

Review by the

Australian Competition and Consumer Commission

into the

Relative financial and corporate differences between Friendly Society Pharmacies and pharmacist owned pharmacies and whether this adversely affects competition in the pharmacy industry

**Submission
of**

Australian Friendly Societies Pharmacies Association Inc

(AFSPA)

30 August 2002,

Australian Competition and Consumer Commission
GPO Box 1199
CANBERRA ACT 2602

Attention: Ms Jaime Norton
cc Professor Allan Fells

Dear Ms Norton,

I refer to the letter from Ms Jennifer Moore of 19 July 2002 advising my Association that the Australian Competition and Consumer Commission (ACCC) had received a request from the Treasurer that it undertake a review into the relative financial and corporate differences between Friendly Society Dispensaries (FSDs¹) and pharmacist owned pharmacies and whether this adversely affects competition in the pharmacy industry.

In her letter Ms Moore advised that the reference for this Review is as follows:

“[The ACCC] will need to consider whether the tax treatment of FSDs and other competition related factors provide FSDs with significant competitive advantages over pharmacist owned pharmacies”

I refer also to a meeting with yourself and other Commission officers including Commissioner Sitesh Bhojani in Canberra on Thursday 8 August when you kindly agreed to discuss the conduct of the Review and some of the issues that may be of relevance to the Commission’s review.

In the course of this meeting a number of issues were raised and discussed to the satisfaction of both parties. However there were three key issues that were not resolved to the satisfaction of my Association and for the record these are detailed as follows:

1. A full copy of the Treasurer’s letter requesting the ACCC to undertake this review was declined.

The request for a copy of this letter was made because AFSPA believed that it would have provided background information to the particular circumstances that the Treasurer was concerned about which prompted his request to your Commission to conduct this review.

¹The descriptor Dispensaries dates from the 1840’s when Friendly Societies established the first ones in Australia. It still appears in some legislative provisions but has largely been replaced by Pharmacy. Friendly Society Pharmacy/ies was used by Wilkinson, the Prime Minister’s letter to pharmacists 9 October 2001 and the COAG Working Group’s Report released 2 August 2002.

Knowledge of this background would have been helpful in the preparation of this submission in ensuring the issues covered were both comprehensive and relevant.

2. The Commission was not able to agree that copies of the submissions made to this Review would necessarily be provided to AFSPA for it to respond to.

This review has both a context and a history. It is fundamentally unfair to this Association and its members that they alone must assume the burden of satisfying this Review that present taxation laws, properly applied to its members, do not “adversely affect competition in the community pharmacy industry”.

3. The Commission was not able to agree that a copy of its response to the Treasurer would be released. It considered that this was up to the Treasurer.

This Review has come about because of a recommendation made by a National Review conducted in accordance with the provisions of the National Competition Principles. Legislative reform by the States of identified restrictive practices that affect only Friendly Society Pharmacies could be seriously jeopardised if the outcome of this Review is not going to be advised to the parties invited to make submissions.

These points are made for the record and are recommended for consideration by your Commission.

Notwithstanding these issues, it is AFSPSA’s desire and intention to provide your Commission with whatever information or material that you require, for the successful completion of your Review.

Against this background AFSPA’s submission is now attached for your consideration.

Yours sincerely

A handwritten signature in black ink that reads "Jim Howard". The signature is stylized with a large, sweeping initial "J" and a long horizontal stroke extending to the right.

Jim Howard
President

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Executive Summary

- 1. This submission by the Australian Friendly Societies Pharmacies Association Inc. is made on behalf of all Friendly Society Pharmacies. It strongly advocates that a review by the ACCC of the relative financial and corporate differences between friendly society dispensaries and pharmacist owned community pharmacies as requested by the Treasurer will confirm that the differences that do exist do not adversely affect competition in the pharmacy industry.**
- 2. Friendly Society Pharmacies are not-for-profit entities that have been operating pharmacies in Australia since 1847 when the first Friendly Society Dispensary was established. Since that time the organised representatives of the commercial pharmacists have consistently opposed their operations.**
- 3. The record shows that this opposition has always really been about the not-for-profit status of these societies and that they are owned by members who are not pharmacists.**
- 4. It is this Association's submission that a comparison of the taxation arrangements that apply to Friendly Society Pharmacies from their mutual status does not provide a significant competitive advantage when compared to the myriad of other financial arrangements available to the pharmacist owner for tax effective business outcomes. In contrast, Friendly Society Pharmacies are properly and legally restricted in their structures.**
- 5. Friendly Society Pharmacies provide the only alternate model for the delivery of pharmacy services in the community pharmacy industry and in those communities where they operate they provide that community with some choice and competition in their purchase of pharmacy services.**
- 6. The community pharmacy industry is part of the health care industry where there is nothing unusual about mutual not-for-profit entities competing directly with for-profit ones in the delivery of services. Mixed model industries provide choice and diversity to the consumer and enhance the competitive environment.**

1. **Background to the Review**

In accordance with the National Competition Principles (NCP) Mr Warwick Wilkinson AM conducted a National Review of pharmacy legislation. His Final Report was presented to the Prime Minister on 8 February 2000.

In his consideration of the restrictive legislative provisions applying to Friendly Society Pharmacies and their continuing role in the community pharmacy industry the Review made the following recommendation:

Recommendation 5

The Review recommends that:

(c) The relative financial and corporate arrangements of pharmacist-owned pharmacies and friendly society pharmacies, as these may affect the competitiveness of these pharmacies with each other, could be referred for definitive advice to the Australian Competition and Consumer Commission (ACCC), or another agency or authority of comparable and appropriate standing; and

(d) The findings of any such inquiry may be taken into account as part of legislative reform processes in this regard.

Consequently, this Report was considered by a Working Group of Senior Officers established by COAG to provide a co-ordinated response. The Working Group first reported to the Prime Minister in August 2001. At that time the Working Group reported on Friendly Society Pharmacies as follows:

- it concluded that there was no sound reason for applying differing pharmacy laws to Friendly Society Pharmacies to pharmacist owned pharmacies; and
- it noted that there has been much made of the advantages or otherwise that they receive from taxation arrangements that flow from their mutuality status but concluded that they do not have a competitive advantage.

In reaching these conclusions the Working Group reported that it had commissioned a report from accountancy firm Walter & Turnbull and sought advice from the ACCC which advised that it would not be appropriate for it to provide advice in this area.

Subsequently on 9 October 2001 the Prime Minister wrote to all pharmacist owners advising them that in recognition of their strong interest in the Wilkinson Report's handling of amongst other things the taxation treatment of their friendly society competitors, the Government would refer taxation and related aspects of this matter to the ACCC for advice immediately upon re-election².

On 2 August 2002 the Prime Minister released the final report of the Working Group which now incorporates this decision.

² Letter from Prime Minister to Pharmacists 9 October 2001

2. Friendly Society Pharmacies

Friendly Society Pharmacies are not-for-profit entities, which have owned and operated pharmacies continuously since the 1840's. They are representative of the long tradition of community services provided by many entities in a range of industries but especially in the primary health care and related industries.

Although they have operated continuously since the first Friendly Society Dispensary was established in Sydney in 1847 their operations have always been bitterly opposed by the representatives of the commercial pharmacists.

The purpose of the Friendly Societies in establishing their own Dispensaries was to ensure the supply to their members of quality medicines as prescribed and at affordable prices. They were able to do this because the Dispensaries were established and operated on true not-for-profit principles.

The restrictive provisions were introduced for commercial and economic purposes for the benefit of the commercial pharmacist and not for professional reasons or on public health grounds. The parliamentary debates of the day made this quite clear³.

However, since then and gradually over time the present legislative restrictions applying to Friendly Society Pharmacies have been increasingly represented and promoted as being required in order to protect the community on public health grounds⁴.

3. Restrictive Practices in the Community Pharmacy Industry

Restrictive practices first commenced to be introduced during the 1940's when the ownership of pharmacies by pharmacists only were introduced. This was in response to a perceived threat from the overseas pharmacy chain Boots.

The Pharmacy Acts in each jurisdiction were amended to provide that a community pharmacy could only be owned by a registered pharmacist or partnerships of same and incorporation of owners was prohibited with grandparenting provisions for companies owning pharmacies at the time. Restrictions on the number of pharmacies able to be owned were also introduced.

At the time the support of the Friendly Society Pharmacy movement was sought by the Guild. In return for their support membership to the Guild was offered. The Friendly Society Pharmacies refused to join the campaign even though it was recognized that ultimately this could bring about their own demise.

The reasons for not joining in with the Guild's campaign then were simple. If Boots had been able to set up operations here in Australia it would have meant lower prices for both their members and the public; joining the Guild and keeping Boots out meant being required to adhere to the Guild's pricing schedules. Ensuring access to pharmaceutical

³ AFSPA Submission to National Competition Policy Review of Pharmacy July 1999 page 15.

⁴ Pharmacy Boards (various eg Queensland) Submissions NCPR of Pharmacy

products at affordable prices was *the reason* for their existence. Joining forces would have been in contradiction to that principle⁵.

Initially Friendly Society Pharmacies were excluded from the operation of the restriction on the number of pharmacies allowed to be owned. This changed quickly as again State governments were persuaded to restrict any further growth in the number of Friendly Society pharmacies by introducing requirements that any new pharmacy premises required Ministerial approval in NSW, QLD and WA. In SA the Friendly Society Medical Association (trading as National Pharmacies) was restricted to the 26 pharmacies it then owned.

Since then further restrictions have recently been introduced. In November 2001 the number of pharmacies allowed to be owned by a Friendly Society Pharmacy in Tasmania was changed from unlimited to a total of 2. In the Australian Capital Territory (ACT) where Friendly Society Pharmacy ownership was permitted, the Pharmacy Act in that jurisdiction was amended in August 2001 to require that for a company wishing to own pharmacy 50% of the directors are required to be pharmacists or close relatives of a pharmacist.

In contrast to this, directors of a Friendly Society Pharmacy in accordance with the provisions of the Corporations Law are required to be elected by the members of the Society at an AGM and any member is eligible to stand for election thus they are now excluded from that jurisdiction or of course any other that is persuaded to make similar provisions.

4. Pharmacy Industry Legislation

Unlike almost all other small businesses in Australia a community pharmacy owner is, on the one hand, subjected to the highest level of regulation at both the State and Federal level but on the other hand also enjoys a high degree of protection from competition because of legislative provisions relating to ownership, number of pharmacies, location and pharmacy only products schedules.

5. Current Legislative Provisions Regulating Pharmacy

Essentially, current provisions can be described as follows:

- a) State Legislation under the various Pharmacy Acts provides for the regulation of:
 - Registration of those allowed to practice the profession of pharmacy;
 - Registration of those allowed to own a business for the purpose of conducting a pharmacy business;
 - Registration of, and in relation to Friendly Society Pharmacies the location of premises where the business of pharmacy is allowed to be conducted; and

⁵ Mutual Aid or Welfare State David Green & Lawrence Cromwell 1982 ISBN 86861 656 7 (hardcover) 664 8 (paperback)

- Regulates the sale and distribution of drugs and poisons on a uniform scheduling basis coordinated by the National Drugs and Poisons Scheduling Committee; the schedules regulate which drugs and poisons can only be distributed by pharmacists or through pharmacies.
- b) Commonwealth Legislation regulates:
- Approval to supply pharmaceutical benefits in accordance with the provisions of the *National Health Act 1953* and the rules determined by the Minister under that Act;
 - Approval of the location of premises from which an approved pharmacist may supply pharmaceuticals under the Pharmaceutical Benefits Scheme (PBS);
 - Cancellation of that approval in certain circumstances;
 - Which drugs are to be supplied under the PBS;
 - The amount of patient contribution to be paid for drugs supplied under the PBS and the prohibition of any discounting of that contribution;
 - The Pharmaceutical Benefits Remuneration Tribunal (PBRT) and determinations made by it;
 - The Australian Community Pharmacy Authority (ACPA), its functions and the Rules in accordance with which it must make its recommendations for the approval of the location of pharmacy premises to the Secretary of the Department of Health and Ageing;
 - The National Standard for the Uniform Scheduling of Drugs and Poisons;
 - By negotiation/agreement the wholesale price at which PBS medicines are supplied to pharmacists; and
 - The Guild/Government Community Pharmacy Agreement (CPA).

6. **The Review**

The purpose of this Review is to undertake a review into the relative financial and corporate differences between friendly society dispensaries and pharmacist owned community pharmacies and whether this adversely affects competition in the pharmacy industry.

The reference for the review is as follows:

“(The ACCC) will need to consider whether the tax treatment of FSDs and other competition related factors provide FSDs with significant competitive advantages over pharmacy-owned pharmacies.”

7. **The Issues**

1) Relative financial and corporate arrangements of Friendly Society Pharmacies and pharmacist-owned pharmacies.

The form of Recommendation 5 (c) of the Wilkinson Review recognised that there are some significant differences between the two types of pharmacies. A proper examination of the advantages and disadvantages presented by a corporate structure for a business compared to the variety of non-corporate business arrangements allowed by the present

Pharmacy Acts for owner-pharmacists has been overshadowed by the single issue of taxation.

This view was accepted by the Working Group when it stated in its conclusion on its considerations of the continuing role of Friendly Society Pharmacies in the community pharmacy industry as referred to earlier.

It is AFSPA's view that the position taken by the Guild in this regard is a very narrow one and reflects only the vested interests of its members and their desire to continue to be protected from the proper application of the National Competition Principles. Such a stance also ignores the community and the benefits that may flow to it by removal of the legislative provisions as recommended by the Wilkinson Review and endorsed by the Working Group for the reasons detailed by each of them.

These issues were addressed substantially in submissions made to the Wilkinson Review and then again to the Working Group but for the assistance of this Commission's task are addressed again below.

(a) Taxation

Friendly Society Pharmacies have been subjected to claims of unfair competitive advantage for over 100 years now. During that time the income taxation regimes and systems have undergone great changes. Whatever taxation arrangements have applied the record of parliamentary debates during that time record the hostility of pharmacist owners to the continued existence of the Friendly Society Pharmacies.

It has consistently been advocated by this Association that taxation is not the real issue. The real issue is that Friendly Society Pharmacies are not-for-profit entities and they are owned by members who are not pharmacists.

As evidence of this submission it should be noted that the present taxation arrangements only came into effect in the income year 1982-83⁶. These changes repealed the then existing special taxation arrangements then applying to Friendly Society Pharmacies.

The special basis taxation referred to in the Budget Speech was an unfair and onerous effective 10% turnover tax regardless of positive earnings or otherwise.

Prior to its repeal there had been three Committees of Inquiry⁷ each of which recommended its repeal. Income tax laws are constantly under review and what applies in one decade may not apply in another.

For purposes of illustration the following material was prepared in accordance with taxation provisions applying at August 2000. On the basis that this Review is concerned with the principles of applicable taxation provisions and not rates of taxation that may apply from time to time, they have not been amended to reflect tax changes effected since.

⁶ Income Tax Laws Amendment Bill (No 3) 14 October 1981 Senate Hansard Page 1199

⁷ Committees of Inquiry: Spooner 1952; Ligerwood 1961 and Asprey 1975

For taxation purposes a Friendly Society Pharmacy was assessed at the company taxation rate of 36% but the profit component of members' trading is exempted (mutuality principle). Pharmaceutical Benefits Scheme (PBS) payments from the Health Insurance Commission (HIC) are assessable income whether generated from members or non-members.

An example of the tax calculation of a Friendly Society Pharmacy (where a ratio of 6:4 members to non-members is assumed)

Revenue		
PBS		650,000 (50%)
Shop and script transactions (members)		390,000 (30%)
Shop and script transactions (non- members)		<u>260,000 (20%)</u>
TOTAL		1,300,000
Expenses		1,170,000
Pharmacist salary		<u>70,000</u>
NET PROFIT		60,000
Less mutuality component (30%)		<u>18,000</u>
TAXABLE INCOME		42,000
TAX PAYABLE at 36%		15,120

(In order to compare with a sole trader situation the total tax paid needs to include that paid by the pharmacist eg \$23,502 hence total tax paid is \$38,622)

A commercial pharmacy for taxation purposes may have a variety of business structures including:

- Sole Proprietor;
- Partnership;
- Proprietor/Service Trust/Family Trust mix;
- Dispensary/Shop split (where the shop may operate as a company and the dispensary operates as a proprietorship or partnership to meet Pharmacy legislation provisions).

Each of these structures permit differing forms of tax minimisation from the higher individual income tax assessment rate of up to 47% eg:

- a) Sole traders and partnerships may exercise Superannuation contributions to minimise their taxation liability;
- b) The trust structure distributes the income across a number of individuals thereby having the income assessed at a lower income tax bracket;
- c) Dispensaries can be operated as a break even (or loss) concern through rents and management fees in order that all profit is generated within the shop structure which can be a company thereby attracting a lower income tax rate.

Some examples of the tax treatment of the above models assuming the same levels of income and expenditure as with a Friendly Society Pharmacy are as follows:

Sole Proprietor

Revenue		1,300,000
Expenditure		<u>1,170,000</u>
	TAXABLE INCOME	130,000
	TAX PAYABLE as an individual	51,702

Sole Proprietor/Trust mix

Pharmacist		
Revenue		1,300,000
Expenditure and Management Fees (10% of expenses)		<u>1,287,000</u>
	TAXABLE INCOME	13,000
Trust		
Management Fees		117,000
Pharmacist TAXABLE INCOME (13,000 + 50% of 117,000)		71,500
	TAX PAYABLE	24,207
Trust Recipient TAXABLE INCOME (50% of 117,000)		58,500
	TAX PAYABLE	18,097
	TOTAL TAX PAYABLE	42,304

Dispensary/Shop split

Dispensary TAXABLE INCOME (break even operation)		NIL
Shop TAXABLE INCOME		130,000
	TAX PAYABLE (at 36%)	46,800

A number of Friendly Society Pharmacies are large enough to bring them within the scope of State/Territory payroll tax provisions which range between 5-7% of salaries paid. Although the rate appears low the tax paid can result in a higher effective rate of taxation on net profits. Most commercial pharmacies do not attract payroll tax as their salaries expenditure does not meet the thresholds necessary to incur a liability.

Some Friendly Society Pharmacies are paying in the order of 20-30% of net profits in payroll tax, which equates to those Societies paying an effective rate of around 45% in taxation.

(b) Equity and the Use of Tax Expenditures as Policy Tools

During 1998 the Ralph committee undertook a full review of Australia's tax laws. That committee, in taxation terms, described in a Discussion Paper horizontal equity as being, broadly, taxpayers (including business entities) in similar circumstances should be taxed similarly. Vertical equity was described also broadly, as being that tax burdens should depend on ability to pay and that those more able to pay (should pay) more tax.⁸

That Discussion Paper focused on business taxation policy and to what extent business tax should be based on horizontal equity allowing the personal tax system and social security and related payments systems to reflect vertical equity concerns. It particularly looked at the operation of the mutuality principle as part of the business tax system.

It concluded that the mutuality principle should continue to be applied to certain business entities *including friendly societies and their dispensaries* and that this should be given explicit effect to in the tax law⁹

The purpose of principles such as mutuality within tax laws is to enable what are described as "taxation expenditures" to be used to purchase services for the community that would otherwise be foregone by Government or for-profit providers. The taxation arrangements that apply to Friendly Society Pharmacies, and as have been recommended for retention by the Ralph review, as a consequence of the principle of mutuality results in the same beneficial outcomes.

For-profit entities provide services for which the profit margins are within commercial benchmarks in order to provide a return on capital invested. In contrast the emphasis of not-for-profit entities such as Friendly Society Pharmacies is to return surpluses as a proportion of business conducted to fund services that, because of lower (or negative) profit margins, would not be undertaken by the purely commercial for-profit entity.

Members (and the community) benefit from this by receiving discounts on all "front of shop" transactions and the costs of private prescriptions. This is at the core of the reason for first, the establishment of our dispensaries in the beginning, second the reason for their continued existence and third for their right to not only continue to exist but to be able to grow.

Not-for-profit entities do not participate in business activities for the same commercial purposes and reasons as for-profit entities. Their purpose is to serve their members and their communities and any surplus income goes back into the business to fund asset replacement and the services they provide.

⁸ Review of Business Taxation (RBT) Discussion Paper *A Strong Foundation*. November 1998

⁹ RBT *A Tax System Redesigned* Report, July 1999 (the Ralph Report).

(c) Pharmacist-owned pharmacies, ownership structures and governance

As outlined above, ownership structures for pharmacist-owned pharmacies can take a myriad of forms. The form of ownership structure will be chosen primarily for its tax effectiveness and sometimes for successor reasons.

This complex mix of ownership arrangements, whilst largely chosen for tax effectiveness purposes, also has the effect of disguising actual ownership thus making very difficult the task of Pharmacy Boards to apply their various regulatory powers relating to ownership issues, for example, the total number of pharmacies permitted to be owned by individual pharmacists.

Unfortunately, business entities that are structured largely for tax effectiveness reasons inhibit a business entity from being structured in a manner that gives maximum weight to best practices and the cost of introducing programs such as the Quality Care Pharmacy Program (QCPP).

This is in direct contrast to Friendly Society Pharmacies and their structures. Under the Corporations Law these Societies and their ownership, structure and financial reports are transparent, fully accountable and open to the public.

Their record of commitment to the provision of pharmacy services to the community is not under challenge and their commitment to the provision of quality pharmacy services is evidenced by the number of Friendly Society Pharmacies' pharmacies, which have been accredited under the QCPP compared to pharmacist-owned pharmacies.

2) Factors that adversely affect competition

There are many factors that can be identified as adversely affecting competition. These are well known to this Commission and need not be detailed here. However they can be briefly stated by reference to AFSPA's understanding of the objectives of the National Competition Policy as set out below.

About National Competition Policy (NCP)

Broadly, this package of reforms is directed towards ensuring that every business or industry in the Australian economy that is currently sheltered from competition is opened to it *except for those businesses or industries for which it can be demonstrated that there is a net community benefit in restricting competition.*

This provision is referred to as the public benefit or interest test. This test requires that governments, when reviewing various NCP reform options, must objectively weigh up all the pros and cons of competition including, but not restricted to, its effects on matters such as employment, equity, social welfare, community service obligations and the interests of consumers generally or a class of consumers.

The rationale for competition reform is that, properly harnessed, competition can boost economic performance and enhance consumer welfare. But the reasons go beyond narrow

economic efficiency considerations and touch on matters as, for example, business ethics, environmental sustainability and social equity.

It aims to promote economic goals such as a better allocation of resources between industries and greater flexibility to adapt to rapid changes such as external shocks. The reforms to Government businesses allow them to more transparently address their social obligations as well as providing the opportunity for more informed decisions on whether those obligations are best met by in-house providers or otherwise.

Competition policy also provides a greater element of public scrutiny *and makes it more difficult for governments to provide favours for "friendly" business groups or to strike deals behind closed doors.*¹⁰

The NCP processes do not seek to favour any kind of business over another, nor are they designed to improve the profitability or viability of specific industries themselves. Rather, they are intended to foster conditions in which the businesses that most benefit the community prevail or prosper.

Whilst many sectors of the economy are exposed on a daily basis to the true rigours of a competitive marketplace, some groups are not subject to the same disciplines. As a matter of equity it is right to question the incomes and conditions enjoyed by all special groups *to the extent that those incomes and conditions derive from unwarranted restrictions on competition.*¹¹

3) Significant competitive advantage

Giving the word its ordinary dictionary meaning “significant” means noteworthy, of considerable amount or effect or importance. It is AFSPA’s submission that the taxation arrangements flowing to Friendly Society Pharmacies from their mutual status are not significant. And if there is an advantage, that advantage must be offset against other relevant factors.

Other relevant factors include:

- Expenses of dealing with members are not allowable deductions. Dealings with members include: administrative costs of membership cards, member newsletters, notices of meetings, maintenance of register of members as required under the Law;
- Payment of relevant fees and charges to ASIC; and
- Many Friendly Society Pharmacies are of a size to bring them within State/Territory payroll taxation levels.

¹⁰ Graeme Samuel, President NCC, speech to Economics Society Qld 25 November 1998.

¹¹ Graeme Samuel, President NCC, speech to Australian Retailers Association 30 May 1998

8. Mutuals And Other Industries

There is nothing unusual about mutual not-for-profit entities operating and competing in other mixed model industries. Examples include:

- the liquor industry (hotels and clubs);
- health insurance, (government, private for-profit, and not-for-profit mutuals);
- employment agencies (charities and religions such as Salvation Army, Government and private for-profit entities); and
- hospitals (government, private for-profit, charities and religious[tax exempt] and not-for-profit mutuals).

Nor is there anything unusual about co-operatives, which also have particular tax arrangements applying to them, competing directly with non co-operatives:

- taxis and chauffeured cars; and
- various agricultural industries.

For whatever reasons, the present taxation arrangements makes provisions for a large variety of differing structures applying to personal, private, company, trusts and so on.

The Productivity Commission considered the mutual not-for-profit taxation issue in detail when it studied the Private Health Insurance industry and compared the position of the for-profit entities competing with the not-for-profit ones¹². It found that there is a basis for the argument that there is a distortion but considered that it is likely to be relatively modest. It went on to conclude that any changes to the taxation treatment of the mutuals would raise implementation issues and that the benefits of taxation equivalence would have to be set against a range of other costs including redistribution elsewhere for the cost of the benefits foregone.

It is not appropriate, nor necessary, for the purposes of this Review for this submission to attempt any analysis of these arrangements. It is only necessary to draw your attention to the fact that the present income taxation laws contemplate and make provision for a complex variety of different provisions for different structures and for differing reasons. All of which were examined in detail by the Ralph Review.

9. Capacity Of Non Friendly Society Pharmacies To Compete

The capacity of entities to compete in any industry is dependent on many factors and includes the regulatory environment and the barriers to entry of the industry concerned.

Importantly it also depends on the amount of surplus profit taken out of the business as the owner's return on capital invested and the amount retained to fund new services, replacement equipment, upgrades and training and similar.

¹² Productivity Commission *Private Health Insurance* p358 and Appendix E Taxation Issues (1996)

As detailed above the community pharmacy industry is very highly regulated and the barriers to entry into the industry are particularly high. The controls relating to approvals to open new pharmacies and the location and relocation Rules as negotiated by the Guild with the Commonwealth under the Agreement process provide a level of protection between pharmacy owners from competition within each other's market.

These factors combined with the limited range of transactions where discounting is allowable, reduces the scope for competition even further. Accordingly, it could be expected that the surplus income of either the for-profit entity or the not-for-profit one should be sufficient to ensure competitive capacity between the entities.

10. Competitive Advantage Not Anti-Competitive

It has been claimed that the corporate status of Friendly Society Pharmacies gives them an unfair competitive advantage.

The organisational structure of Friendly Society Pharmacies has effectively not changed since they were first established in the mid 1840's and onwards. They have always been member based with elected officers and a Constitution or set of Rules familiar to anyone that has ever been a member of a community based organization.

What has changed over the long period of time since their establishment is first, State legislative provisions governing the administrative and financial conduct of such organizations were gradually introduced during the 1900's regulating certain entities and now most recently Commonwealth provisions.

Effective from 1 July 1999 the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1999* transferred a range of entities including, the non financial Friendly Society Pharmacies to the Corporations Law thus changing their status to companies under that Law and imposing on them the requirement to meet all the provisions of that Law.

Competitive advantages can take many forms and can range from excellent location and plentiful car parking facilities to superior staff, better services or lower prices.

A competitive advantage is not by definition anti-competitive.

To be anti-competitive the advantage must have some characteristic that either brings it into breach of the *Trade Practices Act 1974* or is of a regulatory nature that protects a market or participants in that market from usual competitive forces.

In the community pharmacy industry it could be claimed that the State Pharmacy Acts that restrict the number of pharmacies able to be owned by a pharmacist, whilst not restricting the number of pharmacies able to be owned by a Friendly Society Pharmacy in the same jurisdiction, is anti-competitive.

This is the situation in Victoria. In South Australia a pharmacist is restricted to the ownership of 4 pharmacies whilst National Pharmacies is allowed to own 31. There are no restrictions on numbers in the Northern Territory and the Australian Capital Territory (where there are no Friendly Society Pharmacies). All other jurisdictions restrict numbers

of Friendly Society Pharmacies by various legislative provisions requiring Ministerial consent for new premises.

Under the NCP the required solution is to remove the anti-competitive restriction. It would not be acceptable under those Principles to extend the restrictive provision to those it did not currently apply to. This is the recommendation of the National Review and this recommendation has been endorsed by the Working Group.

For the purposes of this Review it is submitted that the ACCC should also recommend that it is the restrictions that are anti-competitive.

11. Corporations Law And New Friendly Societies

Prior to 1 July 1999 all Friendly Societies including Friendly Society Pharmacies (non financial) operated under State and Territory Friendly Society Codes and were supervised and regulated by the Australian Financial and Institutions Commission (AFIC).

Section 22 of the *Corporations Act 1989* empowers the Governor General to make regulations prescribing, among other things matters which are required to be prescribed by regulations for carrying out or giving effect to the Corporations Law.

In June 1990 the Ministers of the States, the Northern Territory and the Commonwealth agreed to the Corporations Agreement, which formed the political compact on which the national companies and securities scheme was subsequently based.

Based on that Agreement the *Financial Sector Reform (Amendments and Transitional Provisions) Act 1999* added a new Schedule 4 into the Corporations Law that had the effect of deeming entities under the Financial Institutions Code and the Friendly Societies Code of the States and the Territories to be registered under the Corporations Law.

At the same time the States and Territories enacted enabling legislation for the transfer of jurisdiction of the specified entities.

Schedule 4 of the Corporations Law transferred the specified entities from their previous State or Territory based governing Codes to the jurisdiction of the (Commonwealth) Corporations Law. The transferred entities were variously defined and were, upon transfer, collectively defined as a "transferring financial institution" and included:

- (i) a friendly society of this jurisdiction (that is a body that is registered as a friendly society under the Friendly Societies Code of this jurisdiction immediately before the transfer date)

Other transferred entities included building societies, credit unions and other friendly societies (financial). Transfer date was 1 July 1999.

Upon the transfer date all registrations under the previous governing Codes were cancelled and no new registrations were allowed to be accepted.

The legislation prohibits the use of certain words in the name of entities without approval.

Under the *Banking Act 1959* this means, no entity can use the words "authorised deposit taking institution (ADI)", "bank", "banker", "banking", "building society" or "credit union". And under the *Life Insurance Act 1995* the use of the expression "friendly society" is prohibited in relation to a financial business if the body is not a friendly society. Section 16C of that Act defines the expression "friendly society". Broadly a body is a friendly society if it is a company registered under the corporations Law and is either taken to be registered under the *Life Insurance Act 1995* or has been determined by APRA to be friendly society.

When these provisions of the Regulations made under the Corporations Law as described above commenced on 1 July 1999 no friendly society was determined by APRA under the provisions of subsection 66A(1) of the *Banking Act 1959*, to be an ADI. And no friendly society that only carries on the business of pharmacy is registered under the *Life Insurance Act 1995*.

There are provisions for relevant Ministerial approvals for new entities in the future to use the otherwise proscribed words including *friendly society* but it is understood that even if such approval was obtained the new entity would not be interpreted as being a friendly society to which the various Pharmacy Acts would presently apply to as a permitted owner of pharmacy.

In the context of current legislation there is now no specific definition for those Friendly Society Pharmacies that own pharmacies. They can only be defined as a transferring financial institution in accordance with the provisions of Schedule 4 of the Corporations Law which, at the date of transfer, were allowed to operate the business of a pharmacy in accordance with the provisions of the various Pharmacy Acts at the time.

Consequential amendments in a number of jurisdictions have incorporated this provision into their Pharmacy Acts defining ownership provisions.

Accordingly it can now be presumed that if a new friendly society were able to be formed it would not be one that would be permitted to own a pharmacy.

CONCLUSION

In conclusion, this Association wishes to emphasise that the issues considered by first, the Wilkinson Review and second by the Working Group, in accordance with the provisions of the National Competition Principles and the National Competition Agreement in regard to Friendly Society Pharmacies and their right to be a permitted player in the community pharmacy industry, have already been examined in great detail.

It is the submission of this Association on behalf of its members that the issue of taxation and the alleged competitive advantage flowing from their mutual status to Friendly Society Pharmacies is in fact not the real issue. The real issue is about the not-for-profit status of my member's pharmacies and that they are owned by members and not by pharmacists.

Additionally, my Association is firmly of the belief that this present Review by the ACCC has been brought about as a direct result of the powerful lobbying expertise of the Pharmacy Guild of Australia representing the interests of only those pharmacists that own pharmacies.

Friendly Society Pharmacies provide to its members and their communities the highest quality, best priced services and products. They do so on a truly not-for-profit basis with all returns being retained in the business to continually fund their services. And they have done so since the 1840's despite powerful opposition.

Presently, they are the only competitors in the community pharmacy industry and, in those communities where they operate, they provide a level of competition to the benefit of that community that is otherwise absent in other communities.

Professions, including the profession of pharmacist, should not be immune to the application of competition laws to them and there is nothing in the professional-patient relationships that requires them to organise in a way that is fundamentally anti-competitive.¹³

The powerful lobbying expertise of the Pharmacy Guild of Australia and the substantial market power that it wields is evidenced by this reference to your Commission and the background to it as cited above. This outcome was in fact publicly flagged by the Guild in its publications even before the Working Group commenced its work.¹⁴

The Association has confidence in the ability of this Review now being conducted by the ACCC to judge the issues fairly against the background and the issues as now submitted.

¹³ Professor Allan Fels, Chairman ACCC Speech to Monash University 8 November 2001

¹⁴ Pharmacy Review April 2000.