Inquiry into perishable agricultural products and the dairy industry code

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Executive Summary

Australian Dairy Farmers (ADF) welcomes the Australian Competition and Consumer Commission's (ACCC) Inquiry into perishable agricultural products and the dairy industry code. Analysis of trading practices throughout supply chains, including relationships between farmers, processors and retailers, has been an area of significant concern for dairy farmers since $1 litre milk was introduced by the major supermarkets in 2010/11. Implementation of the ACCC's Dairy Inquiry (2018) recommendations, in particular the *Competition and Consumer (Industry Codes—Dairy) Regulations 2019* (the Dairy Code), is helping to resolve power imbalances between farmers and processors. However further action is required, particularly in regard to the retailers, to reduce their bargaining power and deliver more value across the dairy supply chain.

Dairy farmers have been adversely impacted by two market failures in the dairy supply chain:

1. Farmers lack information and bargaining power in regard to contracts and pricing.
2. The major retailers have placed unsustainable price ceilings and terms on the industry.

A framework for dairy supply chain reform has been established by eight government and parliamentary inquiries that have occurred over the past ten years since $1 litre milk was introduced in 2010/11. Recommendations arising from these inquiries have or are currently in the process of being implemented. This inquiry should build and leverage these initiatives by further recommending the following:

1. Deterring the misuse of market power by removing the word 'substantially' from Section 46(1) of the *Competition and Consumer Act 2010* (CCA).
2. Reducing the prevalence of unfair contract terms in small business contracts by making unfair contract terms illegal and imposing a penalty in the CCA.
3. Deterring unconscionable conduct by inserting an appropriate definition and penalty in the CCA.
4. Strengthening collective bargaining uptake by expanding the scope and rebooting the Starting Farms Cooperative Program and considering inserting a prohibition on companies undermining Collective Bargaining Groups (CBGs) in Section 93 of the CCA.
5. Increasing security of milk supply and promoting farm investment and innovation by determining options for incentivising longer-term contracts in the Dairy Code.
6. Ensuring the intent of the Dairy Code is honoured by scrutinising exclusive supply arrangements in the industry.

7. Validating farmers' agreement to terms of unwritten contracts by considering inserting a written confirmation clause in Section 18 of the Dairy Code.
8. Addressing the imbalance of bargaining power between retailers and processors by extending the Dairy Code to include retailers.
9. Ending nationalised fixed and heavily discounted pricing of dairy products by establishing a set of fair pricing clauses in the Dairy Code.
10. Avoiding market distortions and national policy breaches by recommending a minimum farmgate milk price not be progressed as a market intervention.
11. Confirming enhanced ACCC dairy supply chain oversight and enforcement by releasing a work plan with industry endorsement.

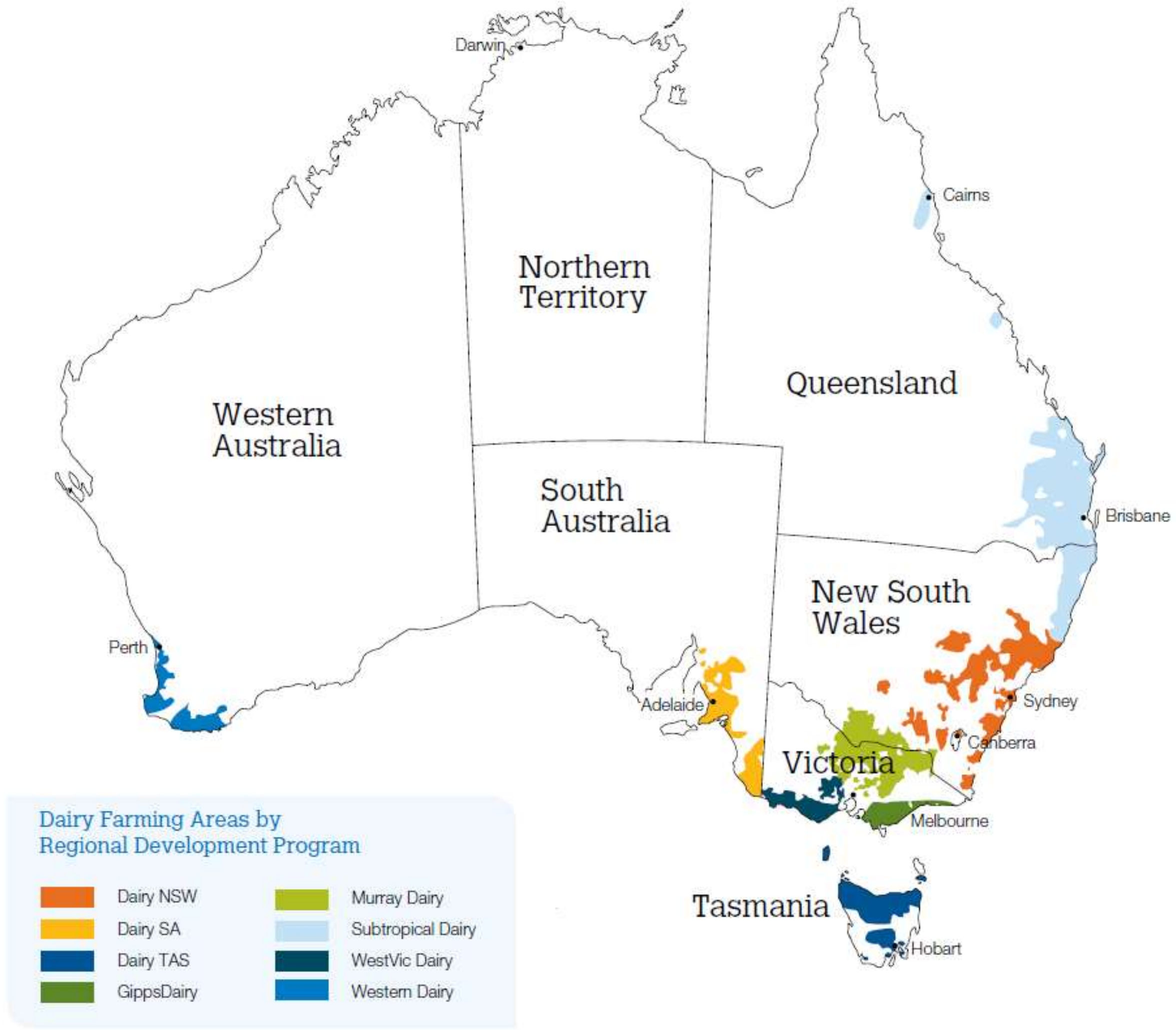
Dairy industry context

Overview

The Australian dairy industry comprises of 46,200 people working in over 5,213 farms producing around 9b litres of raw milk per annum and processing companies transforming the milk into high value dairy products. Around 65% of Australian dairy is sold on the domestic market. It is purchased from supermarkets and other retail or wholesale outlets for direct consumption or as ingredients in food and beverage. The total value of Australia's dairy exports is around $2.8b per annum. This positions Australia as the fourth largest dairy exporter with 6% of global trade. Approximately 125 Australian companies export dairy products to over 100 countries. The largest markets are China, Japan, Singapore, Malaysia and Indonesia (Dairy Australia 2019).

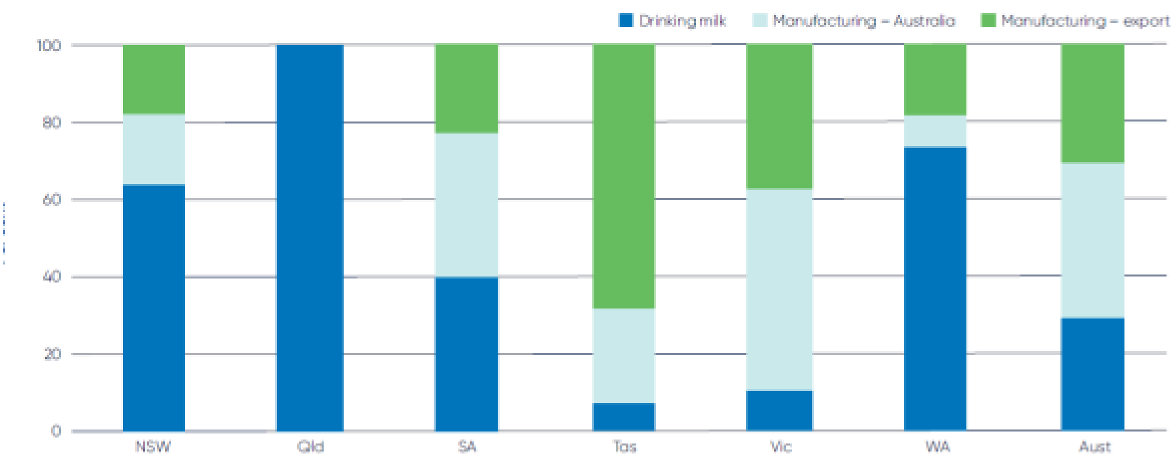
All Australian states produce milk and dairy products. Most of it occurs in Victoria, which accounts for 64% of Australia's national milk production (5.5b litres in 2018-19) and 79% of national dairy exports (Victorian Department of Economic Development, Jobs, Transport and Resources 2018). The remaining milk production comprises 12% in New South Wales, 10% in Tasmania, 6% in South Australia, 4% in Western Australia and 4% in Queensland.

Figure 1: Dairy farming regions in Australia



Dairy Australia (2018) *Australian Dairy In Focus*

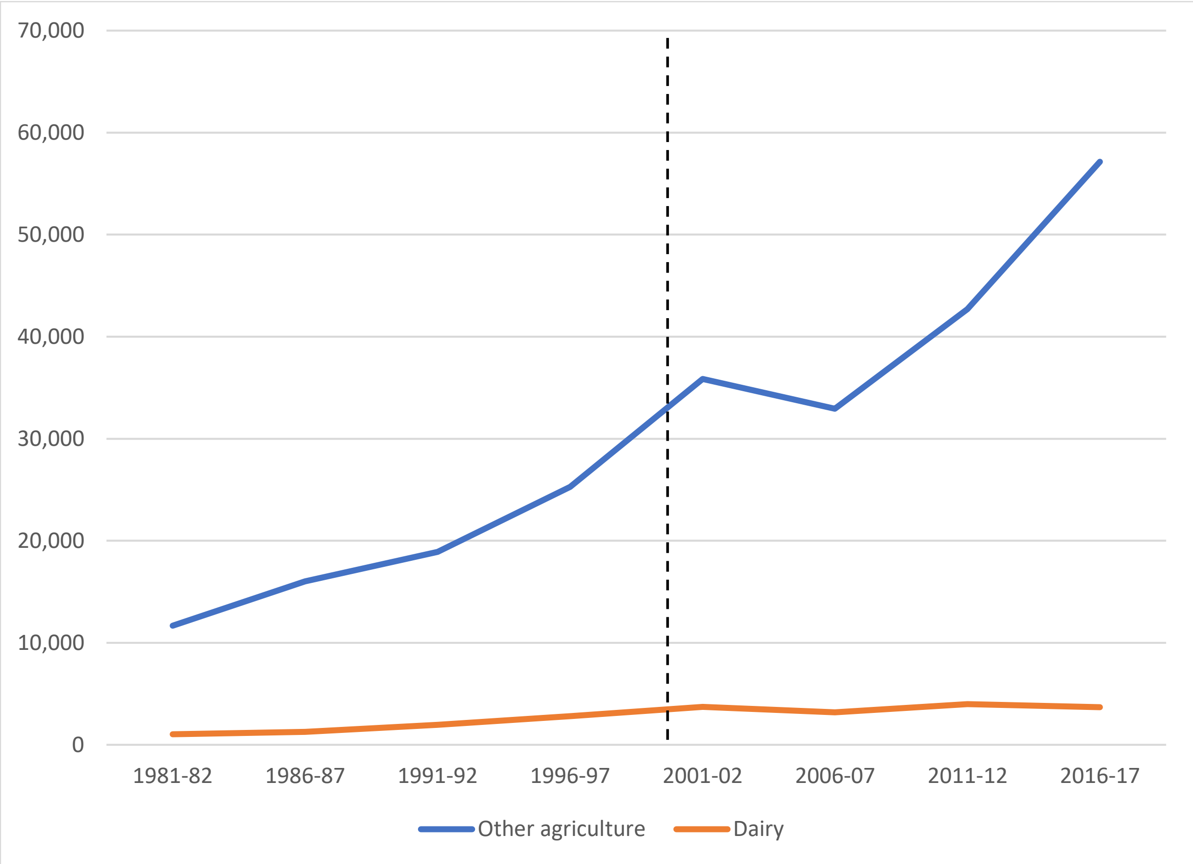
Figure 2: Use of Australian milk by state 2017-18



Source: Dairy Australia (2019) *Australian Dairy In Focus*

Dairy is Australia's third largest agriculture sector with a gross value (output multiplied by price) of $4.4b. Prior to 2000 when the industry was deregulated the sector recorded consistent increases as output increased at a greater rate than prices. Only marginal growth has occurred after 2000 due to prices increasing at a greater rate than output. The concern for the dairy industry is its share of Australian agriculture is declining. Other agriculture sectors are growing at a faster rate since the early 1990s.

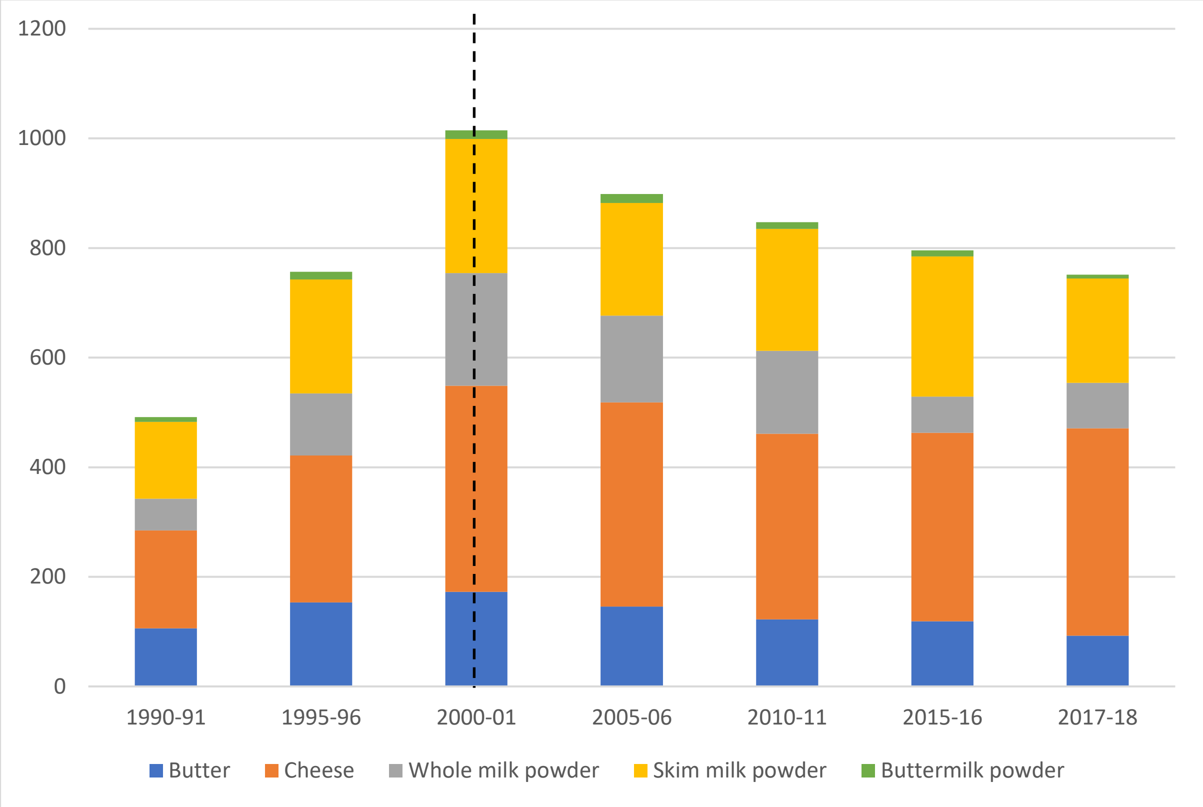
Figure 3: Gross value of dairy versus other agriculture production ($m)



Source: ABS (2018) *Value of agriculture commodities produced*

Since 2000 Australia has been moving from an exporter of bulk commodity dairy products e.g. milk powders to high value/quality (differentiated) dairy products e.g. cheese. While the latter typically generates a higher price or revenue, it is lower on output.

Figure 4: Australian volume of manufactured dairy products (Mt)



Source: ABARES (2018) *Agriculture Commodity Statistics*

Figure 5: Milk production by state (million litres)

	NSW	Vic	Qld	SA	WA	Tas	Aust
2005–06	1,197	6,651	597	646	377	622	**10,089**
2006–07	1,104	6,297	537	655	349	641	**9,583**
2007–08	1,048	6,102	486	606	319	661	**9,223**
2008–09	1,064	6,135	513	628	340	709	**9,388**
2009–10	1,099	5,813	530	605	359	677	**9,084**
2010–11	1,087	5,936	487	572	372	726	**9,180**
2011–12	1,136	6,246	491	575	349	792	**9,589**
2012–13	1,137	6,076	465	542	349	765	**9,334**
2013–14	1,124	6,174	446	525	342	810	**9,421**
2014–15	1,184	6,411	422	530	367	891	**9,805**
2015–16	1,198	6,249	421	538	392	883	**9,681**
2016–17	1,141	5,732	425	497	385	836	**9,016**
2017–18 (r)	1,144	5,979	399	505	385	913	**9,325**
2018–19 (p)	1,082	5,574	359	496	374	910	**8,795**

Source: Dairy Australia (2019) *Australian Dairy In Focus*

Supply chain

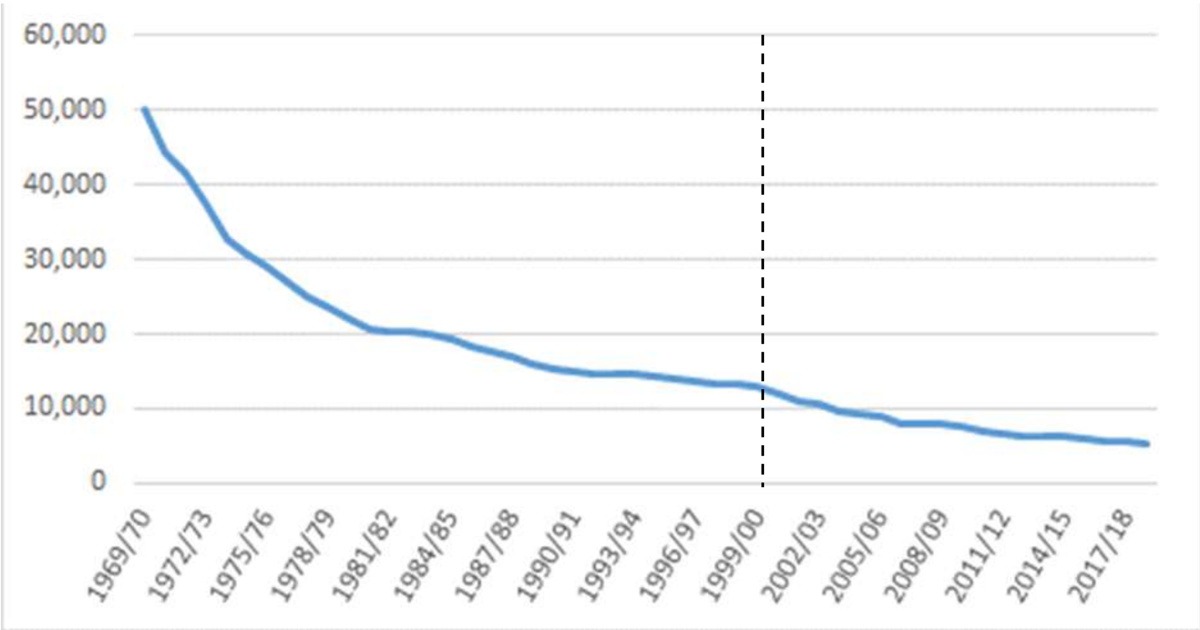
The dairy farm supply chain is different to other perishable product supply chains. It is similar to other livestock industries with procurement of products and services dealing with animal needs e.g. veterinary services and export and sale of live cattle (which comprises around 14% of farm revenue). The main difference is the sale of raw milk. This is sold to processors for manufacturing of drinking milk (around 25% of industry revenue) or other dairy products (around 61% of industry revenue). Raw milk produced by dairy farmers in Victoria, Tasmania and South Australia mainly sell to the manufacturing of other dairy products that are sold to domestic retailers and export markets. This differs to dairy farmers in Queensland and Western Australia where most of their raw milk is sold to manufacture and sale as domestic drinking milk. These regions do not produce enough excess raw milk for it to be used in dairy product manufacturing. New South Wales is a combination of the two supply chains. A common feature across all regions are a set of external factors influencing farm production and profitability e.g. drought.

Figure 6: Dairy farm supply chain

Source: Barry, M. (2019) *Dairy Cattle Farming in Australia*, AU Industry Report A0160, IBISWorld, December.

Each section of the dairy supply chain is becoming more consolidated and rationalised. Generally, the number of businesses are reducing but the size of those businesses are increasing. This trend is not unique to dairy but for most perishable products across the western world.

Figure 7: Number of dairy farms in Australia by year



Source: Esposito, S. (2019) ABARES Australian Dairy Farm Statistics

The dairy manufacturing sector in Australia can be described as having a medium market share concentration. Generally, each of the five product areas are dominated by multinational food companies. These include:

1. Saputo Dairy Australia Pty Ltd, which is a subsidiary of the Canadian dairy company Saputo Inc. Its brand names in Australia include Sungold, Great Ocean Road, Devondale, Liddells and Table Cove. Coon, Cracker Barrel Cheese, Warrnambool Heritage, Mil Lel, Murray Goulburn Co-operative and Warrnambool Cheese and Butter.
2. Fonterra Co-operative Group Limited (Fonterra) is a public New Zealand-based multinational dairy company. Its brand names in Australia include Western Star, Mainland, Girgar, Perfect Italiano and Anmum.
3. Lactalis Australia Pty Ltd, previously known as Parmalat Australia Pty Ltd, is a wholly owned subsidiary of France-based BSA S.A. Its brand names in Australia include Pauls, Farmhouse Gold, Vaalia, Ice Break, Oak, Breaka, Tamar Valley, Soleil and CalciYum.
4. Lion Pty Ltd is a foreign-owned proprietary Australian company wholly owned subsidiary of Kirin Holdings Company Limited, a Japanese conglomerate with worldwide interests in alcohol, soft drinks, pharmaceuticals, and health and functional foods. Its brand names in Australia include Dare, Farmers Union, Fruche, Big M, Moove, Dairy Farmers, Pura, Yoplait, Bornhoffen and Yogo.

These multi nationals seek to achieve economies of scale and leverage international brand awareness to increase market share. Mergers and acquisitions are helping to achieve this outcome. For example, in early 2014 Lactalis took over Harvey Fresh and more recently Saputo took over Australia's largest dairy manufacturer and farmer co-operative Murray Goulbourn. As a consequence, these companies comprise around 50% market share. The remaining 50% comprise over 100 smaller processors that are mostly Australian owned.

The supermarkets and grocery store industry is highly concentrated. There are four major players in the industry – Coles, Woolworths, Aldi and Metcash that account for over 80% of industry revenue. However, Coles and Woolworths alone account for 65%, making this industry one of the most concentrated in Australia (Youl 2020).

Representative and service structure

The dairy industry is serviced at the national level by ADF, Australian Dairy Products Federation (ADPF) and Dairy Australia (DA):

- ADF is the national policy and advocacy body representing dairy farmers across Australia's six dairying states. State bodies, known as State Dairy Farmer Organisations (SDFO), pay a membership fee to participate in ADF's national policy development and delivery. ADF, like other commodity groups, is a member of the National Farmers Federation (NFF).
- ADPF is the national policy and advocacy body representing dairy product manufacturers.
- DA is the industry owned Research Development Corporation (RDC). In 2018-19 it had an operating budget of $56.5m (Dairy Australia 2018). This comprises $40.8m (72%) in industry projects/services and $15.7m (28%) in corporate administration. The breakdown of industry projects/services is $23m for farm R&D, $8.2m for farm extension, $6.2m for industry and community marketing (includes $1.5m for policy support) and $3.4m for trade and international market development. Areas covered in the RD&E are pastures and forages, feedbase and animal nutrition, genetics and herd improvement, resource management, animal health and fertility, farm business and workforce management and advanced management technologies.

On occasions ADF and ADPF come together under the auspices of the Australian Dairy Industry Council (ADIC) to represent the whole of the dairy supply chain. DA supports the ADIC in addition to ADF, ADPF and SDFOs with policy research and technical advice. ADF and ADPF (i.e. ADIC) are Group B members of DA. This provides for consultation on key DA initiatives e.g. strategic and operational plans, collaboration/partnership on industry initiatives e.g. Dairy Plan and representation on the DA's Board Selection Committee (with no voting rights).

Figure 8: Australian dairy industry organisational structure

Source: Dairy Australia (2018) *Australian Dairy In Focus*

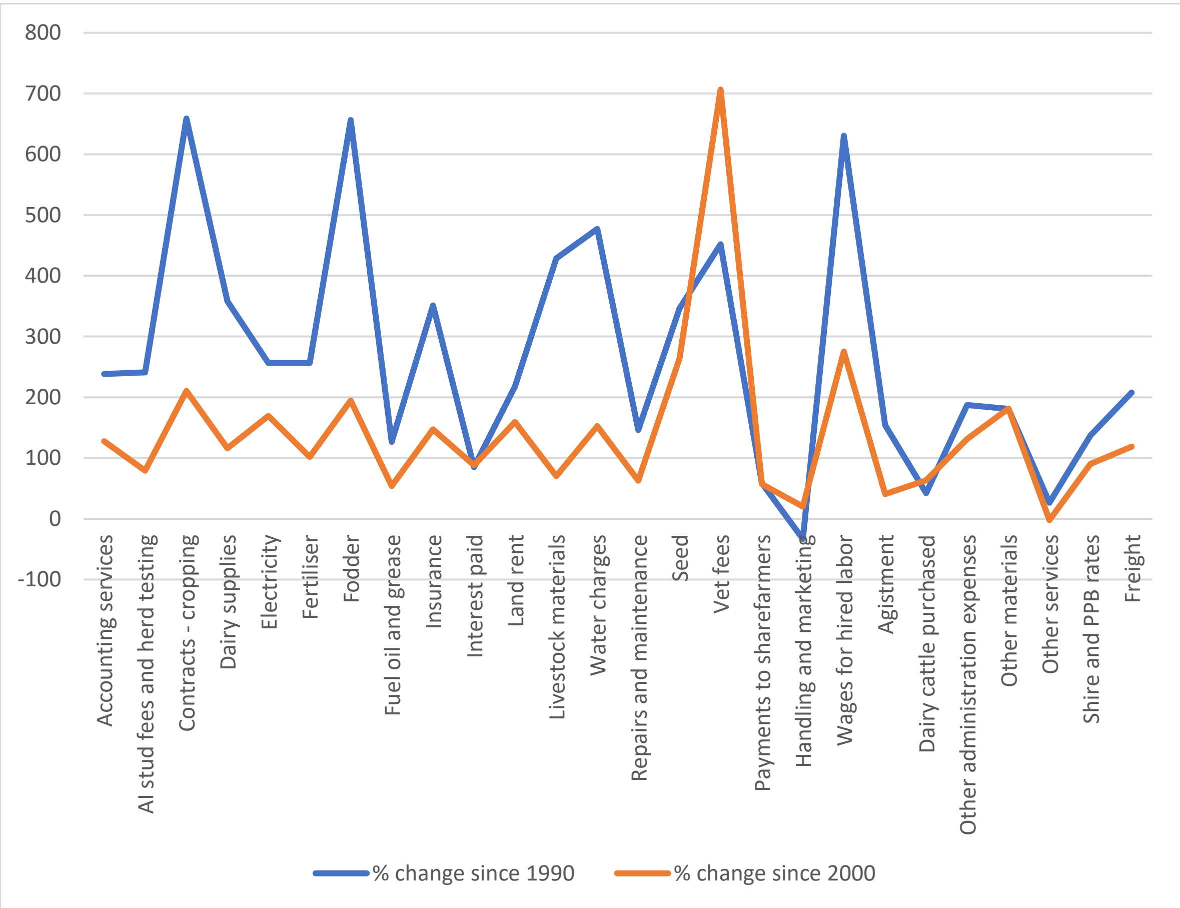
Dairy farm performance

Over recent years the dairy industry has received significant public attention and been the subject of much political debate. This has largely been due to low levels of farm profitability.

Costs

The significant gains made by dairy farmers in reducing inputs (the driver of productivity improvement since deregulation) has not translated to decreased production costs. This is due to significant price rises across the majority of the high cost items (above $5k p/a). With the exception of handling and marketing none of these expenditure items on the Profit and Loss Statement has decreased since 1990 or 2000. In fact, they have increased by 142% for an average dairy farm since 2000 and 265% since 1990.

Figure 9: % change in average dairy farm production costs above $5k p/a (2018-19 $)

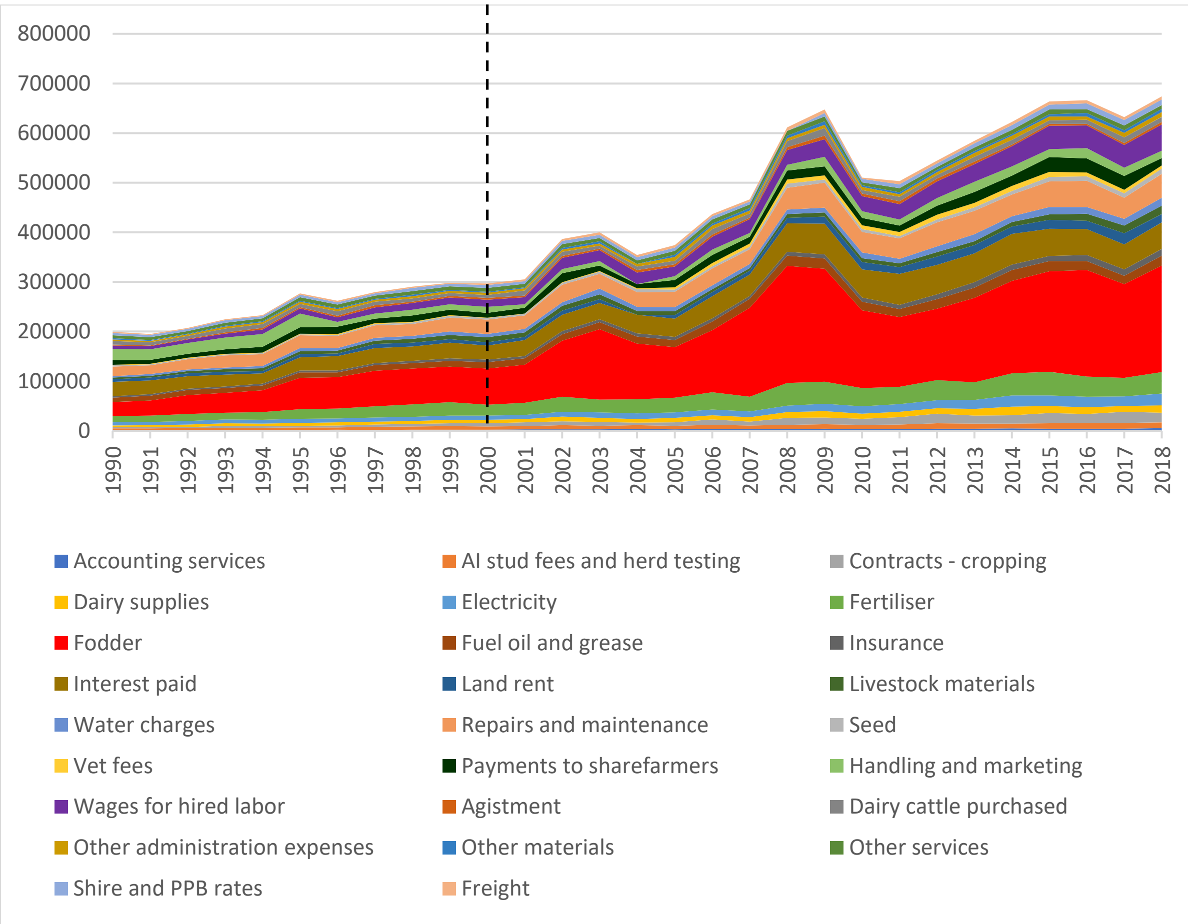


Source: Department of Agriculture and Water Resources (2018) *Dairy AgSurf data*

The cost rises have been driven by a number of factors, in particular the push to a flatter production curve, drought and climate change. This is seeing more farmers relying on higher cost crop production and bought-in feeds.

Fodder is by far the largest and growing expense. This is due to pasture consumption decreasing across the mainland. For example, Victoria's pasture consumption now represents about 50% of a cows' diet. This compares to 78% and 72% in New Zealand and Tasmania respectively (Beca 2018). There is pressure on purchased fodder costs. Factors like unfair freight subsidies by some states and drought handouts to farmers to purchase fodder are increasing the price to farmers in the states who have fodder and do not get subsidies. This is an unfair drought policy outcome. Other commodities, in particular beef and sheep, have seen a doubling to tripling return on their farmgate value. This demonstrates these commodities are more active in purchasing fodder because they can afford it. Dairy has not experienced this, so they are making a loss on purchasing fodder to survive.

Figure 10: Average dairy farm operating costs above $5k p/a (2018-19 $)

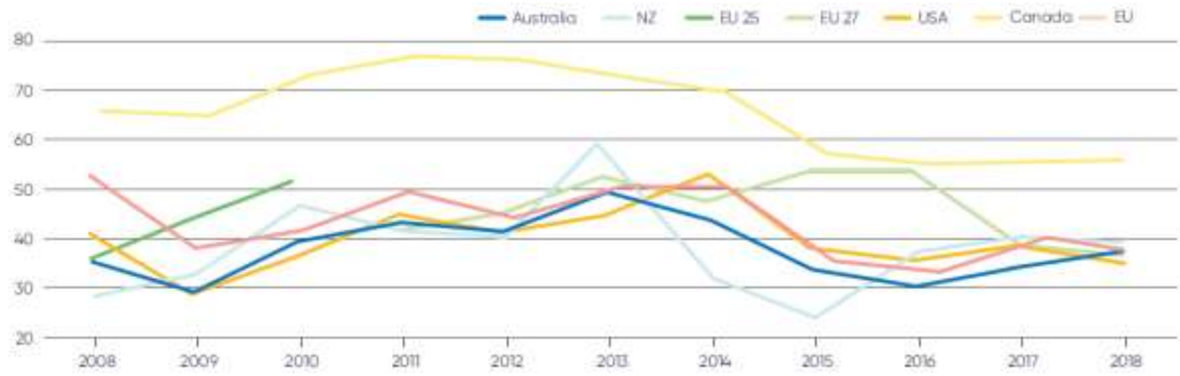


Source: Department of Agriculture and Water Resources (2018) *Dairy AgSurf data*

Price

The Australian farmgate milk price is set by the dairy processors based primarily on the global milk price. With the exception of Canada where there is significant government intervention, price trends of Australian farmers have generally mirrored the EU, US and NZ when compared in US$ terms. The key issue for Australian dairy farmers is that their price is slightly lower than these competitors with the exception of NZ (Productivity Commission 2014). Traditionally this has been largely due to the low cost of raw milk production in Victoria and Tasmania and the absence of price support mechanisms.

Figure 11: International farmgate milk prices (USD/100kg)



Source: Dairy Australia (2018) *Australian Dairy In Focus*

The dairy processors adjust their farmgate milk prices according to local conditions. Key factors include cost of farm and processor production and competition. The processor's profit margin is also considered although often in the broader context of the total raw milk to be procured nationally. Generally, the prices paid are higher in states with a higher cost of production.

Dairy farmers across all states have been receiving consistent increases in the farmgate price since 2000. Over recent years these have been the highest they have ever been. This has largely been driven by a domestic supply shortage. The problem with these increases is they have not kept pace with the rising costs of production. Across Australia, the average dairy farm has experienced a 71% increase in their farmgate price since 2000. This compares to a 142% increase in their production costs over the same period (refer costs section). The term often used to describe this trend is a cost/price squeeze.

Figure 12: Factory paid milk prices (cents/litre)

	2000/01	2005/06	2010/11	2018/19	% increase 2000/01-2018/19
NSW	29.10	34.30	48.30	54.70	88
VIC	29.30	32.90	42.00	48.20	65
QLD	30.60	36.60	53.10	61.00	99
SA	27.70	32.00	38.00	47.20	70
WA	26.60	29.00	43.40	50.20	89
TAS	25.00	33.60	43.15	50.30	101
AUST	**29.00**	**33.10**	**43.20**	**49.70**	**71**

Source: Dairy Australia (2019) *Australian Dairy In Focus*

Since the introduction of $1 litre milk in 2010/11 ADF and SDFOs have consistently argued that using fresh milk as a discount marketing agent by the major supermarkets to increase sales of their own private label brands is unsustainable for the dairy industry. Retailers and ACCC have consistently emphasised the domestic retail price has minimal impact on farm gate price or exits. This is disputed by industry on the grounds that having fresh milk set at an extremely low (near cost) price and fixed for almost a decade significantly limits capacity for price increases back up the dairy supply chain. While retailers and a lesser extent, processors, bear the greatest profitability impact, they are able to offset these losses via margin gain on other products. Dairy farmers have no options. They are price-takers and only have a single perishable product to sell.

Over time processors have pushed farmers towards all year-round production to supply more of their domestic than international markets. This has increased farmers' production costs at a time when they are already confronted with increasing costs arising from climate change, drought and other drivers. The 10c per litre price increase by retailers to some of their home brand fresh milk varieties in February 2019 (a move from $1 to $1.10 per litre) was intended to provide temporary relief until broader structural reform occurs in the industry. The problem is this has had limited effect because:

1. the benefits of this increase only flow to a select group of farmers
2. it does not apply to other discounted dairy products on the retail shelf
3. it continues with fixed pricing, which doesn't reflect supply/demand or inflation changes
4. places trust in the retailers to pass the levy through to farmers. This is of concern to farmers based on the 5 December 2019 finding that Coles failed to pass on the 10c per litre increase in fresh milk to Norco dairy farmers. They were ordered to pay around $5.25m following an ACCC investigation. Mr Rod Simms, ACCC Chairman said 'we were fully prepared to take Coles to court over what we believe was an egregious breach of the Australian Consumer Law. We believe we had a strong case to allege misleading conduct by Coles.'

This finding continues a similar pattern of behaviour that has occurred over recent years:

1. On 10 April 2015 Coles was fined $2.5m by the Federal Court for making false or misleading representations and engaging in misleading conduct in relation to the promotion of its par baked bread products. The judge said 'the contravening conduct in this case is substantial and serious. Notwithstanding the absence of any specific evidence as to loss or damage by a consumer or a competitor, it is clear that the significant potential to mislead or deceive and thus to damage competitors, the duration of the conduct, and the fact that the goods in relation to which the impugned phrases were used were "consumer staples" indicate that the objective seriousness of the offending conduct was considerable.'

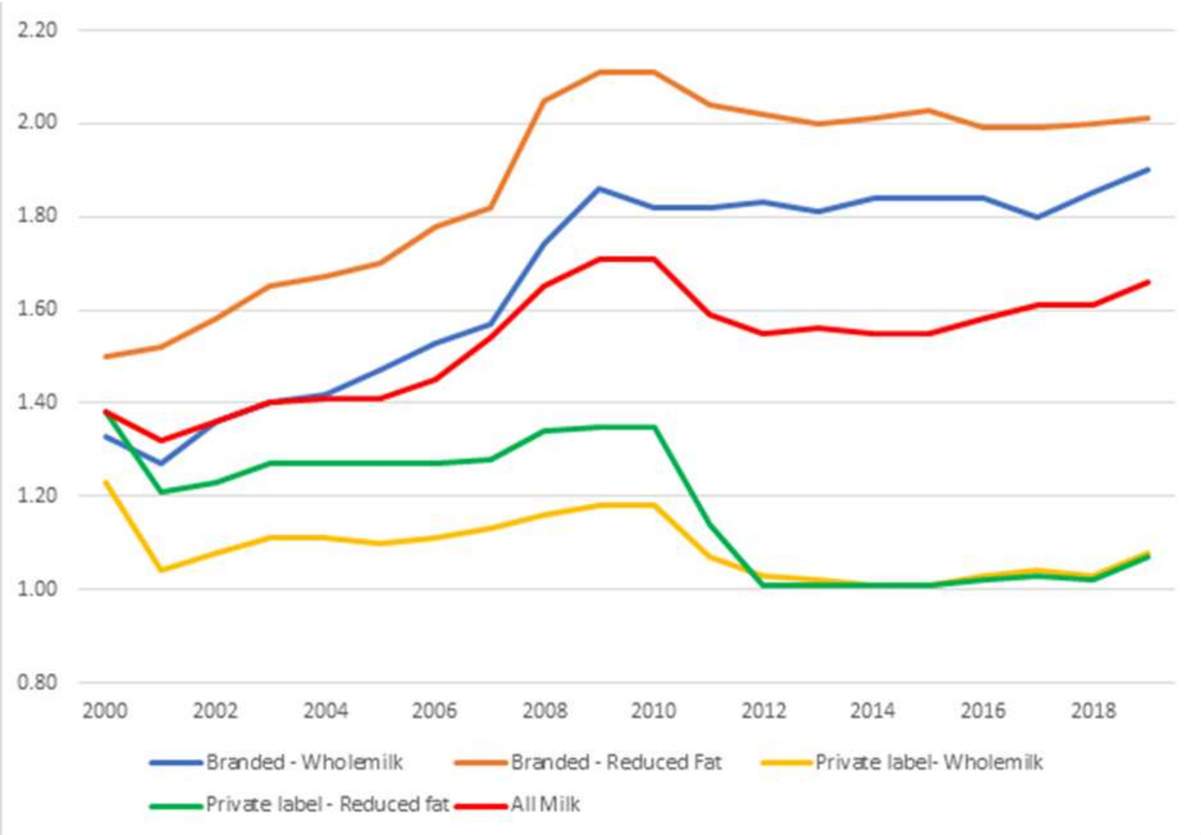
2. On 22 December 2014 Coles was fined $10m by the Federal Court for engaging in unconscionable conduct. The judge said that 'Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings. Coles demanded payments from suppliers to which it was not entitled by threatening harm to the suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold. Coles' practices, demands and threats were deliberate, orchestrated and relentless.'
3. In early April 2014 the ACCC found that the 'Our Coles Brand Milk Story' video and cartoon are likely to have contravened Section 18 of the CCA which contradicts Coles' key claim of 'fully absorbing the price cut.' Section 18 prohibits misleading or deceptive conduct. The 'Our Coles Brand Milk Story' video and cartoon was an exercise by Coles to convince consumers that farm gate prices had increased for dairy farmers when they had actually decreased.

The *Food and Grocery Code Review* (Samuel 2018) also found the retailers to have misused their market power over their suppliers. Statements supporting this position include:

1. 'The Review received consistent complaints from suppliers in relation to the retailers' process for negotiating an increase in the price of goods.'
2. 'The retailer plays a significant role in controlling prices through their acceptance or rejection of the supplier's price point. In practice, the retailer acts as the gatekeeper to pricing changes and will only purchase product at a price that has been approved or permitted by them.'
3. 'With a lack of visibility of the sale transaction or access to market information, growers can find themselves vulnerable to 'price skimming' practices by traders.'
4. 'Some suppliers reported instances where they have been unsuccessful in requesting a price rise for their product but later found that the retailer had increased the retail price on the shelves to capture additional profit for themselves.'
5. 'Heightened retail price competition has limited suppliers from raising prices in line with their higher overheads.'
6. 'The Review does not believe that the current verification process being used by retailers is leading to the best outcomes for suppliers or consumers.'
7. 'Price rises were accepted by the retailer on the condition that the cost was off-set, in whole or in part, by some other means by the supplier.'

This situation places undue hardship on dairy farmers and processors. In 2010/11 when discounted fresh milk came into effect the retailers dropped their retail prices, particularly on their private label products, to near cost prices across the country. Since this time, they have essentially retained that same price despite inflation increases. Australia fresh milk prices are now very low by international standards.

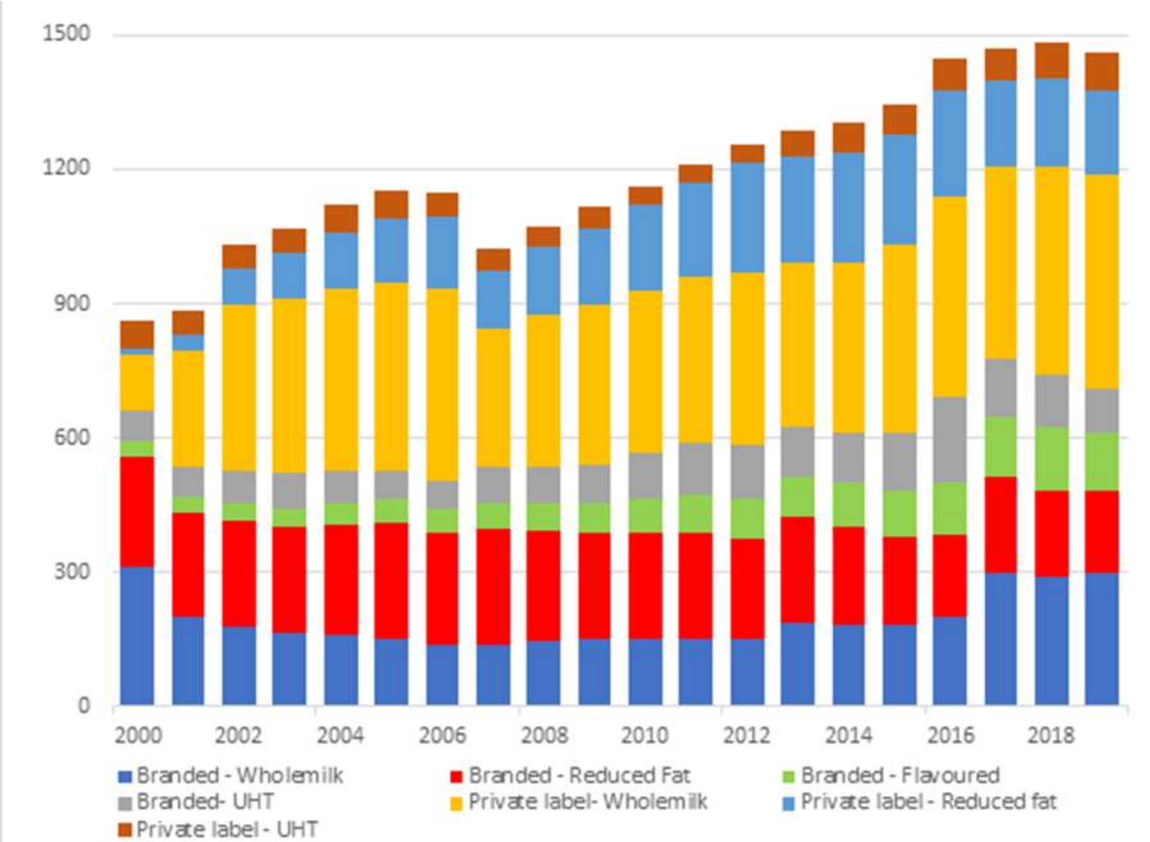
Figure 13: Supermarket milk prices ($ per litre)



Source: Dairy Australia (various editions) *Australian Dairy In Focus*

Maintaining significantly lower prices for private label products over branded products coupled with prioritisation of shelf space and direct supply contracts with farmers are part of a broader strategy by the major retailers to increase market share for their own products. This is a major problem for dairy farmers because as retail sales and market share shift more towards private label products a lowering of price rise capacity occurs back up the chain. In a highly concentrated retail market like Australia, this inevitably translates to more dairy farms and processors becoming unprofitable, especially in times of drought and fire.

Figure 14: Supermarket milk sales by volume (million litres)



Source: Dairy Australia (various editions) *Australian Dairy In Focus*

A 'race to the bottom' in any sector shifts value from the producer to consumer. This is being demonstrated with reductions in net margins for food retailers (supermarkets and grocery stores). These have declined by around 1¾ percentage points since 2011/12 (Carter 2019). This has occurred alongside the expansion of foreign supermarkets into the Australian market as well as a period of aggressive price competition between the major domestic supermarkets.

Quantification of the value stripped out of the supply chain from discounted fresh milk can be calculated by analysis of consumer demand and supply relative to the retail price. Demand (sales) for fresh milk has increased by 21% since 2010/11 at the same time milk production (supply) has declined by 4% over the same period. Based on these figures, the current price for private label milk should be at least $1.52 per litre (as opposed to $1.26 per litre currently) and the average price for all milk should be $2.07 per litre (as opposed to $1.71 per litre currently). This undercutting of dairy supply chain value is inconsistent with free market dynamics (increasing demand and declining supply = increase in price) and is evidence of market failure.

Figure 15: Calculation of retail milk prices

Demand (sales)

1200m litres (2011) – 1450m litres (2019) = 250m litres increase over period

250 / 1200 x 100 = 21% increase over period

Supply (raw milk production)

9,180m litres (2010/11) – 8,795m litres (2018/19) = 385m litres decrease over period

385 / 9180 x 100 = 4% decrease over period

Private label wholemilk: 21% of $1.18p/l (2010) = 25c

Private label reduced fat: 21% of $1.35p/1 (2010) = 28c

25c + 28c = 53c / 2 = 26c

$1.18 + $1.35 = $2.53 / 2 = $1.26

$1.26 + 26c = **$1.52 should be the current price for private label milk**

All milk: 21% of $1.71p/l (2010) = 36c

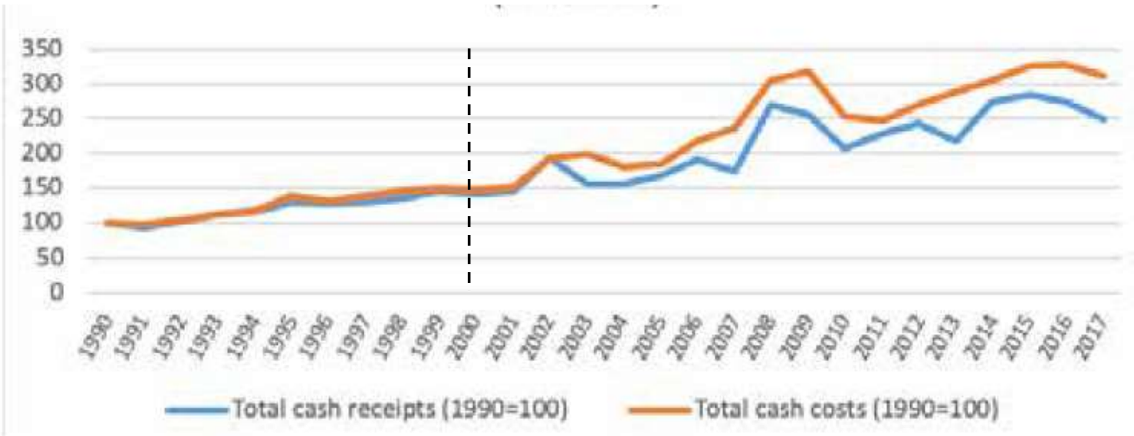
$1.71 + 36c = **$2.07 should be the average price for all milk**

Source: ADF internal analysis

Profitability

Due to production costs rising at a greater rate than farmgate prices the best 25% of farmers are having their margins squeezed, while the other 75% of farmers are having their margins either flat or negative (ADSA 2018). These impacts are even greater in drought years like the current year when grain and other supplementary feeds such as hay and silage, as well as water, are harder to source and more expensive to purchase. This is a significant cash flow problem across all dairy states.

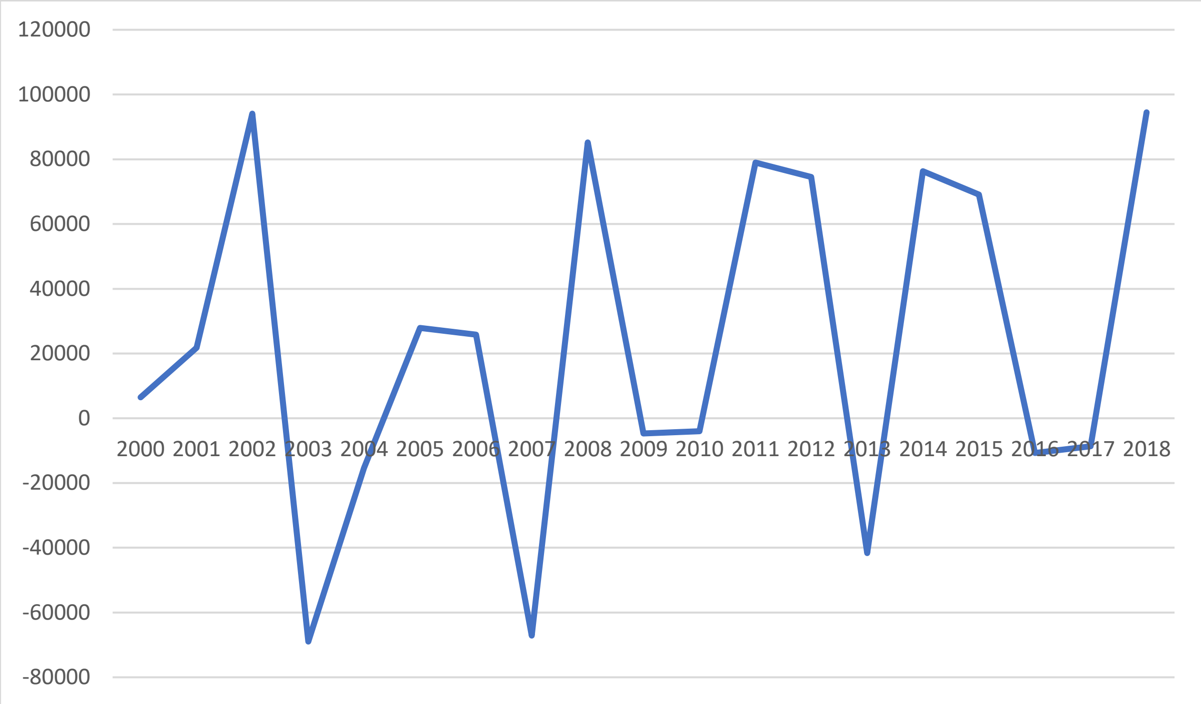
Figure 16: Dairy farm cash costs over cash receipts (1990=100)



Source: ABARES (2018) Dairy farm cash costs versus total cash receipts index

Since 2000 the average dairy farm profit has been $22,818 per annum (Department of Agriculture and Water Resources 2018). This compares to the national minimum wage of $38,512 per annum for a 38-hour week (Fair Work Ombudsman 2019).

Figure 17: Australian dairy industry profit results ($)



Source: Department of Agriculture and Water Resources (2018) *Dairy AgSurf data*

Policy framework for dairy supply chain reform

Over the past ten years there have been eight parliamentary and government reviews focused to some extent on dairy supply chain reform. These include:

1. May 2010 - Milking it for all it's worth—competition and pricing in the Australian dairy industry by the Senate’s Economics Reference Committee
2. November 2011 - The impacts of supermarket price decisions on the dairy industry by the Senate’s Economics Reference Committee
3. March 2015 – Competition Policy Review by Professor Ian Harper
4. August 2017 - Australia's dairy industry: rebuilding trust and a fair market for farmers by the Senate’s Economics Reference Committee
5. April 2018 – Dairy Inquiry by the Australian Competition and Consumer Commission
6. October 2018 – Food and Grocery Code of Conduct Review by Professor Graeme Samuel AC.
7. Current – Inquiry into the performance of Australia's dairy industry and the profitability of Australian dairy farmers since deregulation in 2000 by the Senate’s Rural and Regional Affairs and Transport Committee.
8. Current – Inquiry into perishable agricultural products and the dairy industry code by the ACCC.

Extraction of recommendations relating to the dairy supply chain provides a framework for reform.

Table 1: Policy framework for dairy supply chain reform

Focus area	Recommendation	Inquiry
Equal and fair conduct	Misuse of market power, unfair contract terms and unconscionable conduct	
	• Reframe Section 46 of the Competition and Consumer Act to prohibit a corporation with market power from engaging in conduct that reduces competition	Competition Policy Review
	• Review application of unfair contract laws for dairy	Australia’s dairy industry: rebuilding trust and a fair market for farmers
	Collective bargaining	
	• Strengthen collective bargaining for farmers	Australia’s dairy industry: rebuilding trust and a fair market for farmers Competition Policy Review

Focus area	Recommendation	Inquiry
		The impacts of supermarket price decisions on the dairy industry Milking it for all it's worth—competition and pricing in the Australian dairy industry
	Dairy code of conduct	
	• Mandatory dairy code between farmers and processors • Parties to have written agreements • Processors to make offers at same time prior to start of season • Farmers to obtain legal and financial advice prior to entering	Dairy inquiry
	• Agreements need to be simple • Terms cannot restrict farmers from switching • Dispute resolution process available	Dairy inquiry Milking it for all it's worth—competition and pricing in the Australian dairy industry
	• Dairy code to have a cooling off period	Milking it for all it's worth—competition and pricing in the Australian dairy industry
	• Dairy code to be evaluated independently	Australia's dairy industry: rebuilding trust and a fair market for farmers
	Food and Grocery code of conduct	
	• Enhance the current obligation to act in good faith (clause 28 of the Food and Grocery Code), including the addition of indicators of acting in good faith that are easy to understand and apply; and to introduce the concept of 'fair dealings' as guiding principles for the Code Arbiters. • The Grocery Code should be amended to give suppliers the right to request further details on the reasons for delisting decisions, following the initial receipt of a signatory's reasons. The protection and notification requirements for the delisting of a product should be extended to a significant limiting of distribution resulting from range reviews. • Amend clause 21 (of the Food and grocery Code) relating to fresh produce standards and quality specifications to make it clear that the requirements apply only to fruit and vegetables.	Food and Grocery Code of Conduct Review

Focus area	**Recommendation**	**Inquiry**
	• Food and Grocery Code to capture the entire supply chain	The impacts of supermarket price decisions on the dairy industry
Price integrity	Price setting	
	• Repeal the 'price signalling' provisions in Part IV, Division 1A of the Competition and Consumer Act • Price discrimination not to be prohibited in the Competition and Consumer Act	Competition Policy Review
	• Reinstate specific anti-price discrimination provisions in the Competition and Consumer Act for dairy	Milking it for all it's worth—competition and pricing in the Australian dairy industry
	Farmgate milk price	
	• Introduce a minimum farm gate milk price (under consideration)	Inquiry into the performance of Australia's dairy industry and the profitability of Australian dairy farmers since deregulation in 2000
	• Processors to publish farmgate milk price calculations	Dairy inquiry The impacts of supermarket price decisions on the dairy industry Milking it for all it's worth—competition and pricing in the Australian dairy industry
	• Processors to set conservative opening farmgate milk prices	Australia's dairy industry: rebuilding trust and a fair market for farmers
	• Processors to make their pricing structures for sourcing drinking milk: 1. reflect the volume they estimate they require to meet their total commitments 2. offer more stability in prices rather than changing frequently 3. not be dependent on the final retail sales of branded versus private label milk.	The impacts of supermarket price decisions on the dairy industry
	• Monitor pricing practices	Milking it for all it's worth—competition and pricing in the Australian dairy industry
	Retail milk and other dairy product prices	
	• More accurate estimates of the proportions of the retail price of milk that reflect (i) the	Milking it for all it's worth—competition and pricing in the Australian dairy industry

Focus area	Recommendation	Inquiry
	costs and (ii) the profits, of farmers, processors and retailers	
	• A new provision relating to price rise processes should be introduced to: 1. Prevent signatories from requiring a supplier to disclose commercially sensitive information; 2. Require that signatories take no longer than 30 days to consider a price rise request from a supplier, unless circumstances exist that justify a reasonable extension that is negotiated with and agreed to by the supplier; and 3. Require that signatories report on the times taken to make a price rise decision, to be published in the Code Arbiters' annual reports.	Food and Grocery Code of Conduct Review

Many of these recommendations have or are in the process of being implemented. For this inquiry to be effective it should leverage and augment these initiatives. Context, analysis and recommendations on how this can be achieved is outlined below.

Equal and fair conduct

Misuse of market power, unfair contract terms and unconscionable conduct

The CCA has three sections dealing with anti-competitive and predatory behaviour. This includes prohibition on the misuse of market power (Volume 1, Sections 45 and 46), unfair contract terms (Volume 3, Schedule 2, Chapter 2) and unconscionable conduct (Volume 3, Schedule 2, Chapter 2). While this provides an appropriate protection framework, all areas need to be strengthened to provide more effective deterrence.

Consider removing 'substantially' from V1 S46(1) of the CCA

Amendments to the prohibition on misuse of market power (Section 46) by the Harper Review (2014) was welcomed by ADF. It replaced the prohibition on a firm with substantial market power 'taking advantage of that power for an anti-competitive purpose' with a prohibition on such a firm engaging in conduct with 'the purpose, effect or likely effect of substantially lessening competition.' This simplified the section and separated purpose from effect to breach the section. Proving intent has been very difficult and a significant barrier to prosecution in the past.

Demonstrating that a misuse of market power was designed or actually caused a substantial lessoning of competition is also extremely difficult in a court of law. The term 'substantial' is often considered in the market as a majority or substantial portion. This is a high-level threshold that can ignore unfair dealing upon small businesses, particularly those further up the supply chain where impacts are less obvious.

Make unfair contract terms illegal and impose a penalty in the CCA

In November 2016, unfair contract terms were extended to small business contracts in the CCA. At the time this change was welcomed by ADF as an initial response to price step downs imposed on dairy farmers by the two major dairy processors, Murray Goulburn and Fonterra. Despite the intention this policy change has not been an effective behavioural deterrent.

The Department of Treasury (2019) reported that 'the Regulators have continued to investigate many complaints relating to the possible inclusion of unfair contract terms in small business contracts. The ACCC received 1,238 unfair contract term related contacts between January 2017 and June 2019, of which a large proportion was believed to be related to small business complaints.' Since the extension was implemented the ACCC has successfully litigated several businesses and resolved a number of these complaints via public administrative resolutions, including court enforceable undertakings. However, this is a small representative sample due to limitations in law and enforcement. This was a key driver behind the recommendation for a mandatory Dairy Code.

ADF supports option 3 proposed by the Department of Treasury in its *Enhancements to Unfair Contract Term Protections - Consultation Regulation Impact Statement* (2019). This makes unfair contract terms illegal and imposes penalties in the CCA. ADF concurs with the Treasury statement that 'this option is likely to be the most significant deterrence against using unfair contract terms in a small business standard form contract. It places the onus on the contract-issuing party to ensure the contract does not contain UCTs, or risk facing a financial penalty.'

Insert an appropriate definition and penalty for unconscionable conduct in the CCA

Unconscionable conduct is currently vaguely defined. Section 20 of the CCA says 'a person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time.' A court is required to give consideration to a raft of factors (S22 of the CCA) to determine what may constitute unconscionable conduct but this is not definitive. In the absence of a definition unconscionable conduct is difficult to prove. This appears to be a contributing factor as to why there has been few prosecutions in the past.

The unconscionable conduct provisions in the CCA (Sections 20-22) says that a 'pecuniary penalty may be imposed for a contravention of this subsection.' An act of unconscionable conduct results in a weaker party being significantly disadvantaged by a dominant party. The suffering can include but not limited to financial loss even bankruptcy and emotional hardship at the company or industry level. Not having a penalty imposed provides no deterrent to such a severe negative outcome.

Collective bargaining

ADF has authorisation until 30 August 2021 to register and administer CBGs. This authorisation was provided by the ACCC on 4 August 2011 (authorisation number A91263).

The ADF register currently lists 18 CBGs in operation across the country. 355 dairy farmers are members of 18 CBGs. This represents only 6.8% of dairy farms (based on the current total of 5,213).

The ACCC and Senate dairy inquiries said CBGs enhance bargaining power for farmers and should be utilised at a greater scale. The consistent low uptake is largely due to the following:

1. ADF's limited resources has meant that it can only provide a basic registration and administration service function to CBGs. If more resources were provided e.g. establishment of an ADF CBG Coordinator position functions such as marketing/promotion, education and facilitation services could be provided to boost uptake.
2. Leading and engaging in CBGs often require news skills for farmers. This can be a deterrent to participation, especially when additional costs and time are required to acquire those new skills.
3. There have been examples of processors attempting to undermine and circumvent CBGs by refusing to negotiate with CBGs and/or negotiating directly with individual farmers by offering them more favourable terms.

Expand the scope and reboot the Starting Farms Cooperative Program

On 8 May 2019 the Australian Government announced it will provide $3 million for a Starting Farms Cooperative Program as an election commitment. This program was designed to provide grants to assist farmer groups establish farm cooperatives and other collaborative business models. It builds on the success of the Farm Co-operatives and Collaboration Pilot Program, which operated from 2016-2018 and supported 132 cooperatives, most of whom were grassroot start-ups. It also addresses some ACCC dairy inquiry recommendations pertaining to unlocking regulatory barriers and resource deficits for farmers wanting to vertically integrate by starting or building their own dairy processing facilities to increase revenue.

The Starting Farms Cooperative Program has not been effectively implemented. This appears to be the result of a focus on other priorities, such as Australia's unforeseen COVID-19 response. In the context of enhancing the dairy supply chain, the original program intent still has merit and should be progressed. However, an expansion of program scope to include grants for establishing and improving capacity and capability of CBGs would overcome barriers and increase CBG adoption.

Consider prohibition of companies undermining CBGs under S93 of the CCA

Section 93 of the CCA outlines the processes and requirements surrounding collective bargaining. There may be opportunity to include a section where companies have to deal with a CBG as part of their procurement practices in a manner consistent with other potential suppliers. This section could also include prohibiting companies from undermining a CBG by individual negotiation or other activity. Such changes would address some of the challenges surrounding CBG participation.

Dairy code of conduct

In April 2018 the ACCC's *Dairy Inquiry report* was released with a recommendation for the Australian Government to apply a mandatory code of practice to the dairy industry. The ACCC said that despite industry making significant inroads at self-regulation via its voluntary code, a mandatory code is required to ensure all farmers are protected from unfair contract terms. This was based on a finding that farmers have inadequate information in relation to pricing and payments, limited bargaining power in contract development and find it difficult to switch processors to improve their terms and conditions. It is argued that a mandatory code would help address these issues and fill a gap in Australian competition law.

ADF made a decision to support the mandatory code based on a Discussion Paper it produced on codes of practice in August 2018 and the ACCC's key arguments. Ultimately, ADF could not guarantee the participation of all processors in a strengthened voluntary code. Without full processor coverage there is a greater risk of farmers being disadvantaged from unfair processor terms.

Following a review of the dairy industry's voluntary code (12 months after commencement) a new Dairy Code was developed by ADIC. This was adopted as an initial draft mandatory Dairy Code by the Department of Agriculture and used for national consultation. The new draft code:

1. retained clauses in the voluntary code where there is no stakeholder objection or issue
2. added clauses where there is universal agreement between states and processors. This included good faith provisions, standard contract timelines, protection for collective bargaining groups, independent complaints management and dispute resolution processes, penalties regime and improved administrative arrangements.
3. aligned with the ACCC's guideline for industry codes.

The release of the *Competition and Consumer (Industry Codes—Dairy) Regulations 2019* on 13 December 2019 by the Minister for Agriculture in Canberra adopted most of the ADIC's revised code. It also:

- implemented most of the ACCC's *Dairy Inquiry report* recommendations:
    - that 'processors and farmers should acknowledge in writing the terms and conditions for milk supply'
    - 'processors should provide all contractual documents simultaneously before the commencement of the dairy season or contract term'
    - 'milk supply contracts should not include terms which unreasonably restrict farmers from switching between processors'
    - 'establish a process whereby an independent body can mediate and arbitrate in relation to contractual disputes between farmers and processors'
    - 'processors should publish information identifying how their pricing offers apply to individual farm production characteristics to enable better farm income forecasts'
    - 'a mandatory code of conduct within the act should be established for the dairy industry'.

- implemented many of the Senate's Economics Reference Committee's recommendations:
    - 'that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions'[1]
    - 'processors to make their pricing structures for sourcing drinking milk reflect the volume they estimate they require to meet their total commitments and offer more stability in prices rather than changing frequently'[2]
    - 'dairy processors set opening prices conservatively so that any downward pressure from market forces will not result in retrospective price step-downs that have devastating impacts on dairy farmers'[3]
    - 'any review of the code of conduct for contractual relationships should be undertaken by an independent party that can objectively assess whether the code is working as intended and consider if a mandatory code would be more appropriate.'[4]

Evidence to date is the Dairy Code has been an effective government intervention. The significant effort made by industry and government to develop a code that resolves key bargaining power imbalances between dairy farmers and processors has been rewarded.

Most dairy processors have made a concerted effort to adhere to the code. Many conducted education webinars with farmers prior to 1 June – the date processors are required to release their opening contracts and prices simultaneously. Processor contracts have been significantly reformed to be code compliant. This includes a number of small processors adopting the ADF milk supply agreement template (released in May) despite not being obliged to do so under the code (due to an exemption clause). They agree with the view of ADF and ACCC that having written agreements with suppliers is better business management than having no written agreement.

The 1 June clause has provided a significant boost for industry competition and professionalisation of contract management. Most farmers now have signed written contracts. Generally, these were negotiated and finalised from 1 to 30 June.

[1] Milking it for all it's worth—competition and pricing in the Australian dairy industry
[2] The impacts of supermarket price decisions on the dairy industry
[3] Australia's dairy industry: rebuilding trust and a fair market for farmers
[4] Australia's dairy industry: rebuilding trust and a fair market for farmers

ADF received a few telephone calls from dairy farmers believing they were 'being forced' to sign contracts. The 14-day cooling off period ensured these people had appropriate bargaining power for this situation.

Determine options for incentivising longer-term contracts in the Dairy Code

The length of contracts being offered to farmers appear to have shortened as a result of the Dairy Code. In Western Australia for example farmers are only being offered 12-month contracts whereas in the past they were 2-5-year contracts, including fixed price contracts for up to three years. Such a reduction reduces security of supply and discourages farm investment and innovation.

Review exclusive supply arrangements in the context of the intent of the Dairy Code

According to the Code, the 'milk supply agreement must not provide for both exclusive supply and a maximum volume'. Also, the 'milk supply agreement must not provide for both exclusive supply and tier pricing'. If a farmer does not give exclusive supply to a processor then they effectively receive a lower price. They are penalising non-exclusive contracts by offering two cents less for non-exclusive contracts than for exclusive contracts. The wording of these contracts may technically comply with the Code, but they are against the intent of the Code.

Consider inserting a written confirmation clause in S18 of the Dairy Code

The code allows unwritten contracts. This has been included to provide industry with flexibility around procurement of excess or unforeseen raw milk supply. In these circumstances there is a requirement for processors to confirm such arrangements by providing farmers with a written notification within 30 days from the agreement being made (Section 18 for commencement and Section 19 for variation). There is no requirement for the farmer to acknowledge receipt of this record or provide confirmation of the terms specified. This creates a degree of risk for farmers, particularly in the event of a dispute. Inserting a requirement for the farmer to acknowledge confirmation provides evidence of an agreement to terms.

Extend the Dairy Code to include retailers

Since the commencement of $1 litre milk it has been ADF policy that a mandatory Dairy Code should apply across the entire supply chain to include retailers. Having consistent behavioural expectations is fair to all parties. It is also easier to comply with for dairy processors who no longer have to behave a certain way to farmers (under the Dairy Code) and a different way to retailers (under the Food and Grocery Code).

Comparison of clauses in the Dairy Code with the Food and Grocery Code demonstrate the following:

1. There are far more similarities than differences. This makes an extension of the Dairy Code an easier task than if there were substantive differences.
2. The Dairy Code provides far superior transparency and assurances around price and penalties for non-compliance. Strengthening these provisions would address the issues dairy farmers have in this part of the supply chain.

Table 2: Comparison of Dairy Code and Food and Grocery Code clauses

Requirement	**Dairy**	**Food and Grocery**
Mandatory		
Small business exemption		
Good faith		
Written agreements		
Publish agreements		
Price formula / justification		
Minimum price		
Cooling off period		
Supply period		
Unilateral variation prohibited		
Termination on reasonable grounds only		
Quality and quantity specification		
Retrospective step downs prohibited		
Fees and charges / payment terms		
Funding promotions		
Exclusive supply prohibited		
Loyalty payments		
Confidentiality		
Intellectual property		
Internal complaints process		
Compliance officer appointment		
Independent mediation or arbitration		
Reporting on disputes		
Record keeping		
Training		
Financial penalties for breaches		
Review by Minister		

Price integrity

The Australian dairy market has the least amount of government intervention than the major dairy-producing Western jurisdictions (UK, NZ, US, Canada and the EU). Canada is a regulated market whereas the others have a deregulated market with some level of intervention. With the exception of NZ these countries have swapped regulation for new and larger subsidies. Now, bureaucracies manage a myriad of subsidy programs under which consumers pay for their products once at the retail level and again through their tax dollars. This is economic inefficiency with a significant loss to taxpayers not consuming dairy products.

Evaluation of a market outcome is measured by its economic efficiency. This is the extent to which consumer and producer net benefit is maximised. Any form of price control reduces net benefit on either or both sides (often referred to in economics as deadweight loss). The exception is where there is market failure.

Establish pricing principles in the Dairy Code

Intervention in the retail sector has to be targeted to correct the problem - the low sale price of fresh milk. As previously demonstrated, this is the area of deficiency in the Food and Grocery Code. If an extension of the Dairy Code were to occur it would have to include a set of price clauses deterring unsustainable discounting behaviour. As a foundation ADF suggests working from the following:

1. Retailers will pay suppliers a price for their product which is:
    a. higher than the cost the supply chain has borne to produce it
    b. provides the supply chain with an appropriate profit margin.

    Currently there is a delay of more than a year once a price rise or fall is instigated, which is not an effective way of reflecting the true cost of milk. A cost index utilising real data from industry sources needs to be applied on a regular (quarterly) basis.
2. Prices paid to suppliers will not be fixed for an extended period of time. They will change in accordance with supply and demand.
3. Change in a supplier's price for one product will not be offset or influenced by changes in one or more of their other products.
4. Independent verification of pricing and value distribution along the supply chain will be undertaken on a regular basis by the ACCC.

Recommend a minimum farmgate price not be implemented nationally

Imposing floor prices by region, as proposed by the current Senate inquiry, has a number of problems. The failure that occurred in this part of the supply chain (information asymmetry) is currently being addressed via the Dairy Code and other initiatives. There are also a number of economic and trade consequences that are detrimental to industry and the country more broadly.

If the minimum farmgate price was set above the market clearing rate:

1. it would incentivise producers to increase production to obtain more revenue
2. customers would lose by paying a higher price or dropping out of the market
3. producers would also lose because gains obtained from customers paying a higher price are offset by loss of sales (customers who dropped out will now be purchasing alternatives like cheaper imports) and increased capital costs (debt incurred from production expansion which can no longer be serviced from the loss of customers).

These dynamics diminish incentive to innovate and improve productivity across the supply chain. More importantly they undermine profitability and international competitiveness as consumers and processors source alternate suppliers e.g. NZ dairy and substitute products e.g. plant-based alternatives.

A floor price by region also negatively impacts Australia's international trade obligations and is inconsistent with some sections of the Australian Constitution:

1. Section 38 – Trade between states must be free
2. Section 51 – Federal taxation must not discriminate between states, parts of states; and Commonwealth bounties on production, export must be uniform across states
3. Section 99 - Laws cannot give preference to one state, or part thereof, over another state.

Release a plan for enhanced ACCC dairy supply chain oversight and enforcement

The ACCC Agriculture Unit was established by the government in 2015 under the *Agriculture White Paper*. This had funding until 30 June 2019. Continuation of the unit was guaranteed by the Australian Government when it announced an additional $8.1 million injection into the unit and appointment of a 'Dairy Specialist' as part of the government's dairy support package. These commitments were in addition to more general agriculture funding of $2.7 million provided in the 2019 Budget.

Work on price integrity and more broadly fair-trading and competition across the dairy supply chain can include provision of education, advice and coordination services, investigations and enforcement functions. At this stage it is not clear how the additional funding provided to the ACCC covers this spectrum.

As a minimum the ACCC should be monitoring prices, costs and profits of the dairy supply chain, including the three major retailers engaging in discounted dairy products, and enforcing breaches of the CCA. An assurance that active policing (prevention and response) work is being undertaken for the dairy supply chain is required. These activities should be articulated in some form of work plan with performance metrics. The ACCC's Dairy Consultative Committee is well placed to sponsor this output.

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