22 November 2019

Mandatory Dairy Code Team
Department of Agriculture
18 Marcus Clarke Street
Canberra ACT 2601

Dear Sir/Madam,

Exposure draft *Competition and Consumer (Industry Codes—Dairy) Regulations 2019*

Thank you for providing an opportunity for stakeholders to provide feedback on the exposure draft *Competition and Consumer (Industry Codes—Dairy) Regulations 2019.* As you are aware, Australian Dairy Farmers (ADF), under the auspices of the Australian Dairy Industry Council (ADIC) has been significantly involved in this process to date. These proposed regulations are important as they seek to address various market failures identified by the Australian Competition and Consumer Commission (ACCC) in its Dairy Inquiry. We are hopeful that implementing these regulations alongside other initiatives like the dairy project grants package will contribute to restoring trust, transparency and consistency in contract management and enhance competition and fairness across our industry.

ADF has compared the exposure draft to the clauses we proposed in previous submissions. This is an important analysis given these clauses were based on an extensive review of the industry's Voluntary Code of Practice, which included approval of the clauses by ADF, its six-member State Dairy Farming Organisations and the Australian Dairy Products Federation (ADPF) together under the ADIC banner. As this process is now at the third and final round of consultation, it is appropriate that ADF and ADPF provide separate submissions to you.

There are a number of issues that need to be resolved for the code to resolve the imbalance of power between farmers and processors. For ease of reference, we have focused our response on points of contention or issue. These are outlined in the attached table with analysis and recommendations. Generally, the issues we have relate to proportionality, readability and consistency. It is requested that you consider and resolve these prior to the regulations being submitted to Parliament for approval.

Should you have any questions in relation to our submission please contact Craig Hough, Director Strategy and Policy, Australian Dairy Farmers on the office number below or 0437 057 022 (chough@australiandairyfarmers.com.au)

Yours faithfully,

Terry Richardson
President
Australian Dairy Farmers

Level 2, 22 William Street, Melbourne, Victoria, 3000 AUSTRALIA
Telephone: +61 3 8621 4250 Facsimile: +61 3 8621 4280
ABN: 76 673 412 879

Regulation	Comment	Recommendation
5 - Definitions	The terms *"reasonable control"* (regulation 23 and 27) and *"serious contravention"* (section 28) are inadequately defined. These terms carry significant weight in the Code. They are used in provisions that qualify the processor's entitlement to unilaterally vary Milk Supply Agreements (**MSAs**), grant an entitlement to reduce minimum prices and entitle the processor to unilaterally terminate the agreement. By virtue of their subject matter, these provisions are likely to be the cause of disputes between processors and farmers during the life of the Code. To avoid uncertainty as to what these two qualifying terms mean in relation to parties' obligations and to promote consistency in dispute resolution (whether in Court, mediation or arbitration), these terms should be defined.	<u>Serious contravention / Breach of a condition</u> The term "serious contravention" should be removed in favour of the term "breach of a condition" to describe grounds for termination of the contract. This is consistent with language typically used in contract law. It is also likely to avoid confusion with what test should be applied to the term "serious" and whether the definition should incorporate the meaning of the phrase "serious contravention" used in other legislation (such as section 557A of the Fair Work Act 2009 (Cth; FAW)), which is used to describe knowing contraventions of statutory requirements, rather than contract conditions. Example 1: *Breach of a condition means a breach where:* *(a) a farmer breaches a condition of the MSA; and* *(b) fails to remedy the breach on [within a reasonable time of being asked to do so]; and* *(c) that breach deprives the processor substantially the whole benefit the processor was to obtain from the performance of the MSA.* This definition largely adopts the common law definition of 'serious breach' of a condition that would typically give a party the right to terminate a contract. An advantage of this definition is that it appears to be consistent with the objects of clause 28(2) which gives the processor a right to terminate where there is a "serious contravention [or breach] of the agreement". As it reflects the common law position it is relatively neutral in the advantages it confers to processors and farmers. Example 2: *Breach of a condition means a breach where:* *(a) a farmer knowingly breaches a condition of the MSA; and* *(b) fails to remedy that breach [within a reasonable time of being asked to do so]; and* *(c) that breach deprives the processor substantially the whole benefit the processor was to obtain from the performance of the MSA.*

Regulation	Comment	Recommendation
		This definition adds an element of 'knowledge' in the farmer's commission of a breach of an MSA. This is a hybrid of the common law definition of 'serious breach' with the additional element of knowledge which is found in the definition of a 'serious contravention' under the section 557A of the FWA. Advantages of this definition is that it makes grounds for processors to terminate their contracts with farmers more difficult than Example 1. <u>Reasonable control</u> Example 1: *Circumstances beyond reasonable control includes any of the following:* *(a) acts of war, acts of terrorism, riots, civil or military disturbances, national or state-wide industrial disputes (excluding actions by, between or originated among employees of the processor);* *(b) requisition or compulsory acquisition by any government or public authority; or* *(c) there is a change of law applying to the processor's business;* *which:* *(d) is beyond the control of, and has occurred, without the fault or negligence of the processor;* *(e) was not foreseeable by the processor at the date of making the MSA; and* *(f) the processor was unable to prevent or overcome by exercise of reasonable diligence.* This example defines *"circumstances beyond reasonable control"* strictly, which is generally favourable to farmers where such a clause could be used to affect a price step down. The definition accommodates the Code's example under regulation 23(1)(c) which states that *"A change in legislation that is relevant to the processor's business"* constitutes a circumstance that is "*beyond the reasonable control of the processor"*. It also incorporates typical force majeure events (e.g. riots, terrorism) at subparagraphs (a) and (b) above, that we consider is also contemplated by the terms of regulation 28.

Regulation	Comment	Recommendation
		At the same time, this example adds a further threshold for processors to establish that an event beyond their reasonable control has occurred, namely, they must also establish that the event was beyond their control and not caused by them, was not foreseeable and was unpreventable. The reason for adding subparagraphs (d) to (f) is to avoid circumstances such as where there is industry-wide notice that a law is about to change and then a processor later seeks to rely on that legislative change to affect a price step down. There is option for further events beyond reasonable control to be added to subparagraphs (a) to (c) above or for events to be removed. For example, another common force majeure event includes *"earthquakes, fires or other physical natural disaster"*. The more events added the more grounds for processors to effect price step downs.
6 - Reviews of Code	There is limited specification on the conduct of the reviews.	Under the 'conduct of reviews' title insert a clause that sets out matters which must be addressed by a review. For example, regulation 5 of the Food and Grocery Code identifies matters that a review of that code must address including, whether the purposes of that code are being met and whether it assists in addressing imbalances in the allocation of risks between regulated entities. The body conducting the review should be independent and have capabilities and experience in regulation review.
10(3B) & 26 – Cooling-off period	The Code provides different cooling-off periods for published standard form MSAs (regulation 10(3)(b)) and MSAs agreed by parties (regulation 26(1)). Published standard form MSAs have a default cooling-off period of 14 days and negotiated MSAs have a minimum cooling-off period of 7 days. This is likely to cause confusion both during negotiations and in the event of termination. To avoid unnecessary uncertainty, the Code should be harmonised and provide one cooling-off period of 14 days.	Make 14 days the standard cooling-off period from the date an agreement is signed.
22 & 23 – Price setting	There is concern the setting of minimum prices and subsequent changes in price may not be consistent with market trends. For example, minimum prices may be set too conservative (e.g. below the Global Dairy Trade Index). This is what occurred in 2016 with the Murray Goulburn (retrospective) and Fonterra (prospective) step downs.	Insert a clause enabling the ACCC to conduct an audit of a processor's price setting where there is some difference between the price set by that company and market trends. A period of time e.g. two months should be specified for the ACCC investigation to be undertaken. During this period the ACCC may direct that existing pricing arrangements apply.

Regulation	Comment	Recommendation
25 - Combining exclusive supply and tier pricing prohibited	While exclusive supply clauses may be generally weighted in favour of processors, exclusive supply clauses can have legitimate commercial purposes for farmers as well. For example, processors operating on a demand-driven business model have commercial interests in being able to secure certain volumes as demand increases/decreases. Such exclusive terms may be mutually beneficial to certain farmers who may have more certainty over their products being purchased in their dealings with processors in exclusive contracts. Farmers could otherwise agree to exclusive supply as leverage to negotiate other terms of their MSAs, such as prices. The disadvantages of exclusive supply terms are also ameliorated by the condition in clause 23 that allows farmers to deal with excess supply. Where there is a window of opportunity for farmers to obtain a benefit from exclusive terms (albeit limited), there is a risk of 'over-regulating' MSAs by prohibiting exclusive supply terms outright.	A farmer should be permitted to remove exclusive supply terms in MSAs where there appears to be unfair contract terms or they are anti-competitive and contrary to section 47 (exclusive dealing) of the *Competition and Consumer Act 2010* (Cth) or where they have the effect or likely effect of substantially lessening competition in the market (both demand-side competition between processors purchasing your product, or down the supply chain to ultimately increasing the cost of milk products to customers).
28 – Terminating / non-renewal of milk supply agreements	The Code requires a termination period to be specified in a contract at the agreement of both parties. It does not specify a period of time for the termination period or non-renewal of an existing agreement. As a consequence, the risk of the situation that occurred in Western Australia where a processor did not renew the contracts of four high performing dairy farmers due to a short-term oversupply problem continues to apply (i.e. has not been mitigated). These farmers experienced undue financial and emotional hardship and animal welfare problems because there was no alternate processor to supply. This is a practical example of what the ACCC said in its Dairy Inquiry statement that *"contracting and industry practices are weighted heavily in favour of processors. This has led to inappropriate*	The Code should specify a 90-day period for termination or non-renewal of 90 day or longer contract to enable a farmer to continue milking (they have to otherwise animal welfare and environmental issues arise) while: 1. Identifying alternate processor supply options; 2. Conducting operational and financial analysis of options e.g. changes to calving patterns; 3. Transitioning to the alternate supplier e.g. accessing new capital to scale up or exit the industry with dignity e.g. selling livestock, plant and equipment, land, leasehold improvements, stocks and water rights. If all reasonable attempts have not been successful in sourcing an alternate processor, the farmer needs time to exit from the industry. This period will be extended to 12 months or until an alternate processor is sourced – whichever comes first, and that the farmer be paid at the original price during this period.

Regulation	Comment	Recommendation
	allocation of risk, increased potential for inefficient investment decisions by farmers and less effective competition between processors."	Small processors are to be exempted from this clause.
Subdivision F – Complaints and disputes	The efficacy of the complaints and disputes mechanisms under the Code will be heavily dependent on the establishment of an industry lead and industry respected mediation and arbitration body. That is why the ACCC recommended that 'the industry should establish a process whereby an independent body can mediate and arbitrate in relation to contractual disputes between farmers and processors.' Currently there is no such body. Subdivision F provides sets out dispute mechanism options for farmers and processors. While the Code cannot make arbitration or mediation mandatory this subdivision signals to industry that it is the Department's preference for disputes to be resolved in a quick and efficient manner and by the industry.	To alleviate long term burdens on the Department, Regulator and Court system in resolving disputes, the Department should set up funding arrangements for an industry led mediation and arbitration body. To the extent that industry and stakeholder consultation results in a call for further changes to the dispute resolution mechanism under the Code, this could be tabled as an issue in the 1 January 2021 Code review.
40 – Costs of mediation and 43 – Costs of arbitration	The cost of mediation or arbitration and imposition of penalties for breaches of the code are set at a flat rate for all parties. This gives no consideration to the type of breach, capacity to pay or extent of impact and is inconsistent with the proportionality argument used to exempt small businesses from the regulations (Section 6). According to ABARES in 2017-18 the average dairy farm generated income of $136,000. This compares to most processors who generate revenue in the millions, with many processors generating hundreds of millions of dollars in turnover over the same period. The cost of mediation or arbitration is a 50/50 split. The impact of the 50% cost share on a farmer is	Change the 50/50 cost share arrangement to 25/75 in favour of the farmer. Insert a cost prohibition clause similar to what exists in the Franchising Code (regulation 22). Example: Insert clause 40(3) and 43(3) the following: *A milk supply agreement must not contain a clause that requires the farmer to pay the processor costs incurred by the processor in relation to settling a dispute [in mediation/arbitration] under the agreement, and if it does, the clause is of no effect.*

Regulation	Comment	Recommendation
	significantly more than Norco (in this example) or any of the multinational processors in the industry. In court proceedings the successful party will generally be awarded costs (usually 60% - 70%) spent to run the proceeding. Usually litigation favours companies that have more resources at their disposal including, in-house counsel.	
Subdivision E - Other matters relating to milk supply agreements	The content in this subdivision is covered in previous sections. As a consequence, the reader is required to reference back to those sections to make sense of it. For example, loyalty payments are covered in depth in Section 29, yet reappears in Section 32. While clauses are different and appear valid there positioning adds complexity and diminishes readability.	Remove Subdivision E by: • moving Section 30 – Other terms into Subdivision D—Contents of milk supply agreements • merging 'Written variations', 'Retrospective step downs have no effect' and 'Variations other than in accordance with agreement' from Section 31 - Matters relating to varying and terminating milk supply agreements into Section 27 - Varying milk supply agreements • merging 'Application of termination of agreement' from Section 31 - Matters relating to varying and terminating milk supply agreements into Section 28 - Terminating milk supply agreements • merging Section 32 – Loyalty payments into Section 29 – Loyalty payments. In undertaking these changes clarification of clauses is required in some circumstances.