AUSTRALIAN BEVERAGES COUNCIL

Submission to the NSW Independent and Pricing Regulatory Tribunal (IPART) on the NSW Container Deposit Scheme (CDS)

Monitoring the impacts on container beverage prices and competition

March 2018

Australian Beverages

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About the Australian Beverages Council

The Australian Beverage Council Ltd (ABCL) is the pre-eminent representative body of the non-alcoholic beverage industry. We represent 95% of the industry's production volume and our member companies include every major manufacturer in Australia and many, many small and medium sized companies. A list of our Members can be found at https://tinyurl.com/y9vda6yh.

Collectively, our Members contribute $7 billion to the Australian economy and our Members employ over 46,000 people across the nation. In NSW alone, $2.6 billion is contributed to the state's economy and 17,000 local men and women are employed as a result of the activities of our Members.

We play an integral role in educating people to make informed choices by encouraging nutritional balance and moderation. We advocate on issues such as portion sizes, nutritional labelling, marketing to children and canteen guidelines. We also cultivate openness between industry players to facilitate research, knowledge and informed advice. We listen to consumers and encourage our Members to adapt their products accordingly to make positive changes to society. We stand by our commitment to promote greater choice, smaller portions and more products with low or no kilojoules. As a consequence, we firmly believe that both our industry and our Members are corporate citizens who act responsibly for the benefit of their customers and our community.

Container Deposit Scheme (CDS) Objectives

The Australian beverages industry supports the NSW Government's target to reduce litter in the state by 40% by 2020. We recognise the role of our industry in helping to achieve this goal by reducing beverage container litter.

Moreover, the beverages industry supports the environmental goals of increasing the re-cycling of single-use containers and increasing the collection and reuse of refillable containers.

The beverages industry has a long history of working collaboratively with a broad range of governments and other stakeholders to reduce litter and increase recycling.

Background

The NSW Government launched its CDS in late 2017. It is often quoted that the Scheme commenced operation on 1 December 2017, however, this date is incorrect.

The NSW CDS commenced operation on 1 November 2017 when 'beverage manufacturers', or so-called 'first suppliers', were first invoiced by Exchange for Change (E4C), (the NSW Government's appointed Scheme Co-ordinator). These invoices were issued to beverage manufacturers in advance, for both container deposits and the relevant handling fees for eligible beverage containers, which 'first suppliers', intended to supply to the NSW market from December 2017.

As such, the first day of November 2017 was the true commencement date of the NSW CDS whilst the first day of December 2017 signalled the public commencement of the Scheme, and the date from which retailers commenced charging consumers CDS fees. This was also the first time consumers were able to return eligible containers for refund.

The NSW Premier, has now asked IPART to monitor and report on the impacts of the CDS over the first year of its operation, specifically in relation to *Monitoring the impacts on container beverage prices and competition.*

ABCL's Position and Issues for Consideration

In making this submission to IPART, the ABCL would like to make some preliminary points including:

For ease of reference, the ABCL will, as much as possible, follow the sequence of issues outlined by IPART in its Issues Paper.

Too Early to Tell

As the NSW CDS has only been in operation from a collection and refund perspective for just over three months (December 2017 to February 2018), it is the case that, for many issues, it is simply too early to undertake any meaningful assessment, or to draw any valuable conclusions. Our holistic view is that this may not be possible for perhaps as long as eighteen months from the date implementation.

Reserving Judgement

The IPART Issues Paper largely considers assessment methodology and not matters of fact or substance. As a consequence, the ABCL will reserve judgement on many matters until such time as we see what IPART, or its consultant advisor, claims to establish in undertaking its assessments and what findings and recommendations it might propose in the coming months.

While proposing criteria to form opinions is one thing, drawing conclusions from any assessment undertaken is something quite different.

The ABCL reserves the right to see how the proposed research develops, and ascertain how any conclusions and deductions are made from this work before either accepting or rejecting any conclusions which might be drawn.

Legitimate Right to Increase Beverage Prices

We note that IPART acknowledges that beverage manufacturers "can increase the prices of eligible beverage containers to recover" CDS costs including "monthly fees to cover the costs of the Scheme, including the 10-cent refund and the scheme's operating costs",[1] and that this is a legitimate commercial pricing practice available to beverage manufacturers.

Scheme Effectiveness

We note that IPART has not been asked to monitor indicators of the Scheme's effectiveness. We believe that it is impossible to consider some aspects of CDS, whilst having little consideration of others, particularly where these are matters which go to the very heart of the impact of the Scheme on both its costs and pricing.

[1] IPART Issues Paper - NSW Container Deposit Scheme, Monitoring the impacts on container beverage prices and competition, February 2018 Page 5

By way of example, during all industry and public briefings concerning the introduction of CDS in NSW, the Environmental Protection Authority (EPA) continually advised stakeholders and industry forums that NSW was intent upon having 525 collection points rolled out across the State.

Critically, industry was consistently advised that of these 525 collection points, 85% (or about 450) were to be in place by 1 December 2017, with the remaining 15% (or 75) to be operational by 1 March 2018. Anecdotally, we believe these figures were also included in the Network Operator tender documentation.

The reality is, that the roll out of collection points has been a much less than promised, with only about 260 collection points operational on start-up of the Scheme on 1 December 2017. As at 1 March 2018, the Return and Earn website indicated that the 525 collection point target, had still not been reached.

Moreover, our understanding is that while the Reverse Vending Machine (RVM) network has functioned reasonably well, the Over the Counter collection points have been a significant failure, with many points refusing to accept containers and/or withdrawing from the Scheme after deciding their involvement was not in the best interests of their core business operations.

We believe the current 499 collection points listed on the Return and Earn website is an overstated number due to the closure of many over the counter collection points which are yet to be removed from the website's collection point location map.

The number of functional collection points is a factor critical to the successful operation of the Scheme, and a factor which directly impacts the Scheme's return rates and costs. As such, it is impossible for IPART, or anyone else for that matter, to monitor the impacts on container beverage prices and competition, without properly considering all factors involved in the roll out of the Scheme, including the installation and opening of collection points.

The ABCL suggests that questions be asked and considered as a part of this review by IPART, which directly impact return rates and the associated costs:

? How many collection points were open and operational on:

- 1 December 2017;
- 1 January 2018;
- 1 February 2018; and
- 1 March 2018.

? How many over the counter collection points have closed operations since the 1 December 2018;

- ? Are any of these "closed" collection points still listed as open for operation on the Return and Earn website, and how soon after closing operations are these collection points removed from the website.

- ? What is the average "up" time for RVM collection points since the Scheme commenced operation.

Incorrect Assumptions

As is well documented, the invoicing of first suppliers since 1 November 2017, was based on various assumptions. In particular, it was based on anticipated container return rates of 100% in December 2017, 90% in January 2018 and 80% in February 2018. With the benefit of hindsight, and perhaps due to the rollout of collection points not meeting plans and expectations, the return rates for eligible containers has in no way aligned with the original expectations and budgetary forecasts.

With an average of 300m containers being put into the market every month in NSW by beverage manufacturers, this means that for the first three months of the Scheme, some 900m containers were distributed across NSW. At the time of writing this submission, the ABCL notes that the Return and Earn website indicates that only about 145m containers have been returned, or about 16%, which is a far cry from the 100%, 90% and 80% expected and budgeted.

Without being unnecessarily critical, but rather factual, the assumptions upon which all pricing and invoicing calculation have been based on by the Scheme in NSW have proven to be completely overstated and inaccurate. As a consequence, we ask, how can industry, and in particular beverage manufacturers, be held to account for implementing new pricing regimes, when the cost modelling presented to them by the Scheme Coordinator, and the NSW Government was so wrong, and so inaccurate?

If anyone should be scrutinised in relation to the impact of CDS on beverage prices and competition, then surely the NSW Government should be reviewing the operation and impact of its own Scheme.

Late Publishing of Scheme Costs

Of course, it is also worth noting that E4C, the NSW Scheme Coordinator, only published the estimated costs for CDS levies for beverage suppliers on 18 August 2017. This was only 53 business days, or some 10 weeks prior to the commencement of the CDS for our industry.

By this date, all beverage suppliers had completed their financial year budgets, unsurprisingly well prior to this CDS pricing announcement. The announcement as to the cost of the tax upon industry by Government was far too late and significant regard must be had for Government's role in this situation after the EPA continually deferred their decision making and the announcement of key matters directly effecting the Scheme.

Furthermore, this inadequate notice, failed to allow beverage suppliers to undertake necessary price modelling which significantly hampered negotiations between beverage suppliers and their customers, beverage wholesalers and retailers in relation to price adjustments.

Lack of Guidance

We also note the formal advice from the NSW EPA (Return and Earn) that it advises that "*any scheme participant should form its own opinion on the future implications to their business*."[2] in relation to future CDS charges.

This lack of guidance from the organisation imposing the Scheme costs, the entity who has undertaken all of the relevant modelling and has developed all pertinent assumptions is clearly inadequate, and leaves Scheme participants, including Beverage Manufacturers, with little or no choice other than to act conservatively in undertaking their pricing methodology.

No Regulatory Impact Statement on Bill

The ABCL was surprised when the NSW Government released its draft Bill to introduce CDS in NSW, that in Division 4, Part 5 of the draft Bill a provision created a statutory exemption to the requirements under Section 5 of the *Subordinate Legislation Act* 1989, specifically exempting the requirement to undertake a regulatory impact statement for the first principal regulation made when the Bill was to be passed.

At the time, we stated to the NSW Government that the NSW Department of Finance, Services and Innovation on their website at https://www.finance.nsw.gov.au/better-regulation stated that:

> *"Better regulation leads to a better-performing economy, makes it easier to start and operate a business, increases the competitiveness of doing business in NSW, and improves customer satisfaction with government services.*
>
> *The NSW Government is committed to best practice regulation. The requirements of the Guide to Better Regulation remain current."*

Moreover, that website further states that the seven principles of Better Regulation include that:

> *"The principles should be applied when designing and developing regulatory proposals. This ensures that each proposal is required, reasonable and responsive to the economic, social, and environmental needs of business and the community.*

[2] Exchange for Change, at http://returnandearn.org.au/Assets/pdf/ReturnandEarn_SchemeCosts.pdf at page 10

1. *The need for government action should be established*
2. *The objective of government action should be clear*
3. *The impact of government action should be properly understood by considering the costs and benefits of a range of options, including non-regulatory options*
4. *Government action should be effective and proportional*
5. *Consultation with business and the community should inform regulatory development*
6. *The simplification, repeal, reform or consolidation of existing regulation should be considered*
7. *Regulation should be periodically reviewed, and if necessary reformed to ensure its continued efficiency and effectiveness"*

We find it incongruous as to why when introducing such a revolutionary and wide-reaching piece of legislation, which was to impact Government, Industry and Consumers and effect the political, the social and the economic climate across the entire State, that the NSW Government turned its back on its own declared processes for developing and implementing "Better Regulation".

The ABCL believes that IPART must consider this omission when undertaking its review as a properly conducted and proactive regulatory impact statement process may well have pre-empted the Scheme deficiencies which have since arisen, and it would most certainly have considered the impacts on container beverage prices and competition. The ABCL asks, why did Government choose not to undertake this assessment then, yet it does now?

Container Registration Costs

We note that in NSW, the EPA (in accordance with the legislation) is imposing an $80 container registration fee upon Beverage Manufacturers for registering their eligible containers. In addition, a renewal fee is to be charged after five years.

As IPART notes, currently there are 7,505 containers registered in NSW. This means to date the EPA has raised some $600,400 in revenue from container registrations, which is a Scheme cost, directly transferrable to manufacturers and eligible to be passed on to consumers.

Both the Queensland and ACT Governments in developing their Schemes have already confirmed that they will NOT be charging a container registration fee.

The Western Australian Government have similarly indicated they do not intend to introduce a container registration fee.

In Queensland, the Scheme Coordinator, called a Producer Responsibility Organisation (PRO) in that jurisdiction, has assumed delegated responsibility for registering eligible beverage containers. The Qld PRO has indicated there will be no charge to manufacturers (which in actual fact is now enshrined in legislation), and they

will undertake this function using the existing and readily available GS1 barcode database, which will only incur a negligible administrative cost.

The introduction of CDS in NSW was not and should not be an opportunity for the EPA to generate revenue and ultimately profit from the Scheme.

The ABCL calls upon IPART to investigate whether the actions of the EPA, in charging a fee for initial container registrations (and renewals), constitute profiteering from the introduction of the Scheme, and an unnecessary cost impost imposed upon both manufacturers and consumers.

EPA Compliance Costs

The ABCL would like IPART to consider the imposition of the EPA Compliance Costs to monitor compliance with the Scheme.

The ABCL calls upon IPART to review, and we call upon the NSW Government to declare, the exact amount of these EPA Compliance Costs as we believe these costs could be as high as $5m per annum.

On the basis that the Scheme Coordinator, E4C is responsible for conducting all auditing of Beverage Manufacturers to ensure their declared container numbers are accurate, we are unsure what this compliance fee is for, as we understood that it was E4C, the Scheme Coordinator who was charged with the compliance function.

The ABCL calls upon IPART to consider this cost and transparently report both the amount and the justification for its imposition.

We reiterate our previous comment that the introduction of CDS in NSW was not, and should not be an opportunity for the EPA to generate revenue.

Monopoly Network Operator

The ABCL is concerned that the NSW Government in appointing Tomra Cleanaway as a monopoly network operator and collection point operator, has eroded competition and cost efficiencies which would have been achieved if other entities had been granted a commercial opportunity to operate in the network and collection point space.

The ABCL calls upon IPART to consider whether this decision has had a fundamentally adverse impact upon costs to the Scheme..

Woolworths

We note that within the Centre for International Economics' (CIE) report prepared for IPART, titled "*Monitoring the impacts of the NSW Container Deposit Scheme",* that on Page 10 of that report, a question is raised concerning "*whether the role of Woolworths as a major supplier of collection depots has a meaningful impact on competition in this sector*"?

It is our understanding, that Woolworths does not receive any direct financial benefit from the installation of RVMs adjacent to their supermarket sites, (except reimbursement for utility expenses to operate the RVM, where Woolworths owns the site).

We understand that Woolworths does not earn any handling fee nor any commissions for containers returned through these RVMs at these sites.

This of course rebuts the question raised by the CIE, as Woolworths is not a major supplier of collection depots, contrary to the suggestion of the CIE.

Role of Beverage Manufacturers in Retail Price Setting

Another major consideration is the somewhat limited role beverage suppliers have in relation to setting retail prices for beverages.

Between the time a beverage container leaves a manufacturers facility, it has its retail price impacted by at least one, and on some occasions, two other commercial entities.

A beverage manufacturer will invariably either sell their product to a wholesale distributor or a retailer. When sold to a wholesale distributor, the beverage product will then be on-sold to a retailer.

In both of these cases, the ultimate retail price is set by a commercial entity or entities, other than the manufacturer, the organisation who the tax was imposed upon in the first instance.

As a consequence, any analysis of retail beverage pricing, using indicators such as CPI, must have regard for who is actually setting and or influencing pricing decisions.

To this point, some early price modelling which ABCL undertook involved a pricing analysis for a 2L bottle of Carbonated Soft Drink which was retailing pre-CDS for $2.00 and a 30 Pack of 375ml cans of Carbonated Soft Drink which was retailing pre-CDS for $19.99.

As a part of this exercise, the ABCL assumed a CDS deposit of 10 cents per container and a handling fee of 8 cents per container.

In this example, the container deposit and handling fee, are effectively just treated by the beverage manufacturer as an additional part of 'cost of goods sold' or as a normal production cost.

Here the CDS levies are passed on by the manufacturer 'at cost', that is, 18 cents, in our example.

From that point, it depends upon the price modelling of the retailer (and/or wholesaler) and whether they impose:

(1) their gross margin on top of the CDS levies; and

(2) whether they also impose the GST upon this figure.

See for example the impact upon this below:

	Carbonated Soft Drink				
	2 Litre Bottle			30 Pack 375ml Cans	
	Today	Under CDS		Today	Under CDS
Shelf Price inc GST	$2.00	$2.35	Shelf Price (30 Pack) inc GST	$19.00	$29.80
GST	$0.18	$0.21	GST	$1.73	$2.71
Shelf Price ex GST	$1.82	$2.14	Shelf Price ex GST	$17.27	$27.09
Retailer Gross Margin (45%)	$0.82	$0.96	Retailer Gross Margin (45%)	$7.77	$12.19
Unit Cost	$1.00	$1.18	Unit Cost (per can)	$0.32	$0.50
CDS Handling Fee/Levy	$0.00	$0.08	CDS Handling Fee/Levy	$0.00	$0.08
CDS Container Refund	$0.00	$0.10	CDS Container Refund	$0.00	$0.10
Cost price	$1.00	$1.00	Cost price	$0.32	$0.32
Unit Cost	$1.00	$1.18	Unit Cost	$0.32	$0.50

Specific Issues IPART Seeks Comment on

Issue 1

Do you agree with our proposed approach to include in our price analysis:
– the retail price of all container beverage products regardless of whether they are covered by the CDS
– the period before and after the introduction of the CDS?

The ABCL has no issue with this approach, as it will also indicate normal CPI and industry-initiated price rises which can be used as a benchmark against post CDS price increases.

Issue 2

Do you agree with the two proposed approaches for evaluating the impact of the CDS on beverage prices:

– measuring overall price changes (trends) using price indices for beverages published by the Australian Bureau of Statistics (ABS)
– quantifying the extent to which the costs of the CDS are passed through to beverage prices using product level price data

The ABCL has no issue with this approach, however it needs to be recognised that there are a number of limitations on what conclusions can be drawn and regard must be had for:

- Who is responsible for any price increase above and beyond regulated CDS costs as it may be impossible to identify who is responsible for any additional price increase?

  This will be especially so, as many purchasing agreements are commercially confidential. Any analysis needs to be careful not to make unfair or inaccurate assumptions.

- Beverage Manufacturers are free (at law) to determine whether they will pass on 100% of CDS charges, or none of them, or any amount in between.

- Beverage Manufacturers who treat CDS charges as just another production cost, as a part of Cost of Goods Sold (CoGs), are quite entitled (at law) to add their normal gross profit margin on top of the total CoGs amount. This would be a quite legitimate commercial pricing practice.

  Having said that, we are unaware of any Beverage Manufacturer who has adopted this pricing strategy and to our knowledge, Beverage Manufacturers have not included a 'margin' on top of CDS charges.

The Beverage Industry is a high volume low margin industry, which operates in a very cost sensitive, budget driven consumer market. As a consequence, opportunities to over inflate beverage prices are extremely limited and market forces simply do not permit such latitude.

- Reasonable CPI price rises must be taken into consideration in assessing any price increases in addition to CDS price increases.

Issue 3

What are the relevant markets for our competition impact assessment?

The relevant markets are the retail beverage market including supermarkets, cafes, restaurants, convenience stores, hotels, registered clubs and the like.

Issue 4

Are there any further competition indicators to those listed in Table 5.1 that we should consider in making our assessment?

We are satisfied with this Table.

Issue 5

How has the commencement of the CDS affected competition in the container beverage industry, in particular for small and medium sized enterprises and any cross border issues?

The ABCL does believe that the introduction of CDS has negatively affected competition in the container beverage industry, in particular for small and medium sized manufacturers. We believe that the ability of small and medium sized manufacturers to cope with the added administrative burden, which CDS 'red tape' adds to business operations, has caused difficulty to these entities, lessening their ability to focus on core activities and better compete in the marketplace. Larger manufacturers arguably have had a greater ability to cope with the additional administrative burden and so arguably the impact has been greater the smaller the business.

More particularly, being required to pay CDS levies in advance has caused significant cash flow issues and financial hardship to beverage manufacturers, both small and large alike. Arguably though the impact is greater the smaller the entity, as often they have less cash reserves.

The ABCL holds real fears that when further CDS's are implemented in other Australian States, that if those States also invoice 'in advance', that some manufacturers may simply be unable to cope financially and will have insufficient cash reserves to seed fund these government-imposed schemes, forcing these businesses to cease operations.

This problem is exacerbated by the fact that the industry standard commercial terms of trade imposed by major retailers are payment 90 days in arrears. This means Beverage Manufacturers can be 'out of pocket' for CDS levies for up to 120 days before being paid by their customers, replenishing funds outlaid to the NSW Government.

More holistically, we note IPART's acknowledgement that there is no price regulation in the beverage industry, and that all industry participants in the supply chain can determine how to allocate their costs and set prices for their products. [3] This is provided they act appropriately within the bounds of Australian consumer law.

We also note IPART's acknowledgement that previous assessments of the beverage industry in NSW have either not revealed substantial concerns about competition, or have found there is 'workable competition' in the industry.

We note IPART's recognition that *'workable competition' means there is enough rivalry between firms so that over the long run, prices are determined by underlying costs rather than any market power and where there is workable competition there is no need for any government intervention in relation to prices*.[4]

In addition, we note the EPA's own Regulatory Impact Statement (RIS) which was prepared before the scheme commenced found that the NSW CDS would not restrict competition in the market for container beverages.[5]

Issue 6

Has the introduction of the Scheme Coordinator, Network Operator and other participant bodies in the CDS affected the competitive dynamic in the beverage market?

The ABCL does not believe that the introduction of the Scheme Coordinator, Network Operator and other participant bodies in the CDS has had any affect upon the competitive dynamic in the beverage market.

Issue 7

Do you agree with our proposed approach to monitoring complaints from customers and other scheme participants about the performance and conduct of suppliers in the beverage market?

Yes, provided that regard is had, for vexatious or disgruntled consumers who are opposed to price increases inherently. Regard must be had for consumers who are completely opposed to price rises which have been quite legitimately imposed due to the introduction of CDS. A recent consumer survey has revealed that support for CDS is declining as consumers understand they are now paying more for beverages to cover the cost of the Scheme, something previously not communicated to them.

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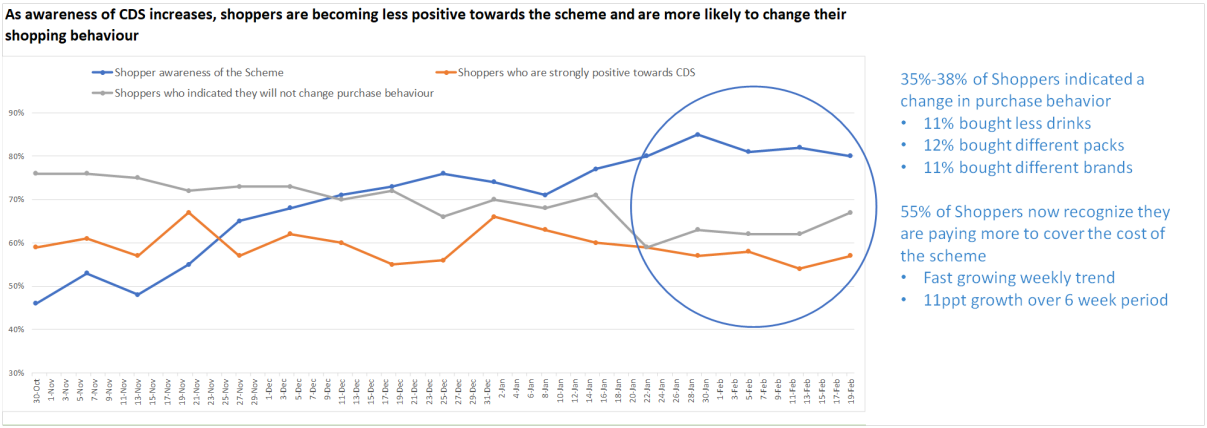
[3] op cit 1 page 12
[4] ibid
[5] NSW Container Deposit Scheme – Consultation Regulation Impact Statement at Page 32, NSW EPA 2017



Source: Koji & Coca-Cola South Pacific, 2018

Issue 8

Do you agree with our proposed criteria in section 5.4 for deciding whether to refer any behaviour or market outcomes that appear unfair or unjustified on consumers or scheme participants to the relevant regulator?

As this matter in not an area in which IPART traditionally operates in, our view would be that natural justice should be afforded in the first instance. We believe that before referring any behaviour or market outcomes that appear unfair or unjustified on consumers or scheme participants to a relevant regulator, the beverage manufacturer, wholesaler or retailer concerned should be afforded a reasonable opportunity to respond to any allegation and outline its position.

Contact

To discuss this submission or any recommendation contained therein, please contact Mr Alby Taylor on 0407 406 400 or via alby@ausbev.org