Submission to:

ACCC Inquiry into the Australian Dairy Industry

Dairy Inquiry Interim Paper

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Introduction

The Western Australian Farmers Federation (Inc.) (WAFarmers) welcomes the opportunity to comment on the ACCC's Interim Report into the Australian Dairy Industry.

WAFarmers is the state's largest and most influential rural advocacy and service organisation, boasting a membership of over 3,500 primary production businesses and individual farmers including grain growers, meat and wool producers, horticulturalists, dairy farmers, commercial egg producers and beekeepers. Collectively our members are major contributors to the $7.5 billion gross value of production that agriculture in its various forms contributes annually to Western Australia's economy.

Additionally, through differing forms of land tenure, our members own, control and capably manage many millions of hectares of the State's land mass and as such are responsible for maintaining the productive capacity and environmental wellbeing of that land and the animals that graze and live in it. Agriculture was the largest contributor to national GDP growth in 2016-17, and is the fastest growing industry, particularly driven by the grains and livestock industries.

Executive Summary

WAFarmers welcomes the opportunity to comment on the ACCC's Dairy Inquiry Interim Report, although we are disappointed the report will not adequately resolve the competition imbalances for the dairy industry in Western Australia (WA).

The ACCC had the opportunity to conduct a detailed analysis of the dairy sector in each state to get an accurate understanding of the competitive issues in these regions. However, this is certainly not the case for WA. The report's recommendations do not provide any compelling solutions that will resolve the bargaining power imbalances being experienced by dairy farmers. We also have particular concern about the ACCC's tendency to justify retail behaviour and the perceived benefits of this behaviour for consumers.

The Western Australian (WA) dairy industry is the most isolated dairy sector in Australia and therefore has its own unique set of circumstances. WAFarmers believes the report has not adequately understood these factors. Effectively, the issues in WA could have been dealt with separately, with specific recommendations proposed to resolve these.

Milk supply contracts in WA are governed by lengthy contracts that are generally more than two years in term, with varying contract conditions that are weighted towards the demands set by processors. Milk payments have been developed as a direct result of the highly competitive domestic market situation in Western Australia.

Over 90 per cent of the milk produced in the State enters the domestic liquid milk market with little or no opportunities outside this market. There is limited manufacturing capacity in WA when compared to eastern states, and this in turn has a significant impact on a farmer's ability to negotiate beneficial contract terms and prices. In fact the situation is so extreme that many dairy farmers in WA strongly believe they are not in a position to negotiate better contract terms for fear of losing their business altogether.

WA is certainly not immune to production variability with significant issues around seasonal production imbalances. Again, this limits a dairy farmer's ability to negotiate favourable contract conditions and the milk prices needed to permit reinvestment into their businesses.

WAFarmers believes that the interim report greatly underestimates the impact of the supermarkets home brand pricing policy.

Australia has the most concentrated supermarket sector in the world with Coles and Woolworths collectively controlling 74 per cent of the grocery retail share. In other developed countries, the market share is between five to ten retail players.

This extreme market concentration in Australia restricts the bargaining power of processors in negotiating contract terms with supermarkets. Consequently this situation restricts processors from working with their suppliers to negotiate contract terms and prices that are favourable to both parties.

WAFarmers would like to stress that WA has been more affected by the $1 per litre milk sales campaign driven by major supermarkets, than any other State. Approximately $25 million annually has been taken out of the white milk supply chain in Western Australia due to this pricing campaign.

Supermarket pricing decisions have an extremely negative impact on the entire supply chain. Decreased margins received by processors erode confidence to invest in much needed processing and manufacturing infrastructure. Consequently, this restricts production and herd growth incentive payments to farmers, a concept recognised as the 'domino effect'.

The ACCC must recognise that supermarket pricing policies could force the closure of more dairy farm businesses as costs continue to increase. Many dairy businesses have become unviable since the introduction of the $1 per litre pricing campaign seven years ago. If more dairy farm businesses are forced out of the industry, and demand for milk products exceeds supply, this will increase the price consumers have to pay for dairy products in the future.

The key points we will be emphasising in our submission include:

a. WAFarmers supports the ACCC's suggestion to develop a Mandatory Code of Conduct. Clear evidence in WA has demonstrated that a voluntary code has not worked.

b. We will further clarify the imbalances in bargaining power within the WA dairy supply chain given the proposed recommendations will not address these imbalances. .

c. We will encourage the ACCC to consider specific recommendations that will drive competitive change for Western Australia's isolated dairy industry.

Recommendations

1. Processors and farmers should enter into written and signed contracts for milk supply.

In WA, dairy farmers are being locked into contracts with restrictive practices on milk trading, herd ownership and a set minimum low price for the entire term of the contract.

A percentage of farmers are being intimidated into signing contracts for three or more years with lower than average prices, which are typically below the cost of production. Regardless of having a signed contract, processors have the power to change not only the terms of the contract, but the prices agreed in the contract. This could be considered as unfair practices?

There is little comparison between established contract terms and pricing policies in the eastern states as opposed to WA. In WA, dairy farmers prefer long contracts i.e. 5 years, providing the farmer has the ability to re-negotiate the price paid per litre at a minimum of 12 month intervals.

The main factor preventing farmers in WA from getting involved in collective action is the fear of losing their businesses if they don't sign a contract. There is also concern around the time it will take for legal action to achieve an outcome and that during this time they could lose their business.

Importantly, the industry needs to have alternatives for supply before farmers would be willing to engage in negotiations with existing processors to achieve better contract terms and prices. It should be noted that 'ruination of a business' gives power under the law, but the farmers need to prove the contract is unfair (not the price) to achieve a beneficial outcome in law.

WAFarmers supports SADA's[1] suggestion that consideration be given to a standardised liquidated damages clause forming part of the mandatory code of conduct.

2. Processors should simplify contracts and indicate which documents contain terms and conditions.

Processors have greater access to trade related information and secondly have a greater insight into all their suppliers businesses. Effectively this puts processors in a superior position to set contract terms and prices. It is important that there should be much greater transparency, particularly for pricing information.

Making changes at the farm level are costly and slow to implement, so it is critically important that the processor reflect the relative value of milk as clearly as possible within contracts. These include:

- Seasonal premiums,
- Milk fat and protein values,
- Milk quality,
- The efficiency that comes from farm size
- The distance from the processor.

These factors lead to a range in prices received by a dairy farmer, even if they supply the same processor.

[1]SADA – South Australian Dairy Farmers Association

Where changes to price are required this should be reflected in the base price, this will have a dual impact because (a) makes the price and supply message clear to the producer and (b) allows the other parts of the production system to remain unchanged assuming the market signal reflects the longer term.

Where possible the processor should take a longer term view on seasonality, fat and protein values, scale efficiency, and transport costs and target their pricing to parallel their market needs. This will minimise unnecessary and/or unwarranted changes in the production system.

In WA, there is a range of fixed term contracts with different start and due dates. If all WA dairy farmers had fixed term contracts with a common expiry date and time, then this would enable farmers and processors to negotiate at the same time, ensuring that when the time period is complete everyone could settle knowing their contract and pricing was fixed for a given term.

3. Milk supply contracts should not include terms which unreasonably restrict farmers from switching between processors.

WAFarmers agrees with this suggestion. However the limited supply option does allow processors the power to exercise exclusive clauses preventing the farmer from a number of activities, including selling excess milk to another outlet at a more favourable price.

If an exclusivity clause is contained within the contract, provisions should be made to ensure the farmer is fairly compensated for being prevented from taking his/her business elsewhere under law.

A court may not enforce an exclusivity clause that is too restrictive or unreasonable. To determine this, the court will consider factors such as whether the clause protects only the genuine interest of the supplier, the period of exclusivity and the geographic area to which the clause applies.

If a farmer is offered a contract with an exclusivity clause and he/she can't negotiate its removal, the supplier should ensure that there is a 'break free' clause included in the contract. This allows the supplier to recover some or all of the costs if circumstances change. However, this requires evidence of losses. It may be easier to agree on a payment (noting the amount) in the contract clause.

As a point of reference there are no exclusivity clauses in the grains contract terms and conditions between CBH (Cooperative Bulk Handling Group) and 4,200 grain growers.

Reference: The terms and conditions apply to the sale of the Commodity by the Supplier named in the Grain Purchase Contract Confirmation (Supplier) and CBH Grain Pty Ltd ABN 39 089 394 883 (formerly Grain Pool Pty Ltd) (Buyer).

WAFarmers recommends exclusivity clauses should not be included in processor agreements.

4: Establish a process whereby an independent body can administer mediation and act as a binding arbitrator.

WAFarmers believes reliance on the court system would be too slow and cumbersome to offer an effective remedy for contractual disputes.

Grain Trade Australia (GTA) was formed in 1991 to formalise commodity trading standards, develop and publish the trade rules and standardise grain contracts across the Australian grain industry. The

GTA arbitration model could act as an initial template in the creation of a Dairy Trade arbitration model.

The GTA arbitration model is effective for that sector, although not totally independent. This can be resolved by the appointment of an independent chair, for example, the appointment of a retired judge, or a senior executive from a non-agricultural industry.

The GTA arbitration model is legally binding and is an effective alternative to both parties enduring a lengthy and protracted process through the tribunal process under the Commercial Arbitration Act 2012. Proceeding decisions are made in a timely manner i.e. within days, rather than taking years. Each party involved in the dispute selects their chosen arbitrator and GTA selects the third independent arbitrator to achieve a resolution.

Alternatively, the Competition and Consumer (Industry Codes—Horticulture) Regulations 2017, forms a mediation structure that could be used as a basis for a similar structure for the dairy industry, which could be extended to include an arbitration process.

Source: http://www.graintrade.org.au/dispute_resolution

http://www.graintrade.org.au/sites/default/files/GTA%20Arb%20Guidelines%20Feb16.pdf

WAFarmers recommends a standardised arbitration clause be inserted into all dairy contracts or that an arbitrator is nominated in the mandatory code of conduct.

5. Farmers should ensure they have properly considered the legal and financial implications of contracts with processors.

WAFarmers recommends farmers need to determine what they want in a contract given supply, budgets, long term security and so on. At present farmers are giving security of supply to processors, but processors are not honouring this commitment to their supplies and there is a need to get balance around certainties and long term supply.

As stated above, in WA there is a range of fixed term contracts with different start and due dates. Having set negotiation periods will resolve this.

WAFarmers recommends a common due date for contract negotiations should apply. This would encourage processors who need a seasonal supply to establish a pricing system that will attract the most suitable farmer to fulfil the contract term.

WAFarmers supports the inclusion in section 46 of the Competition and Consumer Act 2010, which will address the current unequal distribution of market power and encourage transparency to the benefit of producers, consumers and retailers. We believe this legislation will prevent companies with significant market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition.

The effects test is another tool to help provide integrity and transparency regarding the impact of retailer and processor actions on suppliers. WAFarmers believes this ruling has brought processors to the table and encouraged fairer contract terms.

To further emphasise our argument opposing the ACCC interpretation of supermarket pricing decisions, WAFarmers cannot accept that there is no downward pressure on the farm gate price as a consequence of the $1 per litre milk pricing campaign and the corresponding pressure on processors to lower their prices.

6. Processors should publish information identifying how their pricing offers apply to individual farm production characteristics to enable better farm income forecasts.

If payment differences reflect the actual market value received by the processor it is essential to send the market signal to the producer. If for any reason the payment no longer reflects the market the processors should communicate any future changes as quickly as possible to their supplier base.

The significant issue for Western Australia is the lack of secondary processing facilities to add value to liquid milk production. There is an urgent need to find long term solutions to manage spring production outputs and should include investment into infrastructures to produce products like cheese or ice cream for domestic or export consumption.

To achieve this, consideration could be given to a two tiered price scheme split between domestic and export market access. For example, a premium stable flat price relating directly to supplying the domestic market on a level supply pattern, and then a second tiered pricing mechanism specifically targeted towards the export market. This concept may prove beneficial to all parties.

To achieve these solutions WAFarmers is requesting ACCC consider a special dispensation to allow all industry partners to come together to discuss and agree on solutions for the betterment of the industry and consumers.

7. The Voluntary Dairy Code should be strengthened.

WAFarmers recognises that the voluntary code of conduct has not worked to date and if it were to remain it needs to be strengthened substantially.

8. A mandatory code of conduct within the Competition and Consumer Act 2010 should be considered for the dairy industry.

WAFarmers supports the ACCC's recommendation that a mandatory code is warranted to address the issues identified throughout the inquiry, these being;

- Unbalanced risk sharing
- Unfair contract terms – WA contract arrangements favour processors only. Contract term complexities have limited the ability of farmers to negotiate outcomes let alone switch processors in WA. There is clear evidence proving unfair contract terms.
- Imbalances within bargaining power
- Inadequate and confusing communications
- Lack of supply chain competitiveness

The lack of foreseeable changes in this power imbalance suggests the intervention of a Mandatory Code is required to address identified market failures.

A prescribed voluntary code is unlikely to be effective for WA dairy farmers as some processor will choose not to become signatories and opt out. Secondly, there is limited opportunity for systems of redress. The Voluntary Code has failed in Western Australia.

In Western Australia, collective bargaining groups or the concept of a collective boycott is not an option, given the processor having the power to boycott the farmer suppliers involved, forcing them out of the industry. It is simpler for processors to collect milk from fewer suppliers, but the payment advantage to larger producers varies greatly.

Mandatory Codes provide a minimum standard of protection to all parties; they are prescribed as regulations under the Fair Trading Law and can be enforced. An additional feature of many Codes in Australia is that the ACCC underwrites these codes by not only being involved in their development, but also by backing them up with strong enforcement action against those who choose not to participate in the code scheme.

It will be imperative for key representatives of the dairy supply chain to be involved in the development of the mandatory code at the very beginning as the Dairy industry structures and systems are very different to other commodity sectors like the horticultural industry.

In Conclusion

It is clear the ACCC investigation has identified the significant contractual issues impacting the Australian dairy industry, particularly in the eastern states. This inequality has led to the inability of farmers to protect their interests and has a damaging impact on some farming businesses with a long history in the industry.

It is clear in WA that the $1 per litre milk has taken an enormous amount of value out of the WA dairy industry supply chain. This has significantly restricted investment in the industry and has had a direct impact on processors and farmers.

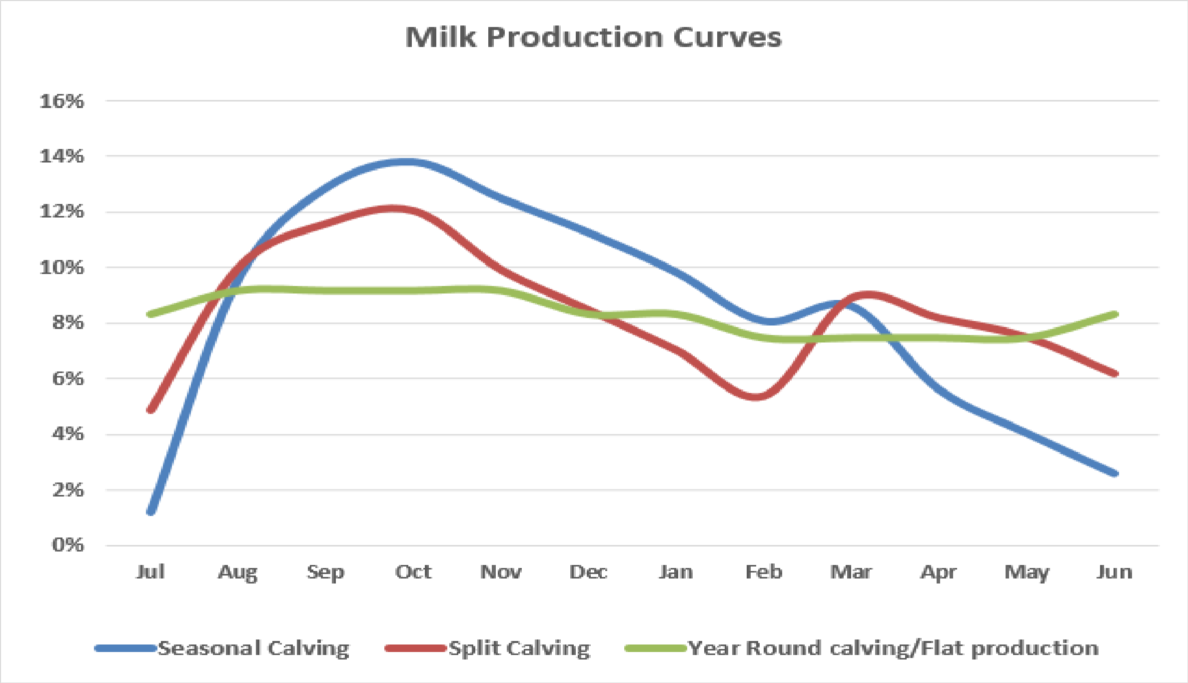
Newly established laws should enable the ACCC to take a more assertive role in the dairy industry and the adoption of a mandatory code of conduct should prevent further distortion of contractual arrangements and create a more even playing field for all within the dairy supply chain.

At the completion of this enquiry WAFarmers looks forward to a fairer contracting environment for all its members and a more assertive ACCC willing to engage in its policing role rather than one that is focussed on investigating breaches of the laws.

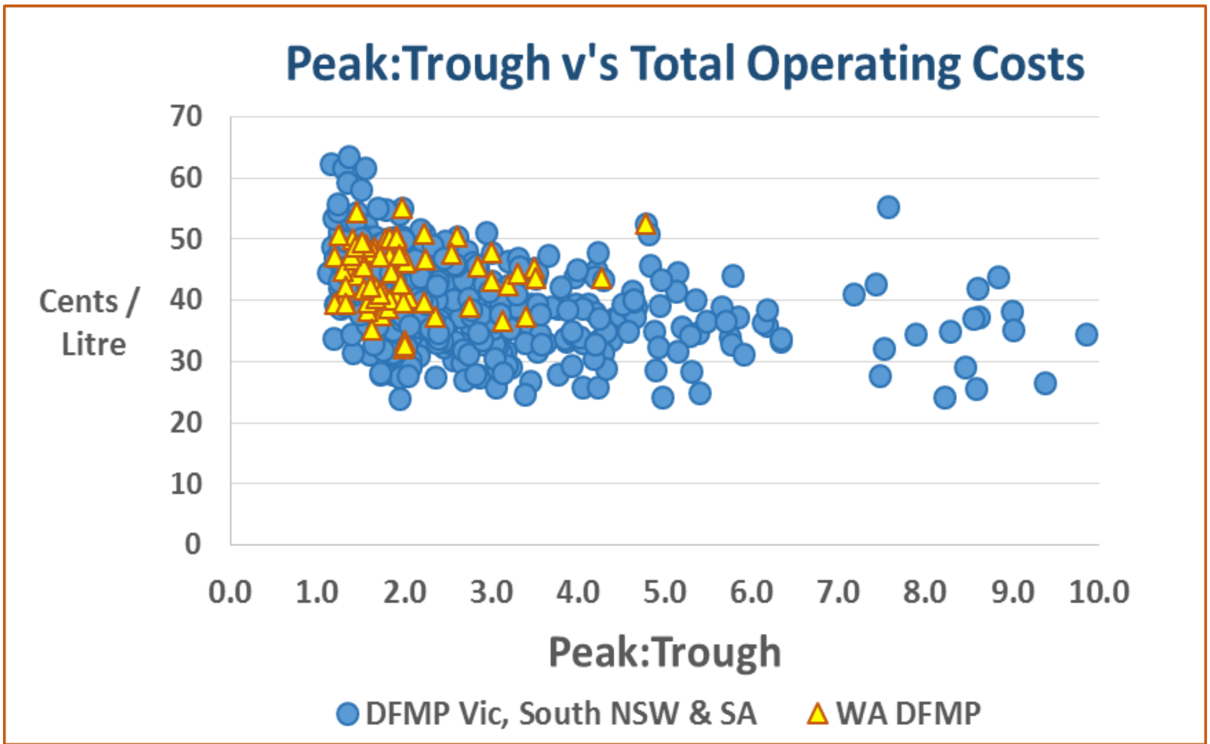
WA Dairy Industry Production Statistics:

Each curve produces 1.6M litres. Peak Trough ratios are:

- Seasonal 6:1
- Spilt 2.3:1
- Flat 1.2:1

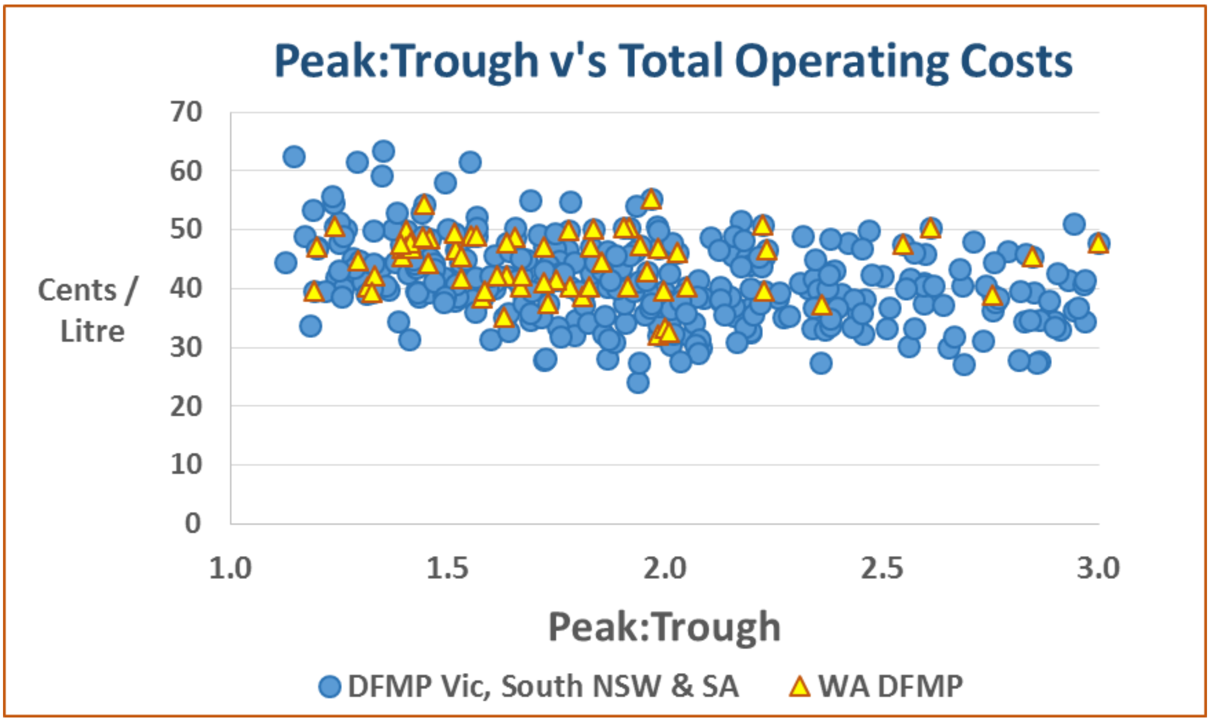


WA has a comparable cost structure to eastern state milk production outputs.



Source: Neil Lane Dairy Australia July 2017

Also, WA has similar cost structures when focussing on a flat milk supply



Dairy Farm Monitor Project (DFMP) and Queensland Dairy Accounting Scheme (QDAS) data

Key Points:

- Overhead costs are not dependant on the percentage of grazed pasture.
- WA farms are more than comparable with SE Australia farms on a like for like basis.
- Zero grazing i.e. TMR (total mixed ration) systems inevitably has a cost of production (before any debt servicing) of at least 50 cents/litre, which is consistent with US and EU farm performance data.
- Well managed TMR systems appear to be the only option for producing milk to a guaranteed perfectly flat curve <1.15:1
- *Flat curves require high 50's-60 cents /litre to cover costs of production, plus reasonable allowance for debt servicing.   ** $1/litre milk price pressures have significantly reduced net margins for processors and dairy farming businesses alike, greatly reducing their capacity to reinvest in to businesses.
- For typical average debt levels, debt servicing (principal and interest) adds an additional 6-8 cents/litre to the total operating costs.

Source: Neil Lane, Dairy Australia.