailed discussion of the range of economic benefits that can arise through collective bargaining.

37 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [4.19]. The relevant cost savings identified by the applicants included a decrease in the number of hours spent negotiating; a decrease in the cost of legal and expert advisors; and efficiencies in the pooling of the limited resources of the smaller applicants: at [4.17]. See also Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91347*, 24 January 2013, [12] regarding collective bargaining by Queensland chicken growers.

Similarly, when considering an authorisation application by the Western Australian Broilers Growers' Association ('WABGA'), the ACCC noted that:

In the Western Australian market for broiler chicken growing services transaction costs can deter grower participation in the negotiation process. These transaction costs reduce the level of input a grower has in developing their contracts with processors and result in less efficient outcomes.<sup>38</sup>

By exploiting economies of scale in negotiation, collective bargaining may allow individual businesses to bargain more effectively, resulting in better contracts. Thus, when considering the WABGA application the ACCC noted that 'the WABGA member growers are, in general, small primary producers with often limited resources and expertise to engage in effective negotiation with businesses with the size and negotiating experience of the processors.'<sup>39</sup>

Similarly, when considering the Australian Processing Tomato Growers' ('APTG') application, the ACCC said that '[o]verall, the ACCC considers that the proposed collective bargaining conduct would be likely to strengthen the bargaining position of growers and therefore enhance growers' ability to have greater input into contractual arrangements.'<sup>40</sup>

The benefits from collective bargaining are reflected in improved contracts relative to the default contract or 'fall back option' that would arise in the absence of the bargaining group. In the absence of collective bargaining, small businesses may be faced with a take-it-or-leave-it offer. For example, when considering the APTG application, the ACCC accepted that 'absent authorisation, growers are likely to continue to negotiate with processors individually, although Cedenco would present them with largely standard-form contracts, with limited scope to negotiate variations.'<sup>41</sup>

Similarly, when considering an authorisation application for collective bargaining by rural doctors, the ACCC stated that:

In many cases, the ACCC has identified that individually, businesses have a limited degree of input into their contracts being offered take it or leave it terms and conditions. These circumstances do not always lead to the most efficient contract. The ACCC has often accepted that collective bargaining arrangements can provide participants with an opportunity for greater input into contracts and accordingly deliver the opportunity for more efficient contracts.<sup>42</sup>

The ACCC has noted that the degree to which a default contract is economically inefficient can depend on the market power of the counterparty.

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38 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.25]. See also Australian Competition and Consumer Commission *Determination: Application for Authorisation A91058*, 19 September 2007, [5.84]–[5.85]; Australian Competition and Consumer Commission *Determination: Application for Authorisation A91007*, 13 December 2006, [7.27].

39 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.25].

40 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91270*, 24 February 2012, [4.50].

41 *Ibid* [4.67].

42 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91078*, 14 May 2008, [5.52].

For example, the ACCC has commented on the potential losses that can arise when individual sellers have to negotiate with a single buyer that has market power (a monopsonist).<sup>43</sup> In this situation, collective bargaining can lead to increased investment.

Having a default contract that is distorted by market power, however, is not a prerequisite for benefits from collective bargaining. The ACCC has noted that collective bargaining can lead to benefits whenever it results in contracts that are more complete or less imperfect than a default contract.

For example, when considering collective bargaining by Queensland coal miners, the ACCC noted that there was a regulated access regime in place for the counterparty, QR Network. This regulatory instrument required that ‘access to below rail infrastructure must be provided by QR Network on fair and equitable terms’ and established ‘standard access terms and conditions’.<sup>44</sup> However, the ACCC accepted that ‘there are access situations which are not dealt with in detail in the Rail Access Undertaking, leading to a requirement for further negotiation of access terms with QR Network’.<sup>45</sup>

Similarly, the ACCC considered an application for authorisation from Homemakers South Limited. Homemakers sought to collectively bargain on behalf of 55 independent furniture retailers. The ACCC noted that both sides of the relevant market were characterised by large numbers of businesses. Even so, the ACCC agreed that collective bargaining could lead to benefits, for example, by helping suppliers ‘align transport and distribution services which also provides the opportunity for efficiencies and cost savings’.<sup>46</sup>

The ACCC has recognised that collective bargaining allows for more nuanced contracts with greater input by the members of the bargaining group. Thus, ‘[t]he ACCC considers that where successful, collective bargaining provides parties to the arrangement with more direct, effective and explicit input into contracts, which may result in public benefits’.<sup>47</sup>

The ACCC has also recognised that, by improving negotiated contracts, collective bargaining can improve investment. Thus:

The ACCC considers that collective negotiations may assist the industry in identifying proposals that seek to satisfy the needs of the relevant parties more fully. To the extent that the collective bargaining arrangements facilitate such an outcome, the ACCC considers the arrangements may contribute to more efficient

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43 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.24].

44 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [2.12].

45 Ibid. See also Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [2.12]–[2.13].

46 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91284*, 12 April 2012, [3.26]. The ACCC went on to note that ‘[to] the extent that these savings are passed on as lower prices to consumers there may be an increase in price competition which would also be a public benefit’: at [3.29].

47 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91064*, 12 December 2007, [5.49]. See also Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91048*, 27 June 2007, [5.35], [5.38].

infrastructure investment ... compared to a situation where negotiations are conducted on an individual basis, and that this results in a benefit to the public.<sup>48</sup>

The economic framework developed in Part III shows that there can be mutual benefits from collective bargaining. In some situations, this is explicitly recognised by counterparties. For example, the ACCC considered a collective bargaining notification from PaintRight, a banner group for independent businesses in the paint industry. With regard to one of the counterparty businesses, Colourtrend, the ACCC noted that:

[Colourtrend] agreed that being able to negotiate core trading terms and other business arrangements with the PaintRight group office rather than each individual Participant provided cost savings that could be passed on to the bargaining group through improved trading terms.<sup>49</sup>

The potential for collective bargaining to benefit both the bargaining group and counterparties explains why counterparties may support collective bargaining agreements. For example, in 2007 the ACCC considered an application for authorisation by potato farmers in South Australia. There were two counterparties, both of which supported the application.<sup>50</sup>

Of course, support for collective bargaining by counterparties is not universal. As we discuss below, collective bargaining may change the relative bargaining power between the members of the bargaining group and the counterparties. For example, when considering the APTG authorisation application, the ACCC noted that the counterparty, Cedenco, opposed the application.<sup>51</sup>

The ACCC recognises that collective bargaining can lead to outcomes that are mutually beneficial. It has also been recognised that:

Given the voluntary nature of collective bargaining arrangements ... opportunities for collective bargaining to influence contract terms and conditions will generally only arise if both sides are likely to benefit from collectively negotiating an outcome.

That is to say, where the target of a proposed collective bargaining group has the option of continuing to deal with members of the group individually, there would be no incentive for the target to agree to a collectively negotiated outcome unless the collectively negotiated agreement was going to achieve a better outcome for it than negotiating individually with each group member.<sup>52</sup>

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48 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [4.28].

49 Australian Competition and Consumer Commission, *Assessment: Collective Bargaining Notifications Lodged by PaintRight Ltd*, Notification Nos CB00081–CB00137, 16 September 2009, [2.20].

50 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91057*, 29 August 2007, [3.3]. Note that in the absence of a bargaining framework that allows for mutually beneficial gains from collective bargaining, such support would be difficult if not impossible to explain. For example, if collective bargaining just altered the bargaining power but did not create economic benefits to all parties, we would expect the counterparties to always oppose collective bargaining authorisations and notifications.

51 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91270*, 24 February 2012, [4.45].

52 Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.45]–[5.46].



In summary, the ACCC's approach to evaluating collective bargaining applications is broadly consistent with the economic framework presented in Part III. However, this framework highlights a number of issues that affect the efficacy and desirability of collective bargaining. We explore these in Part V.

## V ISSUES IN COLLECTIVE BARGAINING

### A Collective Bargaining and Anti-competitive Coordination

While collective bargaining can improve the efficiency of contracts in one market, it can also assist the participants to anti-competitively coordinate their behaviour in a functionally separate market.<sup>53</sup>

To see this, consider a buyer group. The group may face a monopoly seller of a particular input and collective bargaining may assist the relevant businesses to reach more efficient contracts with that monopoly seller. Thus collective bargaining can create benefits in the market for the supply of the relevant input.

However, the businesses that form the buyer group may also compete as sellers in a vertically separate but related market. For example, businesses that collectively bargain to purchase bedding may compete in the retail furniture market. Miners that collectively bargain over the rail transport of ore may compete in the downstream market for the sale of that ore.

By cooperating in collective buying, the businesses may gain opportunities to cooperate and limit competition in selling. Such anti-competitive coordination can raise the profits of the buyer group in the downstream market. Most obviously, the buyer group could restrict the amount of the relevant input that its members can buy, in so doing, restricting their downstream output and raising the downstream price.<sup>54</sup> As such, the ACCC should be wary of any collective buying agreements that artificially restrict total members' purchases.<sup>55</sup>

Collective bargaining may assist downstream anti-competitive coordination in subtler ways. For example, the information exchanged as part of collective bargaining may assist anti-competitive coordination.

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53 As the European Commission notes, '[t]here are two markets which may be affected by joint purchasing arrangements. First, the market or markets with which the joint purchasing arrangement is directly concerned, that is to say, the relevant purchasing market or markets. Secondly, the selling market or markets, that is to say, the market or markets downstream where the parties to the joint purchasing arrangement are active as sellers': *Guidelines on the Applicability of Article 101* above n 6, 44 [197].

54 In other words, 'demand withholding, where downstream prices to final consumers increase as a result of reduced quantity. Purchasers agree to withhold their joint demand upstream in order to generate greater profits by restricting quantity in the downstream (selling) market': Clive Maxwell, 'P & H Makro Joint Purchasing Agreement' (Short-form Opinion, Office of Fair Trading, United Kingdom, 27 April 2010) [5.3] <[http://www.offt.gov.uk/shared\\_offt/SFOs/SFO\\_on\\_Joint\\_Purchasing.pdf](http://www.offt.gov.uk/shared_offt/SFOs/SFO_on_Joint_Purchasing.pdf)>.

55 RBB Economics state that 'the buying group could just be a façade to hide explicit collusion in the downstream market. For example, the European Commission came to this view in relation to the Spanish Tobacco cartel, where purchasing quotas were, in effect, market share targets in the downstream market': RBB Economics, above n 36, 13 [1.45].

In order to engage in the collective bargaining, the Applicants also propose to share certain information between themselves. The exchange of certain information among competitors, particularly in relation to prices, fees and costs, may facilitate collusion or otherwise reduce competition, resulting in increased prices or reduced quality and availability of goods or services. Outcomes of this nature are associated with significant public detriment.<sup>56</sup>

Anti-competitive conduct is more likely to result from collective bargaining if the group of businesses that are cooperating are in close competition in a related market and make up a significant share of trade in that market.<sup>57</sup> For example, when considering the application by five car rental companies to collectively bargain, the ACCC noted that:

The potential anti-competitive effect of sharing this information is increased by the small number of potential alternative car rental companies to those in the group. In this respect, the ACCC understands that the group represents five of the largest car rental companies in Australia.<sup>58</sup>

The ACCC *Merger Guidelines* highlight factors that are conducive to coordinated conduct.<sup>59</sup> However, these factors are generic and apply regardless of the existence of a bargaining group. For example, coordinated conduct is more likely in the related market if the businesses interact repeatedly in a transparent way in that market. Thus, if the members of a buyer group also compete repeatedly as sellers in a related downstream market using well publicised posted prices, then coordinated conduct may be possible with or without the bargaining group.<sup>60</sup>

Potential coordinated conduct is only a harm created by the bargaining group if the existence of that group (for example, the way it is structured or the types of information exchanged by the group) materially facilitates the coordinated conduct. Thus, when considering the potential for collective bargaining to create

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56 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [4.35]. See also Maxwell, above n 54, [7.5]–[7.9].

57 The European Commission has provided guidelines on relevant market shares: '[I]n most cases it is unlikely that market power exists if the parties to the joint purchasing arrangement have a combined market share not exceeding 15 per cent on the purchasing market or markets as well as a combined market share not exceeding 15 per cent on the selling market or markets. In any event, if the parties' combined market share does not exceed 15 per cent on both the purchasing and the selling market or markets, it is likely that the conditions of Article 101(3) are fulfilled': *Guidelines on the Applicability of Article 101* above n 6, 45 [208].

58 Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.88]. In general the ACCC appears to have less concerns about any public detriment arising from a collective bargaining group if membership of the group is small. For example, '[t]he ACCC considers the Proposed Conduct is unlikely to lead to any significant public detriments due to: ... the limited composition of the collective bargaining group': Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91277*, 16 February 2012, [4.30].

59 Australian Competition and Consumer Commission, *Merger Guidelines*, November 2008, ch 6.

60 The European Commission provides specific factors for assessing the likelihood of anti-competitive coordination in purchasing agreements. These include 'if the parties achieve a high degree of commonality of costs through joint purchasing'; if there is 'the exchange of commercially sensitive information such as purchase prices and volumes'; and if 'the market characteristics are conducive to coordination': *Guidelines on the Applicability of Article 101* above n 6, 46 [213]–[216].

competitive harm through anti-competitive coordination in a related market, the ACCC needs to consider the exact structure of the bargaining group. In particular, the greater the role of the group in coordinating business conduct beyond simple negotiation and the greater the level of information that flows between businesses due to the bargaining group, the more likely it is that the group will create competitive harm in a related market.

A bargaining group can negotiate over the terms and conditions that will apply to its members broadly, without determining the specific contract terms for each member. For example, the bargaining group can negotiate a price menu with varying terms of quality, delivery and product specifications for the member businesses, leaving it up to each business to determine its exact terms of trade with the counterparty. Alternatively, the bargaining group may negotiate comprehensive terms and conditions that will apply to each member business including the specific volumes to be traded by that business.

The more specific the terms of trade negotiated by the group, the more likely it is that the group will facilitate anti-competitive coordination in a related market. For example, if a buyer group negotiates specific volumes of an input for each of its members then each member will have considerable knowledge about the potential output of other members of the group in the related market. This information makes it easier to avoid competition in the related market. Indeed, as noted above, the buyer group could go further and deliberately limit the total quantity of the input purchased by member businesses in order to explicitly control output in the related market. Such a structure is likely to significantly harm competition in the related market if the bargaining group members make up a significant share of trade in that related market.

A collective bargaining group, by its very nature, may require considerable information about the competitive strategies that its member businesses are likely to adopt in a related market. After all, the specific terms negotiated with a counterparty will depend on the exact needs of the member businesses. The more of this information the bargaining group requires – and the more that the group allows this information to be shared between members – the more likely it is that the bargaining group will facilitate anti-competitive behaviour. If each member business needs to flag any strategies to its competitors via the bargaining group, then it creates a high degree of transparency that makes it easier for member businesses to restrict competition in the related market.

The potential for anti-competitive coordination can be avoided in two ways. First, anti-competitive coordination is unlikely if the related market itself lacks the environment to sustain ‘tacit collusion’ and the bargaining group is a relatively small part of that market.<sup>61</sup> If the related market, for example, has

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61 Tacit collusion refers to any situation where, due to the nature of market competition and the repeated interaction by market participants, those participants can develop mutually beneficial strategies that limit competition and raise their profits without explicit agreement. The strategies are self-enforcing in the sense that no individual businesses has an incentive to deviate as this will lead to lower profits, say, due to triggering a price war. For a brief discussion, see Australian Competition and Consumer Commission, *Merger Guidelines*, November 2008 [6.4].

significant import competition or entry is easy into this market, any anti-competitive coordination facilitated by the bargaining group will be transitory. Second, if the market environment would support ‘tacit collusion’, the risk of coordinated conduct can be reduced by limiting the scope of the bargaining group in terms of both its role in determining exact trades and its role in information exchange. The information provided to the group should be no more than required for negotiation and the role of the group in negotiations should be no more than required to achieve efficient contracts for individual members of the group.

It may be the case that a bargaining group can only be approved where there are safeguards and conditions to limit potential anti-competitive features. For example, the group may need to be structured so that information is segregated within the group and negotiators who need to know a range of information are external to the specific members and are bound by confidentiality conditions. Such conditions need to be enforceable, possibly through third party auditing being included as a requirement of the authorised conduct.

In summary, collective bargaining can assist firms to engage in anti-competitive coordinated conduct in a related market. If the market environment is unlikely to support ‘tacit collusion’ (for example, due to the strong competitive nature of the related market) then a collective bargaining arrangement is unlikely to facilitate anti-competitive coordination. If the related market is highly conducive to ‘tacit collusion’, then a collective bargaining arrangement may not make this situation materially worse. However, for in-between situations, where anti-competitive coordination is unlikely without the assistance of the bargaining group, the ACCC needs to exercise care to make sure that both the composition of the group and the activities of the bargaining group are sufficiently restricted to avoid collective bargaining in one market facilitating anti-competitive conduct in a related market.

## **B Collective Bargaining and Bargaining Power**

Collective bargaining may alter bargaining power in that it can result in the bargaining group taking a higher share of the gains from contracting. In the extreme, collective bargaining can raise the gains from contracting but also alter the share of the gains that flow to the bargaining group to such a degree that the counterparty is worse off once the buyer group is formed.

The ACCC recognises that shifts in bargaining power may occur that result in transfers from the counterparty to the bargaining group.<sup>62</sup> The ACCC does not

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62 See, eg, Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.61].

consider such transfers to be benefits. Rather, benefits flow from improved efficiency of the contracting process.<sup>63</sup>

The ACCC also recognises that a shift in bargaining power to the bargaining group may lead to economic inefficiency by pushing contract terms and conditions 'too far' to the benefit of the bargaining group. However, it tends to view these issues as relatively minor. For example, it has noted that 'while collective bargaining may improve growers' ability to have effective input into their contracts, it is not likely to change the bargaining power relativities between the parties to such an extent that any imbalance in bargaining power would be reversed.'<sup>64</sup>

The ACCC's approach is predicated on three criteria in collective bargaining applications. The ACCC considers that the possibility of increased bargaining power that make counterparties worse off can be reduced by:

1. making participation in the bargaining group voluntary;
2. limiting the number of participating businesses so that the bargaining group only covers a relatively modest market share; and
3. limiting collective boycotts.<sup>65</sup>

If participation in the bargaining group were voluntary then 'it would still be open for processors to negotiate individually with growers if that is their preference'.<sup>66</sup> The ACCC considers that the ability of the counterparty to revert to individual negotiations if it chooses protects the counterparty from excessive increases in the buyer group's bargaining power.

With regard to the size of the bargaining group: 'the ACCC considers that where the size of bargaining groups is restricted, any anti-competitive effect is

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63 For example, the ACCC has stated that '[a]rguments based on changes in relative bargaining strengths as a result of a proposed collective agreement are not of themselves public benefits. The ACCC will consider the likely outcomes resulting from the change in relative bargaining strengths arising from the proposed collective bargaining agreement; and whether the outcomes are likely to be more efficient than in the counterfactual. In these circumstances, the outcomes would be a public benefit': Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91270*, 24 February 2012, [4.51].

64 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.63]. The contrast between the ACCC's approach and the practice of agricultural collective bargaining associations in the United States is stark. In the United States, where protected by state laws, farmer bargaining groups may set up sophisticated systems of rewards and penalties to try to limit farm output, create monopoly power, and raise the price of their members' produce to a monopoly level. See, eg, Joseph F Guenther, 'The Development of the United Potato Growers Cooperatives' (2012) 26 *Journal of Cooperatives* 1.

65 See, eg, Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91080 & A91081*, 19 March 2008, [5.94].

66 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91262*, 16 June 2011, [5.64]. See also Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.46].

likely to be smaller having regard to the smaller area of trade directly affected and to the competition provided by those suppliers outside the group.<sup>67</sup>

Similarly, when the ACCC considered a collective bargaining authorisation application from growers of dried vine fruit it noted:

The ACCC considers that the relatively small size of the group will limit the possibility of anti-competitive effects flowing from the proposed arrangements. The competitive tension provided by domestic growers outside the group, and in particular, strong import competition for dried fruit, will constrain the bargaining group in negotiations with processors.<sup>68</sup>

Third, there is a collective boycott if ‘the collective bargaining group agrees not to acquire goods or services from, or not to supply goods or services to, the counterparty unless it accepts the terms and conditions offered by the group’.<sup>69</sup> The ACCC has argued that a collective boycott can bias bargaining power too far in the direction of the bargaining group:

Collective boycotts can remove the discretion of the target to participate in collective bargaining and to accept the terms and conditions (including price) offered by the collective bargaining group. This is because the target, faced with the threat of withdrawal of supply, will be under increased pressure to accept the terms and conditions offered by the collective bargaining group.<sup>70</sup>

Similarly, in objecting to a collective bargaining notification lodged by Hertz Australia, the ACCC stated that:

Collective boycotts can have significant anti-competitive effects. In collective negotiation, the right to impose a collective boycott could enable a collective bargaining group to inflict significant commercial damage on those that it negotiates with and cause significant disruption not only for the target, but also for upstream and downstream businesses and ultimately consumers.

...

[G]iven the significant disruption and commercial damage collective boycotts can cause the ACCC is generally very reluctant to allow protection for collective boycott activity without extremely strong justification for the arrangements being provided.<sup>71</sup>

These concerns about the effects of a collective boycott echo the view of the Tribunal.<sup>72</sup> Indeed, it is reasonable to conclude that the ACCC is unlikely to authorise a collective bargaining agreement if it contains collective boycott

67 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91080 & A91081*, 19 March 2008, [5.44].

68 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91064*, 12 December 2007, [5.35].

69 Australian Competition and Consumer Commission, *Assessment: Collective Bargaining Notifications Lodged by PaintRight Ltd*, Notification Nos CB00081–CB00137, 16 September 2009, [1.3].

70 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91284*, 12 April 2012, [3.51].

71 Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.56]–[5.57]. See also Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91134*, 16 July 2009, [5.56]–[5.58].

72 See, eg, *Re VFF Chicken Meat Growers’ Boycott Authorisation* [2006] ATPR ¶42-120, 45,110–1 [381]–[383] (Heerey DP, Members Beerworth and Walsh). The Tribunal noted that a collective boycott has never been authorised under the Act: at 45,120 [438].

provisions and, even if it did, such provisions are unlikely to survive an appeal to the Tribunal.

However, even if these three conditions are met, collective bargaining may still change the balance of bargaining power. The formation of a cooperative group of businesses may change the outside options for bargaining, which in turn may alter the balance of bargaining power.

To demonstrate, consider the situation where a buyer group faces two sellers. If individual members of the buyer group are relatively small then, before the group is formed, no individual buyer can exert much pressure on a seller. No individual buyer is critical for a seller in the sense that the individual buyer only makes up a small part of total sales. Thus, each buyer will have little if any bargaining power.

In contrast, by collectively bargaining and offering their business to a single seller, the members of the buying group create a large and potentially critical block of sales. Both sellers will be keen to gain the business of the buyer group and to prevent that business from going to the other seller. Loss of the business of the buyer group will have significant implications for the profit of an individual seller, so the buyer group will have increased bargaining power and will gain more of the surplus created by bargaining.<sup>73</sup>

Note that this gain is not due to improved contracting. Rather it is a pure transfer reflecting that, by collectively offering their business, the members of the buyer group have transformed from insignificant customers into a single important block of customers. This allows them to ‘play off’ counterparties and increase their share of the gains from contracting. The counterparties can be worse off despite the collective bargaining agreement satisfying the three ACCC criteria.<sup>74</sup>

In some matters, the ACCC appears to recognise the possibility of increased bargaining power by a bargaining group leading to prices being distorted. However, it also appears to limit these concerns to situations where the bargaining group faces multiple target businesses. Thus when considering collective bargaining by Queensland coal miners, the ACCC dismissed anti-competitive concerns as the counterparty was a monopolist.<sup>75</sup>

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73 The ability of ‘large’ buyers to extract volume discounts due to their importance to the counterparty’s production is examined in Tasneem Chitty and Christopher M Snyder, ‘The Role of Firm Size in Bilateral Bargaining: A Study of the Cable Television Industry’ (1999) 81 *Review of Economics and Statistics* 326; Roman Inderst and Christian Wey, ‘Buyer Power and Supplier Incentives’ (2007) 51 *European Economic Review* 647.

74 Of course, this depends on the interpretation of the term ‘relatively modest market share’ used by the ACCC. However, the increase in bargaining power is derived from the ‘block’ of sales provided by the group. The group may only have an aggregate, say, 20 per cent market share. However, if all other buyers are small (eg, no other buyer has a market share greater than 2 per cent) a 20 per cent block of sales can be significant and shift bargaining power.

75 ‘[T]he target of the collective bargaining is a monopoly provider, reducing the probability that the collective bargaining group will achieve inefficiently low prices’: Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [4.37].

Bargaining power can change even if there is only a single counterparty. By forming a buying group, the relevant businesses may be able to access options that are not available to the individual businesses. For example, the volume of the group's collective purchases may make it economically viable to bring the relevant product in from 'outside' the market – from another geographic region or through imports. While this may be too costly for an individual business, the collective bargaining group can share the costs of establishing the alternative source of supply and the costs of shipping the product.

Similarly, because of the volume of purchases that a buyer group can offer to an individual seller, the buyer group may be able to sponsor new entry in a way that is infeasible for single businesses. The buyer group effectively lowers the cost of entry for a new supplier by offering that supplier a significant volume of business.

In summary, by forming the buyer group, previously uneconomic sources of supply may become viable.<sup>76</sup>

The same can hold true for seller groups. By forming a 'collective' source of product and pooling their resources, the members of the seller group may be able to economically access buyers beyond their traditional market. This places them in a stronger position when bargaining with their traditional counterparty, even if that counterparty was previously a monopsonist. Overall, by increasing the set of opportunities and alternatives that the businesses in the group can access if bargaining with the counterparty fails, the seller group can increase their share of the surplus from bargaining.

It is easy to see that these increased alternatives can make the counterparty worse off. For example, if the counterparty was previously a monopoly supplier to the individual businesses, then the potential competition created by the ability of the buyer group to sponsor new entry means that the supplier will need to lower its price and improve the terms and conditions it offers to the buyer group, even if there were no change in the total value of contracting.

However, the concern for the ACCC is not whether the change in bargaining power makes the counterparty worse off but whether it lowers the benefits of collective bargaining. In this sense, the above examples fall into two distinct categories. If the change in bargaining power is due to the bargaining group, as a whole, gaining such a degree of countervailing power that it can distort prices in its favour, then this may reduce the public benefits of collective bargaining. In the extreme, it could see one inefficient contract (say a monopoly contract offered by the counterparty) being replaced with an alternative inefficient contract (say a monopsony contract offered by the bargaining group).

Alternatively, if the change in bargaining power is due to the bargaining group being able to access a competitive alternative that cannot be accessed by

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76 These types of alternatives, and their impact on competition and pricing, have been considered, for example, by Michael L Katz, 'The Welfare Effects of Third-Degree Price Discrimination in Intermediate Good Markets' (1987) 77(1) *American Economic Review* 154; Roman Inderst and Christian Wey, 'Bargaining, Mergers, and Technology Choice in Bilaterally Oligopolistic Industries' (2003) 34 *RAND Journal of Economics* 1.



individual businesses, such as sponsoring entry, then there seems little cause for concern. Such a change in bargaining power may force the counterparty to match the new competitive alternative. However, this is likely to create a public benefit in that it forces the counterparty to offer competitive pricing to the members of the bargaining group. Alternatively, the new entry may occur, potentially benefitting both the businesses in and outside the bargaining group.

In this sense, the three conditions used by the ACCC when considering bargaining power – voluntary membership of the bargaining group, limited membership of the group and the absence of collective boycotts – provide a good foundation for analysing the costs and benefits of bargaining. However, the ACCC may need to inquire further even if these conditions are met. If there are claims that there will be a loss of efficiency due to the excessive bargaining power of the bargaining group, the source of this power should be considered.

### C Bargaining Group Homogeneity

A bargaining group may reduce the per-business cost of external negotiations with a counterparty. However, the ability of the group to exploit economies of scale in bargaining costs depends on the group's own ability to agree on relevant contractual parameters. As such, the bargaining group substitutes internal costs of coordination for external bargaining costs.<sup>77</sup>

The internal costs of coordination will depend on the nature of the members of the bargaining group. The 'more alike' the members, the lower the internal costs of coordination. In contrast, if the members of the bargaining group are very different, so that desirable contracts for each member of the group differ considerably, then coordination costs are likely to be high.

The coordination costs involve two aspects: the actual costs of intra-group negotiation and the costs involved in contractual compromise if group members accept a contract with the counterparty that is based on parameters negotiated for the bargaining group as a whole rather than for their specific business.

In the application by the APTG, the target, Cedenco, opposed the application arguing that collective negotiation would not be efficient. The ACCC noted that 'Cedenco submitted that individual negotiation is necessary and it "must conduct individual negotiations with growers, and tailor individual contracts to suit the needs of [the] grower and Cedenco's requirements as a processor"<sup>78</sup>.

The argument put forward by Cedenco was based on the differences between individual members of the bargaining group. Thus:

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77 'If the buyer group acts as a representative of its members, contracting issues may well remain between the buyer group and its members. Thus, in order to solve transactions costs, the buyer group must be better placed than the supplier to contract with its members': RBB Economics, above n 36, 39 [3.10]. The bargaining group will only be viable if the internal costs of group bargaining are outweighed by the saving in the external costs of having each member individually negotiate with the counterparty. If this were not the case, then individual bargaining, rather than collective bargaining, would be efficient for the members of the collective bargaining group.

78 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91270*, 24 February 2012, [4.63].

Cedenco submitted that it requires individual arrangements with growers because the 'capabilities and characteristics of individual growers differ' and it 'must have arrangements with the growers that allow it to receive the correct types of tomatoes, at the correct time, to allow it to operate its plant efficiently and meet the requirements of customers'. Therefore, Cedenco submits that the proposed conduct will not result in fewer negotiations and lower total transaction costs.<sup>79</sup>

Similarly, when the ACCC considered collective bargaining by grape growers in Victoria, Fosters submitted that this could lead to an average price that would disadvantage higher quality growers in the bargaining group.<sup>80</sup>

The ACCC has noted that bargaining groups can have a broad and diverse membership. For example, in the application by Queensland coal miners the ACCC noted the diverse size of the applicants. They included small miners such as Carabella Resources Limited, 'a \$39 million company that listed on the Australian Stock Exchange in December 2010. Carabella has focused its initial exploration activities at its coking coal tenement in the Bowen Basin at Mabbin Creek'.<sup>81</sup> But the group also included large miners such as Rio Tinto Coal Australia, 'a subsidiary of Rio Tinto Limited ... worth around \$3186 million'.<sup>82</sup>

The ACCC has accepted that homogeneity of the membership of the bargaining group means that 'transaction cost savings are more likely'.<sup>83</sup> Similarly, the ACCC considered an application by the Coalition of Major Professional Sports ('COMPS'):

[T]he ACCC is of the view that the proposed collective bargaining arrangements may generate some public benefits from allowing COMPS members to have greater input in contract negotiations. The ACCC also considers that the revised collective negotiation structure may provide scope for some transaction cost savings. ... However, the ACCC considers that any such benefits would be reduced by the diverse nature of the parties.<sup>84</sup>

Costs associated with the heterogeneity of the members of a bargaining group must be set against the benefits created by the group. However, it can be difficult for the ACCC to accurately identify these costs, as they can arise from broader market interactions involving the bargaining group and may change over time. For example:

- If some members of the bargaining group are less efficient than either other members of the group or 'outside' firms, then the bargaining group may effectively protect these inefficient businesses from competition. The less efficient businesses will gain the benefits of more efficient contracts negotiated by the group. Their inefficient cost structure or

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79 Ibid [4.65].

80 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91080 & A91081*, 19 March 2008, [5.17].

81 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91275*, 16 February 2012, [2.2].

82 Ibid [2.7].

83 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91078*, 14 May 2008, [5.61].

84 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91007*, 13 December 2006, [8.5]–[8.6].

management may offset these benefits, but the ACCC is unlikely to have the information to evaluate such inefficiency.

- The buyer group may create uniformity and, over time, reduce or eliminate differentiation by its members even if such differentiation is desirable. For example, contracts negotiated by the bargaining group may encourage uniformity in the product offered by the bargaining group's members.
- Because a member firm either has to leave the group (and face significantly increased negotiation costs) or change the negotiated position for the whole group, the incentives for member businesses to innovate and differentiate their product offerings in a way that will involve re-negotiation with the counterparty may be diminished. Note that this reduced incentive may arise even if the innovation is beneficial to both the relevant member firm and the counterparty, because re-negotiation for the whole bargaining group can involve internal coordination costs and the information required for such re-negotiation may remove any competitive advantage from the innovation.<sup>85</sup>

Overall, when considering the costs and benefits from a bargaining group, the ACCC and the Tribunal should downplay the benefits of a group with members that exhibit significant differences.<sup>86</sup> Benefits of collective bargaining are more likely to flow when the group has both a limited membership and when the member businesses are relatively similar.

#### **D Does Collective Bargaining Harm Third Parties?**

Bargaining groups not only affect the member businesses and counterparties; they also affect third party businesses that deal with the same counterparties as the bargaining group. For example, when considering a collective buyer group, there will be businesses who are not members of the bargaining group but who also negotiate with the same suppliers as the bargaining group. These third parties may or may not also compete in downstream markets with members of the buyer group. For example, if the buyer group involves paint retailers, then third parties will include other paint retailers who are not in the group, and also other businesses, such as builders or maintenance companies, who purchase paint.

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85 For buyer groups, 'short-term gains [may] come at the expense of longer-term innovation': RBB Economics, above n 36, 13 [1.52].

86 See, eg, Australian Competition and Consumer Commission, *Determination: Application for Authorisation A90974*, 22 February 2006. This determination dealt with a collective bargaining application by Tasmanian forestry contractors. The final decision noted that '[t]he ACCC considers that the introduction of collective bargaining to such a diverse group of contractors may result in lost efficiencies ... [T]he ACCC considers that the proposed collective bargaining arrangements may lessen competition between forest contractors and reduce their incentive to: innovate in respect of the services that they provide; differentiate themselves from their competitors; and pursue more effective work practices': at [9.9].

Similarly, consider a seller group involving chicken farmers. The seller group may negotiate with a chicken processor. Third parties include other chicken farmers who are not in the group but who sell product to the same processor, and other businesses who deal with that processor.

As a starting point, a successful bargaining group will often harm third party competitors because the aim of the bargaining group is to improve contracts and make the member businesses more successful competitors. For example, if a buyer group is able to negotiate better contracts with a supplier then this will improve their ability to compete in a downstream market. Other competitors in this market who are not members of the buyer group and who have less efficient supply contracts will suffer a loss in custom and a reduction in profits due to this more effective competition.

Similarly, if a seller group is better able to meet the needs of a buyer then that same buyer will choose to purchase less from competitor suppliers outside the seller group. Those competitor sellers will make fewer sales and will suffer a reduction in their profitability.

In general, losses to specific businesses caused by the members of a bargaining group becoming more efficient competitors would not be considered a public detriment. It is the very nature of competition that more efficient businesses 'harm' their less efficient rivals and, in so doing, make consumers better off. However, it must be realised that the increased intensity of competition created by a bargaining group may lead some competitor businesses to exit, particularly if these businesses are unable to join the bargaining group (say due to fears about collusion by the regulator) or to start a group of their own (possibly because the 'remaining' firms are too heterogeneous to make collective bargaining worthwhile). The competition may also make particular classes of customer worse off, such as those who interact closely with a business outside the buyer group.<sup>87</sup>

The ACCC, in a number of its decisions, has considered the implications of a bargaining group for third parties. However this analysis does not appear to be systematic. For example, in the PaintRight notification, a member-owned franchisor, 3D Paint Stores ('3D'), whose franchisees compete with some of the members of PaintRight, opposed the application. 3D claimed that the notification unfairly provided PaintRight with many of the benefits of a franchise without the

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87 For example, there has been significant analysis of the 'waterbed effect', a situation where a reduction in supply price to one firm (or group of firms, such as a buyer group) leads the supplier to raise the price it charges competitors, undermining the ability of those competitors to compete and making the customers of those businesses worse off: see Competition Commission, *The Supply of Groceries in the UK Market Investigation*, Final Report (2008) <[http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/reports/2008/fulltext/538](http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538)>; Roman Inderst and Tomasso M Valletti, 'Buyer Power and the "Waterbed Effect"' (2011) 59 *Journal of Industrial Economics* 1; Stephen P King, 'Countervailing Power and Input Pricing: When is a Waterbed Effect Likely?' (Working Paper, Department of Economics, Monash University, 24 April 2012).

associated compliance cost.<sup>88</sup> The ACCC dismissed these concerns, noting that 3D could establish similar arrangements to PaintRight and that ‘the proposed arrangements are likely to have a pro-competitive effect on retail competition between paint suppliers’.<sup>89</sup>

The ACCC has expressed concern that collective bargaining may harm third party businesses by limiting the market that is available to businesses that already compete against the members of the bargaining group. It may also create barriers to entry for new businesses that seek to compete against members of the bargaining group and allow members of the group to share information to their commercial advantage.<sup>90</sup>

A bargaining group could harm third parties through anti-competitive conduct. An example is if the contract negotiated between the bargaining group and the counterparty explicitly involved terms that impact on the third parties. Thus, a bargaining group might negotiate a contract that involved a ‘most favoured firm’ provision.<sup>91</sup> Such a provision would reduce the ability of the counterparty to offer better terms or conditions to any third party, even if those terms and conditions benefited the counterparty and the third party.

The ACCC has recognised this issue. For example:

[T]he ACCC has significant reservations as to the collective negotiation of exclusive supply arrangements with suppliers to the exclusion of competing health food stores. Accordingly, the ACCC will not grant authorisation for any such provisions and would be concerned with any such arrangement.<sup>92</sup>

Contract terms that harm third parties however may be subtler. For example, a negotiated contract may involve a take-or-pay clause that pushes any market variability onto third parties. Alternatively, the contract could involve investments by the counterparty that reduce the competitive impact of third party products, by aligning the counterparty’s production capabilities with the bargaining group’s product.

The ACCC has noted that competitive harm can accrue to third parties even where there is mutual benefit to both the bargaining group and the counterparty:

While the target would likely only agree to such an arrangement if it was to its commercial advantage to do so, the effect of doing so would be that those outside the bargaining group would be prevented from competing on equal terms with

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88 Australian Competition and Consumer Commission, *Assessment: Collective Bargaining Notifications Lodged by PaintRight Ltd*, Notification Nos CB00081–CB00137, 16 September 2009, [2.23].

89 Ibid [3.32].

90 Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.93]–[5.94], [5.98].

91 A most favoured firm provision requires that if another party receives terms and conditions (such as a price) that are more favourable than the terms and conditions for the bargaining group, then those more favourable terms must also be offered to the bargaining group. The potential anti-competitive effects of these types of contracts, and other contracts that ‘reference rivals’ is considered in Fiona Scott-Morton, ‘Contracts That Reference Rivals’ (Speech delivered at the Georgetown University Law Center Antitrust Seminar, Washington DC, 5 April 2012) < <http://www.justice.gov/atr/public/speeches/281965.pdf>>.

92 Australian Competition and Consumer Commission, *Determination: Application for Authorisation A91071*, 6 February 2008, [3.43].

those within the bargaining group to supply to or acquire services from the target.<sup>93</sup>

There are two issues with this approach. First, if the creation of the bargaining group alters bargaining power in favour of the group, the counterparty may be willing to agree to terms and conditions that harm its profit compared to the situation in the absence of a bargaining group. Put simply, the counterparty will be bargaining after the group is formed and approved by the ACCC. At that point of time, the gains relative to negotiating in the absence of the bargaining group are irrelevant. Rather the counterparty faces the bargaining group and must 'make the best of it'.

In such a situation, the counterparty may oppose the formation of the bargaining group. However, the ACCC does not take approval by a counterparty as the sole criterion for approving a bargaining group.

Second, there will be situations where both the counterparty and the members of the bargaining group gain by harming third parties. This is most obvious when the members of the buyer group and the third parties compete in a downstream market. If the bargaining group can contract with the counterparty in a way that harms its third party competitors, then this may enable the members of the group to raise prices in the downstream market. The losers in this situation are both the third party competitors and customers. However, if the bargaining group are able to effectively gain increased profits through limiting downstream competition then these increased profits can be shared with the counterparty.

In summary, the ACCC is correct to note that mutual agreement between the bargaining group and a counterparty does not mean that the benefits of the group outweigh the anti-competitive harm to third parties. However, it is far from clear how the ACCC can evaluate these harms. The ACCC may find it difficult to separate pro-competitive and anti-competitive harm to third party businesses. At a minimum, the ACCC should be wary of any collective bargaining agreement that limits the counterparty's ability to interact with third parties.<sup>94</sup>

## VI CONCLUSION

When considering whether the benefits of a collective bargaining group exceed the costs, so that it can be approved under the *CCA*, the ACCC faces a difficult task. Collective bargaining by either a buyer group or a seller group can improve the efficiency of the contracts negotiated with a counterparty. This can be mutually beneficial to both the bargaining group and the counterparty. It can enhance investment and assist the parties to better mould contracts to their particular requirements. It can also be pro-competitive, leading to benefits to

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93 Australian Competition and Consumer Commission, *Objection Notice in Respect of a Collective Bargaining Notification Lodged by Hertz Australia Pty Limited*, Notification No CB00143, 16 July 2010, [5.95].

94 The Office of Fair Trading, United Kingdom ('OFT') has also noted the harms to third parties discussed above. See Maxwell, above n 54, [5.3].

customers. Overall, collective bargaining by businesses can create significant public benefit.

However, collective bargaining can raise a variety of potential costs. Collective bargaining agreements can be used to facilitate anti-competitive coordination and limit competition in a related market. It can lead to shifts in bargaining power so that, potentially, an inefficient contract that favours the counterparty may simply be replaced with an inefficient contract that favours the bargaining group. Further, while collective bargaining may lower the costs of negotiation between the group and the counterparty, it will create a series of internal costs associated with organising the group itself. Finally, collective bargaining may harm third parties, such as businesses that are not in the group, and this may create a public detriment.

Our review of recent decisions for collective bargaining authorisation and notification shows that the ACCC is both aware of many of these difficulties and has adapted its approach to deal with these potential problems. For example, as a rule of thumb, the ACCC is more likely to authorise a collective bargaining group if its membership is limited and voluntary. In such situations the ability of the bargaining group to either foster anti-competitive coordination or rebalance bargaining power in an anti-competitive way is limited.

However, this type of rule of thumb has costs. Limiting the membership of a bargaining group limits the ability of the group to adopt pro-competitive bargaining strategies, such as sponsoring new entry to compete against the counterparty. As such, the usefulness of any rule of thumb will be limited by the exact details of the bargaining arrangement that is under examination.

The current rule-of-thumb approach lacks both consistency and transparency. As a result, some of the approaches that the ACCC adopts in authorisation decisions can appear ad hoc. It can be difficult for businesses and their legal advisors to establish a bargaining group when they lack clear guidance about the trade-offs that the ACCC considers in its decisions.<sup>95</sup>

One solution would be a set of 'collective bargaining guidelines', similar to the ACCC's *Merger Guidelines*. The European Commission already has such guidelines, albeit in the context of broader guidance on horizontal arrangements.<sup>96</sup> These types of guidelines would assist business, for example, to evaluate the structure and breadth of a bargaining group that would avoid concerns about anti-competitive coordination.

That said, the European collective bargaining guidelines are essentially a series of simple case studies. The ACCC could easily design a similar set of case studies based on its considerable experience with collective bargaining. However, in my opinion, the ACCC should go further. The *Merger Guidelines* summarise how the ACCC will analyse mergers and provide a broad framework

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95 The ACCC does provide some guidance to its evaluation of collective bargaining authorisations and notifications. See, eg, See Australian Competition and Consumer Commission, *Guide to Collective Bargaining Notifications*, above n 14. However, this guidance is mainly 'mechanical' rather than assisting parties to understand the competitive consequences of their proposed bargaining arrangement.

96 *Guidelines on the Applicability of Article 101*, above n 6, 47 [219].

as well as specific examples. Collective bargaining guidelines could similarly discuss how the ACCC will evaluate collective bargaining agreements, the types of issues that would raise concerns for the ACCC, and how relevant parties could structure a collective bargaining arrangement to avoid these concerns.

While the ACCC is clearly aware of the potential competitive harm that can be created by collective bargaining, its approach could be stronger in two areas. First, the ACCC should be sceptical of bargaining groups with heterogeneous members. Even if such groups operate effectively, the differences between members create internal coordination costs. Differences between group members may also alter competitive interactions over time, limiting innovation and the variety of product offered in the market.

Second, the ACCC needs to consider the potential for third party harm more fully. In particular, it may be desirable for more limits to be placed on the nature of contracts that can be negotiated between a bargaining group and a counterparty, to ensure that such contracts do not contain clauses aimed at undermining third party competition.<sup>97</sup>

Finally, the economic framework developed in this article highlights the information needed by the ACCC to evaluate collective bargaining. The ACCC may be assisted in its task by the reactions of market participants. For example, if a counterparty supports the bargaining group then there will be few if any concerns about anti-competitive shifts in bargaining power. If third party businesses also support (or do not oppose) the formation of the collective bargaining group then concerns about harm to these parties are likely to be misplaced. However, the arrangement may still raise issues of anti-competitive coordination that the ACCC needs to consider.

In this sense, the reactions of market participants can assist the ACCC to focus its inquiries. Where opposition to the collective bargaining arrangement is muted or non-existent the ACCC's role will be to make sure all parties are 'represented' in the evaluation and to check that the collective bargaining agreement is able to withstand changes that, over time, may raise its costs and lower its benefits.

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97 This problem has been highlighted in a recent speech by Fiona Scott-Morton, former Deputy Assistant Attorney General for Economic Analysis for the Antitrust Division of the United States Department of Justice: Scott-Morton, above n 91.