

# COMPETITION & REGULATION UPDATE

## COLES' \$10 MILLION PECUNIARY PENALTY ORDER FOR UNCONSCIONABLE CONDUCT IS A WIN FOR BUSINESSES IN ENCOURAGING GOOD STANDARDS OF CONDUCT IN COMMERCIAL DEALINGS, BUT THE LAW MAY STILL NEED TO DO MORE

On 22 December 2014, the Federal Court ordered Coles to pay \$10 million in pecuniary penalties for engaging in conduct that constituted unconscionable conduct in contravention of section 22 of the Australian Consumer Law (ACL) as it stood in 2011 (now sections 21 and 22 of the ACL and in substantially similar terms to the former provisions). The orders arose from two proceedings brought by the Australian Competition and Consumer Commission (ACCC) alleging that Coles engaged in unconscionable conduct in its dealings with particular suppliers in 2011.

Justice Gordon described Coles' conduct as serious, deliberate and repeated, and said that Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings. Occurring in the midst of the Competition Policy Review and at a time when supermarkets are facing ongoing scrutiny regarding their commercial practices, the decision encourages us to re-evaluate whether Australia's competition and consumer laws sufficiently protect business-to-business commercial dealings.

### BACKGROUND TO THE PROCEEDINGS

The following table provides a background to each proceeding:

	ARC PROCEEDING	CLAIMS PROCEEDING
<b>The conduct</b>	Coles introduced the Active Retail Collaboration Program (ARC) rebate, being a payment from a supplier to Coles, calculated as a percentage of the price Coles paid for the products and deducted by Coles from monies owed to the supplier for products that it had already supplied to Coles.	Coles sought the following payments from certain suppliers outside of their negotiated trading arrangements: <ul style="list-style-type: none"> <li>payments for Coles' "profit gap" being the difference between a supplier's sales growth and Coles' profit growth;</li> <li>payments for the cost of waste and markdowns; and</li> <li>payments for fees arising from short or late deliveries.</li> </ul> <p>Coles also refused to cease deducting and retaining deferred rebates that were due to expire, and retained payments outside the terms of its supply agreements.</p>
<b>Key facts</b>	<ul style="list-style-type: none"> <li>Coles targeted \$16 million in ARC rebates from Tier 3 Suppliers in the financial year ended 30 June 2012.</li> <li>Coles established a process where its employees sought agreement from suppliers, responded to questions with set answers and at their discretion provided particular information about the ARC rebate.</li> <li>Coles threatened commercial consequences against suppliers that did not agree to pay the ARC rebate.</li> </ul>	<ul style="list-style-type: none"> <li>Coles demanded profit gap payments and waste and markdowns payments even though it knew that the profit gap or waste and markdown could be caused by its own acts or omissions rather than that of the supplier.</li> <li>Coles sought monetary penalties from suppliers that were not calculated by reference to any assessment of Coles' likely loss, if any, arising from the short or late delivery.</li> </ul>
<b>Number of suppliers affected</b>	The ARC Proceeding involved five "Tier 3 Suppliers", however Coles' introduction of the ARC rebate affected approximately 220 Tier 3 Suppliers.	The Claims Proceeding involved five suppliers.
<b>Penalties ordered</b>	<ul style="list-style-type: none"> <li>\$3.7 million in pecuniary penalties.</li> <li>\$1 million towards the ACCC's costs.</li> <li>Undertaking provided by Coles establishing an independent review process for the affected Tier 3 Suppliers to seek refunds.</li> </ul>	<ul style="list-style-type: none"> <li>\$6.3 million in pecuniary penalties.</li> <li>\$250,000 towards the ACCC's costs.</li> <li>Undertaking provided by Coles establishing an independent review process for the five affected suppliers to seek refunds.</li> </ul>

## 10 QUESTIONS FOR BUSINESSES TO CONSIDER IN THEIR COMMERCIAL DEALINGS

The unconscionable conduct provisions prohibit a person from engaging in conduct that is, in all the circumstances, unconscionable. Therefore, the particular circumstances of any case involving allegations of unconscionable conduct will be relevant, together with any relevant matters listed in the ACL which the court may choose to have regard to. The following circumstances were relevant in the Coles decision and may provide guidance to businesses querying whether conduct in commercial dealings involves unconscionable conduct:

- 1 Is one business in a substantially stronger bargaining position relative to the other?
- 2 Have sufficient details been disclosed to understand the basis of a particular demand?
- 3 Has any undue pressure or unfair tactics been exerted, for example through repeated requests for a response or threats of commercial consequences if agreement is not reached?
- 4 Have incorrect assertions been made about the value a process would bring to a party without specifically considering the value to that party?
- 5 Has there been a willingness to negotiate the amount and timing of payments and engage in informed negotiations about the basis of payment requests?
- 6 Is a payment demand being made with knowledge that there is no reasonable basis for asserting an entitlement to the payment?
- 7 Is there awareness of the financial difficulties that the business is experiencing in making the payments demanded?
- 8 Is the business retaining money that it knows or ought to know it has no lawful entitlement to withhold and retain?
- 9 Is the business requesting an indemnity for particular costs, including those caused by its own conduct?
- 10 Is the business refusing to give sufficient details to provide an understanding of the extent to which it has suffered loss due to the other business' conduct?

## ARE BUSINESSES ADEQUATELY PROTECTED UNDER THE CURRENT LAW?

In the ARC Proceeding, Justice Gordon rejected Coles' submission that the contraventions were somehow distinguishable, or of a less serious nature, because they did not involve vulnerable consumers. Her Honour stated that the conduct involved vulnerable suppliers and "it is difficult to envisage circumstances involving a larger disparity in bargaining power".

The Coles decision reinforces that businesses need legal protection to regulate standards of conduct in their commercial dealings and encourages us to consider whether the ACL, the *Competition and Consumer Act 2010* (Cth) (CCA) and other laws adequately provide that protection. The diagram below outlines some existing prohibitions and legal rights and others under consideration, which may contribute towards regulating standards of commercial behaviour.

The diagram on the following page shows that statutory unconscionable conduct appears to be the most appropriate protection for businesses in regulating standards of conduct in commercial dealings with other businesses. The Panel in the Harper Review was asked to examine the ACL provisions insofar as they relate to small businesses. Before the Coles decision was made, the Panel expressed the view that there is not a strong case that the current unconscionable conduct provisions are not working as intended to meet their policy goals.

EXISTING LEGAL PROTECTIONS				FURTHER PROTECTIONS UNDER CONSIDERATION
Unconscionable conduct – ss 20 and 21 of the ACL	Misuse of market power – s 46 of the CCA	Rights under contract	Food and Grocery Code of Conduct (voluntary code)	Unfair contract terms ACL
The Coles decision suggests that the statutory unconscionable conduct provisions are working in relation to business to business conduct.	A party with a substantial degree of power in a market must not take advantage of its market power for the purpose of damaging a competitor.	Businesses may have terms in their contracts imposing a duty on the parties to act in good faith or to otherwise act fairly in their commercial dealings with each other.	The Code imposes limitations on retailers regarding their grocery supply agreements and their conduct in commercial dealings.  The Code is now prescribed under the Competition and Consumer Act 2010.	Unfair terms of standard form consumer contracts are void.  The Government is considering whether these protections should be extended to small businesses.
ISSUES				
<ul style="list-style-type: none"> <li>■ Sufficiency of maximum penalties under the ACL.</li> <li>■ The scope of s 21 unconscionable conduct is unclear (unconscionable conduct in relation to the supply or acquisition of goods or services).</li> </ul>	<ul style="list-style-type: none"> <li>■ Need to prove that the second business is a competitor of the business with market power.</li> <li>■ Difficult to prove that the business with market power had the requisite purpose.</li> </ul>	<ul style="list-style-type: none"> <li>■ An action for breach of contract involves a private proceeding and can be resource intensive.</li> <li>■ If the business cannot prove it is entitled to substantial damages, it will only receive nominal damages.</li> </ul>	<ul style="list-style-type: none"> <li>■ Applies only to the Food and Grocery sector.</li> <li>■ The Code is a voluntary industry code where retailers agree to be bound by it.</li> </ul>	<ul style="list-style-type: none"> <li>■ The prohibitions do not apply to business to business contracts.</li> <li>■ The prohibitions only apply to standard form contracts.</li> </ul>

The unconscionable conduct provisions may work in leading to penalties for businesses, but the law must also ensure business are deterred from engaging in similar conduct in the future. In the Coles decision, Justice Gordon stated that but for Coles' admissions and acknowledgments of its contravening conduct, the conduct and circumstances in which it was committed would have warranted imposing penalties at or close to the maximum the law permits, being \$1.1 million for each contravention. Her Honour stated that the current maximum penalties are arguably inadequate for a corporation with annual revenue in excess of \$22 billion. Time will confirm whether the unconscionable conduct provisions and their associated penalties encourage adherence to appropriate standards in business-to-business commercial dealings or whether further legal protections, such as those currently being considered by the Australian Government, are needed.

## MORE INFORMATION

For more information, please contact:



**Simon Uthmeyer**  
Partner  
T +61 3 9274 5470  
simon.uthmeyer@dlapiper.com



**Fleur Gibbons**  
Partner  
T +61 3 9274 5840  
fleur.gibbons@dlapiper.com



**Natasha Koravos**  
Solicitor  
T +61 3 9274 5397  
natasha.koravos@dlapiper.com

Or contact your nearest DLA Piper office:

### BRISBANE

Level 28, Waterfront Place  
1 Eagle Street  
Brisbane QLD 4000  
T +61 7 3246 4000  
F +61 7 3229 4077  
brisbane@dlapiper.com

### CANBERRA

Level 3, 55 Wentworth Avenue  
Kingston ACT 2604  
T +61 2 6201 8787  
F +61 2 6230 7848  
canberra@dlapiper.com

### MELBOURNE

Level 21, 140 William Street  
Melbourne VIC 3000  
T +61 3 9274 5000  
F +61 3 9274 5111  
melbourne@dlapiper.com

### PERTH

Level 31, Central Park  
152-158 St Georges Terrace  
Perth WA 6000  
T +61 8 6467 6000  
F +61 8 6467 6001  
perth@dlapiper.com

### SYDNEY

Level 22, No.1 Martin Place  
Sydney NSW 2000  
T +61 2 9286 8000  
F +61 2 9286 8007  
sydney@dlapiper.com

[www.dlapiper.com](http://www.dlapiper.com)

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