Chapter 2

Issues

2.1 This chapter discusses issues relating to the Tasmanian dairy industry, especially in relation to farm gate prices and contractual arrangements between suppliers and dairy companies, especially National Foods Pty Ltd (National Foods).[1]

2.2 The main companies operating in the Tasmanian milk market are Fonterra Australia Pty Ltd (Fonterra), National Foods and Cadbury as well as a number of smaller companies. Fonterra buys about 65 per cent of Tasmanian milk.[2]

2.3 National Foods buys approximately 145 million litres of milk annually in Tasmania which represents about 23 per cent of the total production in Tasmania. Thirty per cent of that milk goes to the domestic drinking milk market and fifty per cent into the domestic and international cheese market. Twenty per cent of the milk 'we actually do not need' but the company stated that it buys the excess milk to assist its suppliers in managing excess supply.[3]

Background

2.4 Low milk prices offered to suppliers by companies were raised during the inquiry. In relation to National Foods, the Tasmanian Suppliers Collective Bargaining Group (Bargaining Group) have been seeking to secure an improved liquid milk price offer from the company on behalf of suppliers. The Group is a collective of over 90 dairy farming members throughout Tasmania. Mr Philip Beattie, spokesman for the Group, stated that collective bargaining with the company 'worked quite well in the past'.[4] Mr Kemball Perkins, Chairman of the Group, argued that negotiations this year have proved more difficult:

> We did a negotiation, but when we were in Melbourne they asked for a flat price. We were talking about the pricing and they said they would not move the price. That was the final straw. We said, ‘We’ve got to take it further than that because we can’t survive.’ They were very intransigent on moving the price and they still are.[5]

1 Lion Nathan Ltd has now formally merged with National Foods.

2 Mr Donnison, Fonterra, *Committee Hansard*, 23 October 2009, p. 54.

3 Mr Waugh, NFL, *Committee Hansard*, 7 October 2009, p. 78.

4 Mr Beattie, Bargaining Group, *Committee Hansard*, 6 October 2009, p. 10.

5 Mr Perkins, Bargaining Group, *Committee Hansard*, 6 October 2009, p. 11.

Farm gate price for milk

2.5 Submissions and other evidence received during the inquiry commented on the low prices for liquid milk offered by major companies.

2.6 The Bargaining Group stated that in relation to National Foods:

> Basically, what happened was that the price offered formally last year was 49.7c on the base price. The cost of production is 39.8c in this scenario, and the offer this year is 29.7c, so it is pretty easy to deduce that it is about 10c less than we require to carry on the business—not to make money; that is just to survive.[6]

2.7 Under the new contract schedule announced in October 2009, National Foods stated that it will provide a minimum base price of 33 cents per litre across the year plus around 3.8 cents per litre in contract, quality, volume, and compositional bonuses to farmers. This adds up to 36.8 cents per litre. Should there be future price increases by Fonterra in response to world price movements, National Foods stated that it 'will maintain its minimum price premium guarantee against the Fonterra price'. In addition to the milk price offer, National Foods stated that it is offering a $1.1 million assistance package to help Tasmanian farmers – 'therefore, the total offer to farmers equates to a value of more than 37.5 cents per litre over the year.'[7]

2.8 The committee notes that Murray-Goulburn has increased its price this week to an average 31 cents per litre. Fonterra is expected to match or slightly increase this price reflecting general market circumstances.

2.9 The committee questioned National Foods about its latest price offer arguing that the new prices provide nothing additional in payments to what was on offer in the former contracts. Any additional payments are largely dependent on movements in Fonterra's prices, yet the offer was marketed as a 'new price'.

> Senator COLBECK—In other words, as you indicated to suppliers in your letter of 13 November, you are not going to offer that 1c step-up—or whatever it adds up to, 1.1c—because it is within the range of the premium that you are already offering over and above the cost. So effectively your offer decayed by that amount with the increase, or the step-up, that Fonterra offered last week.
>
> Mr Jeffrey—That is correct. We basically put our offer on the table two weeks prior to the Fonterra offer. We believe that our price is well and truly ahead.
>
> Senator COLBECK—So effectively you are not offering anything more than you offered at the beginning of the season in the new offer, because, if

6 Mr Perkins, Bargaining Group, *Committee Hansard*, 6 October 2009, p. 2. See also *Submission* 129, Bargaining Group, p. 9.

7 National Foods, 'National Foods takes offer direct to farmers', *Media Release*, 30 October 2009. See also Mr Jeffrey, *Committee Hansard*, 18 November 2009, p. 5.

> the Fonterra price moves enough, the only thing you are offering farmers is what you offered them at the beginning of the season. It has almost achieved that by the decay from the price offers in the last three or four weeks.[8]

2.10 National Foods responded that it understood the committee's argument but 'do not accept the analysis' that the company had not improved its price offer.[9] National Foods indicated that some farmers had accepted the price offer, although they declined to provide the committee with exact numbers.[10]

2.11 The committee also questioned National Foods concerning the $1.1 million assistance package (which amounts to 0.7 cents of the total price offer of 37.5 cents per litre). The committee argued that unless farmers apply for the package, because it involves an application process, they will not obtain the additional payment. The company indicated that this interpretation is 'incorrect'.[11]

2.12 In addition, the committee questioned National Foods on options available to the company should farmers not sign the contract by the closing date of 30 November 2009. The company was only prepared to indicate that it was considering a number of options.

> Senator COLBECK—Is it correct that your implication to farmers has been that you will pick up their milk but that you will pay the excess price, which is a much reduced price, for the milk that you pick up?
>
> Mr O'Malley—There are a range of options, and what you have just described is one of the options that would be open to us.
>
> Senator COLBECK—So will you be picking the milk up on 1 December if farmers do not sign?
>
> Mr O'Malley—We have said that we will be picking up the milk if farmers are not in a position to sign for their own reasons.
>
> Senator MILNE—What is the oversupply price you will be paying?
>
> Mr O'Malley—That has not been put in the public domain yet. We are still working on trying to ensure that we sign our farmers up through the current offer.[12]

2.13 Mr John Barker of John Barker and Associates, on behalf of the Bargaining Group, informed the committee that the National Foods offer 'fell well short' of the

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8 Mr Jeffrey, *Committee Hansard*, 18 November 2009, p. 5.

9 Mr O'Malley, *Committee Hansard*, 18 November 2009, p. 6.

10 Mr O'Malley, *Committee Hansard*, 18 November 2009, p. 7.

11 Mr Jeffrey, *Committee Hansard*, 18 November 2009, pp 9-10.

12 Mr O'Malley, *Committee Hansard*, 18 November 2009, pp 7-8.

39.8 cents per litre which dairy farmer suppliers require to cover their costs of production.[13]

2.14 ABARE data indicate that an average farm's total production costs would be approximately 38 cents per litre in 2008-09.[14] National Foods however disputes this figure arguing that, based on its estimates, milk production costs would be around 35 cents per litre.[15]

2.15 The Tasmanian Department of Primary Industries estimated dairyfarmers' costs of production at 42.3 cents per litre in 2007-08, 37.9 cents per litre in 2008-09 and 38.3 cents per litre in 2009-10.

2.16 The committee notes that in its submission to the Economics Committee inquiry into the Australian dairy industry the department noted that:

> The recent decrease in milk prices by the three major processors (Cadbury, Fonterra and National Foods) means that dairy farmers are predicted not to achieve satisfactory earnings this financial year as the milk price is below the cost of production.[16]

2.17 The committee notes that it is generally accepted that there is a higher cost of production for whole milk than for the drinking market.

2.18 National Foods argued that the global financial crisis has had an impact on the global trade in dairy commodities with dairy prices going into free fall – 'this led to a sharp reduction in the price being paid internationally and in Australia for farm gate milk'.[17]

2.19 National Foods stated that its contracts in Tasmania include a minimum price guarantee that ensures, on an annualised basis, that the price paid is higher than its major dairy co-operative competitors. The company stated that it paid a 3 cents per litre premium over Fonterra's price for milk in Tasmania in its previous contract, and 4 cents above the Fonterra seasonal ratio payment in its current offer.[18] The Bargaining Group argued that the pricing comparison is an example of 'smoke and mirrors' with National Foods not paying the same price for the same type of milk product. The National Foods premium is also conditional on strict adherence to

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13 Mr Barker, Correspondence to Chair, dated 23 October 2009.

14 ABARE, *Australian Dairy*, June 2009, p. 8.

15 National Foods, Answers to questions on notice, dated 25 November 2009.

16 Submission from the Tasmanian Department of Primary Industries to the Senate Economics Committee inquiry into the Australian dairy industry, p. 6.

17 *Submission* 136, NFL, p. 1.

18 *Submission* 136, NFL, p. 5; Mr Evans, *Committee Hansard*, 18 November 2009, p. 2.

quality and daily production requirements and heavy penalties apply.[19] Fonterrra also argued that the comparison is not valid:

> They are in a different business to us. We are in the commodity milk business and we pass those returns on the commodity international market through as the milk price.[20]

2.20 National Foods operates on a model farm concept. To ensure a year-round milk supply, the company has devised a model or a contract offer that rewards farmers that produce milk in the second half of the year – the January to June period. The basis of the offer to farmers is to pay a matching price in the first half of the year – the July through to December period – and in the second half of the year to pay a premium above its competitor of 4c to 6c per litre, depending on the market situation.[21]

2.21 National Foods argued that the underlying principle of this approach is that it calculates a contract offer that rewards farmers that produce milk in the second half of the year and ensures that the company can access milk supply throughout the year in order to satisfy its processing requirements.[22]

2.22 The committee raised concerns with this approach in that the model does not make allowances for such things as droughts and increases in the price of grain. Effectively the price locks farmers within some fairly tight supply constraints. Any seasonal circumstances such as have been occurring in Tasmania over past months create problems for farmers.

2.23 National Foods expressed confidence with the current system in that the company argues that it rewards farmers for providing milk at the period when it needs that milk, across 12 months of the year. The company noted however that:

> If you supply National Foods with milk when it is very efficiently produced and cheap, in the spring, you are penalised to a certain extent. But, in the autumn and winter and, in some parts of the country, late summer, where the cost of production is high because of the farming systems that have been adopted to produce that milk, there is a reward to the farmer who meets that supply pattern.[23]

2.24 National Foods suppliers do not appear to share this confidence and the committee received evidence that suggests that when averaged over the year payments to farmers are still below the costs of production and not more than Fonterra on average.

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19 *Submission* 129, Bargaining Group, pp 16-17. See also Mr Davenport, TFGA, *Committee Hansard*, 7 October 2009, p. 105.

20 Mr Donnison, *Committee Hansard*, 23 October 2009, p. 56.

21 Mr Bake, NFL, *Committee Hansard*, 7 October 2009, p. 83.

22 National Foods, Correspondence, 15 October 2009.

23 Mr Bake, NFL, *Committee Hansard*, 7 October 2009, p. 83.

2.25 The Bargaining Group argued that National Foods model system is based on a flat milk supply curve which does not 'exist in the real world'. Production is usually always lower in July and August and peaks in the later spring. National Foods bases its averages and pays more in these two months, and less than Fonterra for the rest of the six-month period although they claim on average they are paying the same.[24]

2.26 One witness noted that:

> …they [NFL] work on averages through this period. Fonterra pay slightly more in the first couple of months, in July-August, and then it goes down, whereas National Foods will pay a lot for July and August milk and then they will drop the arse end out of it for the rest of the season, which is what we are on at the moment. They work it out on the basis that, because we are supposedly producing the same amount of litres every day of the year, on average we are getting paid the same. So, again, in reality that is not right.[25]

2.27 Farmers who supply milk to Fonterra also complained about the low farm gate prices which are below the costs of production. One witness noted that:

> We have just been given a rise. At 29.4 cents a litre, it is well below the cost of production. The cost of production is, in our minds, about 40 cents. There is a DPI fellow independent who has done an assessment of four dairy farms in the whole local area. The independent survey showed that the cost of production was 40.56 cents per litre. So you can see we are well down on what we need to secure our investment.[26]

2.28 Other Fonterra suppliers noted that:

> We are currently paid $3.67 for a kilo of milk solids. This is around 27.8 cents. Our business is currently losing money and it is of great concern to us.[27]
>
> So the way we are headed at the moment with our Fonterra payments, we are actually going into reverse.[28]

Transparency in pricing

2.29 The issue of a lack of price transparency was raised in evidence to the inquiry, as well as difficulties in establishing relative costs in the value chain.

2.30 The companies argued that milk prices are set by market forces. National Foods stated that:

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24 *Submission* 129, Bargaining Group, section 4.

25 Mr Rogers, *Committee Hansard*, 6 October 2009, p. 4.

26 Mr Clarke, *Committee Hansard*, 12 October 2009, p. 21.

27 Mr Jones, *Committee Hansard*, 12 October 2009, p. 45.

28 Mr Gribble, *Committee Hansard*, 12 October 2009, p. 45.

> Both the ACCC and Dairy Australia have published reports that clearly identify that the international value of dairy commodities determines the farm gate value of milk in Australia. Over 60 per cent of the milk produced in Australia is exported to the global market. The key value drivers of that milk that is exported are the value of the dairy product itself that is traded as a commodity and the Australian dollar-US dollar exchange rate.[29]

2.31 Fonterra likewise argued that:

> The Australian manufacturing milk price is predominantly dictated by the global price of commodity products, set in US dollars. There is a direct correlation between dairy commodity prices and the farm milk price that we pay.[30]

2.32 Witnesses questioned this interpretation of price setting. Mr Beattie of the Bargaining Group argued that National Foods' milk products are sold domestically yet the international price argument is still used in setting prices:

> What are the reasons behind why National Foods are doing this to us? They are saying that it is part of the world market. They are saying that they have to respond to world market signals. There is no doubt that the world market has come back considerably, although it has gone back up again very recently. The only problem is that National Foods are selling almost none of their produce on the world market. It is being sold here as liquid milk, yoghurt and as premium soft cheeses in Tasmania and on the mainland of Australia. So we are at a bit of a loss to understand how they can use the world market price to force our price down.[31]

2.33 The committee also questioned National Foods in relation to international pricing arrangements. In relation to higher prices offered to NSW suppliers in contrast to Tasmanian suppliers, National Foods offered the following explanation:

> Mr Jeffrey—New South Wales pricing is under totally different market conditions to the Victoria, Tasmania, South Australia pricing. They are different markets and, due to that, there is different pricing in those markets.
>
> CHAIR—Is that just code for there is more market milk and less manufactured milk?
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> Mr Jeffrey—Yes.[32]

2.34 The committee noted, however, that previously National Foods indicated that prices were dependent on the international price yet the company was now suggesting

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29 Mr Waugh, *Committee Hansard*, 7 October 2009, p. 78.

30 Mr Donnison, *Committee Hansard*, 23 October 2009, p. 41.

31 Mr Beattie, *Committee Hansard*, 6 October 2009, p. 3.

32 Mr Jeffrey, *Committee Hansard*, 18 November 2009, p. 10.

that the price depended on different markets in different locations. National Foods stated that:

> There are many factors that go into a milk price. That is why it is such a complicated area. The southern prices are certainly run by the world commodity price, and the northern markets are a different market.[33]

2.35 Another submission also argued that in relation to the dramatic reduction in the prices offered to farmers – 'we do not accept their argument that the world commodity prices have slumped. We are producing milk for the liquid milk market in Tasmania. We believe they are ripping us off, because they can'.[34]

2.36 The committee raised the issue of a letter sent by National Foods to its wholesale customers in June 2009 informing them of 'necessary' price increases because of unprecedented increases in farmgate milk prices particularly in NSW, despite the fact the farm suppliers were struggling to survive with contract milk prices below the costs of production.[35]

2.37 The committee noted that:

> Senator COLBECK—It does not [send] much of a message to the farmers, though. You are telling them that because global prices are falling you are going to have to pay them less, well under the cost of production, and yet when you go into the market you are telling your customers that you have to put prices up.[36]

2.38 Mr Chris Oldfield, CEO of the Tasmanian Farmers and Graziers Association (TFGA), commenting on the letter found it 'offensive'. He added that:

> What National Foods need to understand is that, in a place like Tasmania, the bigger the company, the bigger the level of responsibility. I just do not think they quite understand that yet.[37]

2.39 The committee also raised the issue of relative costs in the value chain. While farmers have been obtaining as low as 20 cents per litre for milk, in supermarkets prices are over $2 per litre in many instances.

2.40 Witnesses noted the difficulties in obtaining cost estimates in the various phases of the value chain. Mr Robert Wilson, with long experience in the dairy industry, including milk processing, noted that:

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33 Mr Jeffrey, *Committee Hansard*, 18 November 2009, p. 11.

34 *Submission* 126, Mr Wilson, p. 3.

35 National Foods letter, dated 18 June 2009 – Tabled Document, 7 October 2009. See also Mr Evans, *Committee Hansard*, 18 November 2009, p. 2.

36 *Committee Hansard*, 7 October 2009, p. 85. See also National Foods, Correspondence, dated 15 October 2009.

37 Mr Oldfield, *Committee Hansard*, 7 October 2009, p. 111.

> All the industry today, under the deregulation terms, has to equate back to some form of benchmark price and, because we are deregulated, the industry is using the export earning price as that benchmark and that, of course, has dropped dramatically in the last couple of years because of all sorts of issues. But, if you take a farm-gate figure for farmers, the expectation of many farmers today of getting high levels per litre in the current deregulated situation is out of context to reality.[38]

2.41 Mr Wilson observed that in relation to the processes involved from receiving the milk to the discharge of the finished product 'efficiencies have been made in most factories and there have not, in my opinion, been large increases in costs'.

> If you are looking at a farmgate price plus a processing and packaging cost so that you get an ex factory price, including a reasonable margin on that part of the business, in my opinion there have not been any great price rises.[39]

2.42 Mr Wilson indicated that a lot of the 'intimate costs' in relation to distribution and retail costs are now 'in-house' and are therefore 'difficult to evaluate'. Mr Wilson noted that:

> …if you look at how this works, I do not think the farmers and their returns are considered enough by both supermarkets and current processors in terms of that particular aspect of the market milk industry today. Farmers are paid what is left over; they are not paid a price that is based on what would be a good benchmark for them to get a good return. That is the Australian market.[40]

2.43 Witnesses and submissions pointed to greater transparency in pricing under the former regulated system. One witness noted that:

> In traditional markets under the old market milk regimes of state authorities there was a price paid for the milk. There was a price which was a semi-wholesale price ex the factory. There was a wholesale price and a semi-wholesale price and then there was a recommended retail price. When there was a change in the price of liquid milk, it usually made the front page of the paper.[41]

2.44 One submission noted that since dairy farmgate deregulation, farmgate and retail dairy prices in Australia have become 'disconnected' and the large cuts in farm gate prices for market milk have been artificially linked to 'international milk prices' even though there is no one international milk farmgate price and the prices paid to Australian dairy farmers have been amongst the lowest in the world of international

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38 Mr Wilson, *Committee Hansard*, 23 October 2009, p. 23.

39 Mr Wilson, *Committee Hansard*, 23 October 2009, p. 23.

40 Mr Wilson, *Committee Hansard*, 23 October 2009, p.24. See also Mr Wilson, *Committee Hansard*, 23 October 2009, p. 29.

41 Mr Wilson, *Committee Hansard*, 23 October 2009, p. 29.

dairy exporters. This has meant that local market conditions have often been ignored despite the growing costs for Australian dairy farmers in times such as drought.[42]

Contracts

2.45 A number of concerns were raised during the inquiry in relation to the former contract arrangements with National Foods.

2.46 The Bargaining Group argued that in relation to the former contract:

> The National Foods liquid milk supply contract is completely company biased leaving virtually no leeway for suppliers.
>
> The Group is seeking to renegotiate the Clauses of the contract that it believes is unfairly weighted in favour of the Company.[43]

2.47 Specific issues raised by the Bargaining Group regarding the former contract included:

- multiple provisions in the contract that permit National Foods to make unilateral changes to the terms of the contract regardless of the consent of the producer;
- the requirement to supply minimum quantities of milk per month and the penalties imposed if the requirement is not met; and
- lack of indemnity by NFL in relation to any loss or damage that they may suffer resulting from NFL's breach of the agreement or NFL negligence.[44]

2.48 The Circular Head Dairy Farmers also raised a number of concerns with the former contract arrangements. These included:

- lengthy delays in contract negotiations and the withholding of any documentation, effectively forcing farmers to sign at a lower price or face the uncertainty of no contract and the risk of being unable to sell their product to National Foods;
- inferences that if contracts were not signed, back pay would not be forthcoming;
- evidence of manipulation of the monthly payment periods to suit a lower milk price being paid to producers;
- dairy farmers negotiating an agreement with one representative of National Foods, only to have the subsequent representative of National Foods deny any knowledge of such agreements;

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42 *Submission* 153, Ms Margetts, p. 3.

43 *Submission* 129, Bargaining Group, p. 10.

44 *Submission* 129, Bargaining Group, pp 10-12. The contract is at Section 6 of the submission. The legal opinion from Temple-Smith Partners, dated 9 September 2009, relating to the contract is also at Section 6 of the submission.

- farmers not being given copies of contracts despite agreeing to them and repeatedly requesting them;
- contracts not clearly being explained to farmers;
- farmers being penalised if they produce under contract levels or over contract levels;
- an inability to transfer milk contracts should their property be sold, thus reducing the value of the property; and
- unwieldy and complex accounting systems put in place by National Foods.[45]

2.49 The committee also received many individual submissions from farmers detailing their concerns with contracts with National Foods.[46]

2.50 National Foods have subsequently revised their contract arrangements with suppliers. The revised contract, dated 26 October 2009, was provided to the committee on 4 November 2009. National Foods informed the committee that the revised contract for 2009-10 was put to the collective bargaining group's law firm on 26 October 2009. No response has been received to date.[47]

2.51 National Foods argued that the revised contract offer for 2009-10 contains the following benefits for suppliers:

- the offer of longer term contract options with significant premiums for suppliers who seek the security of a longer term contract;
- the introduction of a minimum price guarantee;
- quality payments based on percentage of contract and monthly price; and
- confirmed contract pricing to December 2010.[48]

2.52 National Foods stated that the contract that the company put to suppliers:

> …has been amended to deal with the issues raised by the collective bargaining group.
>
> …We believe that these amendments address the specific issues raised by the Committee.[49]

2.53 In relation to Fonterra, rather than operate under an individual contract, the majority of Fonterra's suppliers are members of the Bonlac Supply Company (BSC)

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45 *Submission* 130, Circular Head Dairy Farmers, p. 1. See also Dr Abbott, *Committee Hansard*, 6 October 2009, pp 44-45.

46 See, for example, *Submission* 126, Mr Wilson, p. 2; *Submission* 140, L & E Carter, p. 1; *Submission* 137, Mr Oliver p 1.

47 National Foods, Correspondence, dated 4 November 2009.

48 National Foods, Correspondence, dated 4 November 2009.

49 National Foods, Answers to questions on notice, dated 25 November 2009.

and come under the formal supply agreement between BSC and Fonterra.[50] Fonterra's farmer suppliers are paid on the basis of the yield of butterfat and protein in the milk they supply the company to satisfy its manufacturing requirements. As a result the company does not offer farmers a price based on volume (i.e. cents per litre), but rather in dollars per kilogram of milk solids This means that there is no one single Fonterra farmgate milk price, but rather each supplier receives a price based on the quality composition of the milk they produce.[51]

2.54 In relation to the renewal of contracts, National Foods stated that it will honour contracts that were signed before the milk price collapse, and have not sought to re-negotiate these contracts. Contracts that have come up for renewal this year in Victoria and SA have been finalised. There are currently contracts up for renewal in Tasmania and WA. A majority of dairy farmers in NSW and Queensland will have their contracts renewed next year. NFL stated that 'as these contracts come up for renewal, dairy farmers will face reduced prices unless there is a major improvement in global dairy prices'.[52]

2.55 The committee questioned National Foods about the renewal of contracts.

> Senator COLBECK—Your submission tells us that you have got some contracts that are still in force that have higher prices. Have you renewed any contracts this year at higher prices?
>
> Mr Bake—No.
>
> Senator COLBECK—As you said in your submission, some contracts still include prices prevailing at periods when the world market was very high and, as a result of the global financial crisis, which we all understand, the contracts have been progressively reset. So the farmers in Tassie, who are getting 45c, the guys in Northern New South Wales, who are getting 48c, and the ones in Queensland, who are getting higher prices, are all, when their contracts expire, going to progressively see a reduction in the prices that you are paying to them?
>
> Mr Waugh—That is correct.[53]

2.56 In relation to the range of prices offered to newly contracted farmers across the states National Foods stated that:

> Mr Waugh—I can give you the equivalent number in our model. I gave you 32c and 32½c per litre. We have all of our farmers contracted at 34c a litre in terms of the new milk price in Victoria and 34c a litre in South Australia.

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50 *Submission* 50A, Fonterra, p. 4. BSC is owned by more than 1300 dairy farmers who supply Fonterra. The company operates on co-operative principles and acts as a collective group for negotiating prices with Fonterra.

51 *Submission* 50A, Fonterra, p. 3.

52 *Submission* 136, NFL, p. 4.

53 Mr Waugh, NFL, *Committee Hansard*, 7 October 2009, p. 84.

> That is based on the largest cooperative companies' position in those markets.
>
> CHAIR—How is New South Wales?
>
> Mr Bake—In New South Wales, new contracts have been signed at around 50c per litre.
>
> Senator COLBECK—New contracts?
>
> Mr Bake—Yes.
>
> Senator COLBECK—What is the change in price on those contracts?
>
> Mr Bake—They have come back from, I believe, about 54.
>
> Senator COLBECK—So, at 50c, there has not been much of a reduction in price in New South Wales?
>
> Mr Bake—That is right.[54]

2.57 A number of options were suggested to reduce the risk to dairy farmers from the financially damaging impacts of current milk pricing arrangements. Professor Ian Lean suggested three options:

- Allow producers who are supplying milk for internal supply to negotiate milk pricing based on being priced above or minimally equal to the cost of production of milk produced by export milk producers on an annual basis. Therefore if external markets drop below costs of production for a prolonged period, the more expensively produced internal market is buffered, allowing Australia to maintain a base level of milk production to meet internal needs.
- Establish a rolling average system to reduce spiking in the market, either up or down. While this will reduce the potential for 'windfall profits', this is difficult to achieve in dairy systems due to the underlying biology. This option may act to reduce the effect of profound declines in milk value in the past 12 months.
- Allow for parity in negotiation – large farmer groups controlling a significant proportion of production capacity are essential to provide some degree of parity in the negotiating process.[55]

Viability of producers

2.58 Submissions and other evidence emphasised that the low farm gate price for milk is threatening the viability of many dairy farmers.

2.59 The Tasmanian Department of Primary Industries stated that:

> By our calculations, costs of production are currently well above prices offered—that is, prices are about $3.70 per kilo for milk solids and costs are at least $4. In our experience, this is unique over the last two decades. This

54 Mr Waugh/Mr Bake, NFL, *Committee Hansard*, 7 October 2009, p. 84.

55 *Submission* 141, Professor Lean, pp 4-5.

understates the problem, as the costs exclude financing. This can add up to a further $1 per kilo of milk solids to costs. Unfortunately, this hits hardest the younger and most progressive farmers who have invested heavily in their farms. To complete this perfect storm, the current slight recovery in world prices is being offset by the high exchange rate of the Australian dollar against the US dollar.

So all dairy farmers are under stress, but there appear to be particular issues around the supply of fresh milk to National Foods.[56]

2.60 The Tasmanian Department further added that if milk prices continue at their current level more farmers will exhaust their financial resources and come under pressure to exit the dairy industry. Tasmanian dairy farmers have the lowest costs of production in Australia but their businesses 'will not be viable if farm gate prices do not allow a profit to be made'.[57]

2.61 The committee heard evidence that National Foods had actively encouraged producers to increase production and thereby invest in plant and equipment.[58] Mr Perkins of the Bargaining Group stated that:

I do not know what the exact number is, but that was a ploy they used to encourage more production at that time, when things were looking good.[59]

2.62 The committee raised this issue with National Foods. The company indicated that it was not their policy to encourage production.

Mr Bake–At times a lot of farmers come to us to talk about their growth aspirations and that is usually initiated by the grower, not by National Foods.

…..

Mr Waugh—If it is established that that took place, I feel we would have an obligation to buy that milk, but from where I sit in National Foods, there has been no corporate directive to grow milk supply in Tasmania.[60]

2.63 The committee notes that in contrast Fonterra has encouraged suppliers to expand production and this policy continues.

Senator O'BRIEN—So there was in the past an encouragement. When did that cease?

Mr Donnison—It has not ceased. If Bonlac Supply Co. suppliers still want to grow their business they are free to do so. We are obligated through the

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56 Mr Evans, *Committee Hansard*, 6 October 2009, p. 33.

57 *Submission* 138, Department, p. 11.

58 *Submission* 129, Bargaining Group, p. 14; *Submission* 125, R & C Bignell p. 1; *Submission* 126, Mr Wilson, p. 2.

59 Mr Perkins, Bargaining Group, *Committee Hansard*, 6 October 2009, p. 8.

60 Mr Bake/Mr Waugh, NFL, *Committee Hansard*, 7 October 2009, p. 94.

milk supply agency agreement pick up every drop of milk that they produce.[61]

2.64 The committee also questioned National Foods regarding the industry-initiated growth plan for the industry in Tasmania – Dairy Tas 500. National Foods indicated they were unaware of the program.

> Mr Waugh—…I was surprised to hear the other day of how substantial that growth plan is in Tasmania. My feedback to the minister I was talking to at the time was: who is going to process it and where is it going to be sold? I am the CEO of National Foods and I was unaware of it.
>
> Senator COLBECK—You are kidding me.
>
> Mr Waugh—I am not kidding you.
>
> Senator COLBECK—I went to a public launch with most dairy farmers in Tasmania three or four years ago. You must have your hands over your ears or something. I cannot understand that you do not have any understanding of the growth plans of the industry in Tasmania. It was a significant launch. It got huge publicity within Tasmania.[62]

Effect on regional communities

2.65 Evidence to the committee indicated that the low milk prices are having a number of adverse consequences on local communities and the local economy.

2.66 The financial and emotional effects on the community were highlighted during the inquiry. The Circular Head Dairy Farmers stated that farmers fear for the future 'of their family, farm, livestock and the community in which they live'.[63]

2.67 One witness commented on the emotional impact of the situation:

> The other thing I will touch on very briefly in this…is the effect this all has on the family situation. My ‘hand-holder’ is not here today. She is totally disillusioned with the whole thing. We have done a lot of hard work. We have had two dry years. We are finally at the point where we think we can make some money, and that has just been pulled out from under us. She cannot understand why I get up in the mornings at some terrible hour.
>
> We have put our everything into this operation. We have spent a long time building equity. We have put a lot of hard work into it. It is our superannuation; it is our retirement. It is our dream. But greedy multinationals who do not have regard for the families are benefiting. They

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61 Mr Donnison, *Committee Hansard*, 23 October 2009, p. 58.

62 Mr Waugh, *Committee Hansard*, 7 October 2009, p. 95.

63 *Submission* 130, Circular Head Dairy Farmers, p. 1. See also *Submission* 123, Mr Bovill, p. 5; *Submission* 121, Dr McCall, p. 7.

> do not consider what they are doing in terms of breaking the families, killing dreams and bankrupting people.[64]

2.68 The Tasmanian State Opposition also commented on the 'serious emotional and financial distress' of farmers in the North-West of the state and the 'grave plight they are in'.[65]

2.69 Witnesses raised the question of how long these businesses can sustain the losses they are currently experiencing. One witness noted that some farmers 'have already gone beyond the tipping point'.[66] Another witness stated that:

> In fact, it has got so serious in Tasmania, and perhaps even worse on the northwest coast, that the aged payables, the creditors from last season, cannot be paid. To give you a real farm case, I was at a farm on Monday whose income is only going to be $313,000 dollars for the year but the farmer has $307,000 in aged payables out to 120 days. That is the seriousness of the situation for the majority of the dairy farmers in Tasmania. It is fact.[67]

2.70 Mr Oldfield of the TFGA noted that the economic effects on the region impact far beyond the farm gate:

> Farmers in the north-west and Circular Head believe that there will be a reduction between $80 million and $100 million a season in that region. A whole lot of businesses rely on this industry…This is not a matter of losing money. Farmers will survive, and sometimes for a while, losing money. What they will not survive is when the bank says, ‘We want our cash.’.[68]

2.71 The Tasmanian Department noted that if dairy farming becomes unviable the ultimate consequence is significant rural adjustment which has flow-on effects to both rural communities and urban service centres – 'such impacts are more pronounced in a State such as Tasmania where the economy is highly dependent on agriculture'.[69]

Role of the ACCC

2.72 The role of the *Trade Practices Act 1974* and the effectiveness of the ACCC in protecting consumer interests were raised during the inquiry.

2.73 The Bargaining Group indicated that it has obtained an initial legal briefing and a legal letter had been sent to National Foods.

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64 Mr Wilson, *Committee Hansard*, 6 October 2009, pp 17-18. See also Dr Abbott, *Committee Hansard*, 6 October 2009, p. 48.

65 *Submission* 135, Tasmanian State Opposition, p. 1.

66 Mr Davenport, *Committee Hansard*, 7 October 2009, p. 108.

67 Ms Williams, *Committee Hansard*, 7 October 2009, p. 108.

68 Mr Oldfield, TFGA, *Committee Hansard*, 7 October 2009, p. 109.

69 *Submission* 138, Department of Primary Industries, p. 12.

> The initial legal brief suggests National Foods has potentially contravened the provisions of Point IVA of the *Trades Practices Act* exercising unconscionable conduct. It is also quite possible that other Sections of the Act have been contravened.[70]

2.74 The submission from the Circular Head Dairy Farmers details a number of individual allegations by farmers suggesting unconscionable conduct by National Foods.[71] Concerns were also raised by franchise owners and their relationship with National Foods.

> The excessive price rises endured by Franchisees, have allowed the Coles and Woolies generic milk sales to skyrocket, and price to remain constant. We are ripped off, and Dairy Farmers Limited hides behind our Franchise Agreement to do it – to the detriment of the customer who choose to support local business.[72]

2.75 Some allegations of price collusion between National Foods and Fonterra were made during the inquiry. The committee was informed that National Foods, as a matter of course, issues their prices after Fonterra has announced their price.[73]

2.76 The committee questioned National Foods about this price setting arrangement. National Foods stated that:

> Senator STERLE—…Fonterra normally set the price first in Tasmania and then you follow?
>
> Mr Waugh—We like to see where the market opens.
>
> Senator STERLE—Why don't you lead?
>
> Mr Waugh—Because we are not the price setter in the marketplace; we are a price taker.
>
> CHAIR—You are the market milk people though, aren't you? They are the manufactured milk people.[74]

2.77 Fonterra also denied allegations of price collusion:

> Our milk price is based on market returns and that is based on the international price and taking into account what is happening with the Australian dollar. What other companies do in terms of their milk price is entirely their business.[75]

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70 *Submission* 129, Bargaining Group, p. 18.

71 *Submission* 130, Circular Head Dairy Farmers, pp 4-13.

72 *Submission* 148, J Gration & D White, p. 6. See also *Submission* 152, Mr Williams, p. 13.

73 *Submission* 130, Circular Head Dairy Farmers, p. 1; Mr Wilson, *Committee Hansard*, 6 October 2009, p. 23.

74 Mr Waugh, *Committee Hansard*, 7 October 2009, p 101.

75 Mr Donnison, *Committee Hansard*, 23 October 2009, p. 55.

2.78 The matters raised during this inquiry highlight the broader question of the current capacity of the Trades Practices Act to effectively protect small and medium businesses from unfair and unreasonable conduct.

2.79 Some submissions were highly critical of the role of the ACCC in protecting consumer interests. One submission noted that:

> Being a both a regulator and policeman is a problem but the ACCC is a peculiar policeman. The ACCC doesn't fight crime independently. It doesn't search for evidence or seek to prevent corporate misadventure under the Trade Practices Act (1974). The ACCC acts when [a] complaint is made or it is directed by its responsible Minister to do so. The ACCC is a stay-at-home policeman, only called out after the crime has been alleged or committed.[76]

2.80 Another submission noted that the dairy industry represents:

> …one of the clearest examples of increasing market power for corporations whilst reducing market power for primary producers and other participants in Australia's food supply chain.[77]

2.81 The committee notes that in competitive market situations in other areas of Australia prices paid to dairy farmers are substantially greater. As previously indicated, National Foods is offering new contracts to NSW farmers at 50 cents per litre, whereas in Tasmania the price is substantially lower.

2.82 The committee questioned National Foods about this situation:

> Senator COLBECK—And that is based on the fact that you have got competitors in the market that are paying a higher price so you have to pay a higher price to get milk?
>
> Mr Bake—Regional market forces do play a part, yes.[78]

2.83 The Tasmanian Department noted that issues of market power are particularly important in Tasmania. The state's size and industry composition mean that relatively small numbers of farmers, often individually of limited economic strength or bargaining power, are inherently at a disadvantage as against the companies that provide their buying market. The Department noted that the Tasmanian Government is highly conscious of what is often perceived as a power imbalance in this area, and argued that the ACCC should continue providing for reasonable bargaining frameworks for farmers'.[79]

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76 *Submission* 121, Dr McCall, p. 3. See also *Submission* 123, Mr Bovill, pp 5-6.

77 *Submission* 153, Ms Margetts, p. 9.

78 Mr Bake, *Committee Hansard*, 7 October 2009, p. 85. See also Mr Jeffrey, *Committee Hansard*, 18 November 2009, pp 10-11.

79 *Submission* 138, Department of Primary Industries, p. 3.

2.84 The Tasmanian State Opposition also argued that the use of market power by major milk companies should be closely examined so that farmers receive a fair price for their premium product.[80]

Committee view

2.85 The committee views with great concern the relatively low farm gate prices offered to Tasmanian dairy farmers which are well below the costs of production.

2.86 The committee believes that the new contracts announced by National Foods in October 2009 provide nothing additional in payments to what was on offer in the former contracts. Any additional payments are largely dependent on movements in Fonterra's prices, yet the offer was marketed as a 'new price'. The maximum price offer of 37.5 cents per litre is well short of the 39.8 cents per litre which dairy farmers require to cover their costs of production.

2.87 The low farm gate price for milk is threatening the viability of many dairy farmers in Tasmania. If milk prices continue at their current level many farmers will exhaust their financial resources and come under pressure to exit the industry. As the Tasmanian Department of Primary Industries noted, Tasmanian dairy farmers have the lowest costs of production in Australia but their businesses will not be viable if farm gate prices do not allow a profit to be made.

2.88 Low farm gate prices will have dire consequences not only for individual farmers but also for local communities. If dairy farming becomes unviable it will also have a resultant economic impact on the regional and Tasmanian economy. Evidence indicated that such impacts are more pronounced in a state such as Tasmania where the economy is highly dependent on agriculture.

2.89 Evidence presented during the inquiry raised a number of issues concerning the former contract arrangements between suppliers and, in particular, National Foods. The committee notes that National Foods has recently revised its contract with suppliers. The committee sought independent legal advice on the contract. This advice indicated that the contract is fairer than the original contract. However, although the revised contract addresses some of the concerns raised in evidence to the committee, the advice suggested that there is scope for further improvements in the terms of the contract. The advice is at Appendix 3. The committee believes that the Senate Economics Committee's inquiry into the Australian dairy industry should further examine the contractual arrangements between suppliers and buyers.

2.90 The committee believes that there needs to be greater transparency in relation to milk pricing by companies. Evidence pointed to great difficulties in obtaining cost estimates in the various phases of the value chain.

80 *Submission* 135, Tasmanian State Opposition, p. 2.

2.91 The committee also has concerns about the market concentration by major dairy companies in Tasmania and believes that this situation raises serious questions in relation to the use of market power within the industry. The recent merger of Lion Nathan with National Foods creates an even larger conglomerate and may have further implications for competition in the market. The committee notes that one of the terms of reference of the Senate Economics Committee's inquiry into the dairy industry is to inquire whether aspects of the Trade Practices Act are in need of review having regard to market conditions and industry sector concentration in the industry. The committee believes that this aspect of the reference should be rigorously pursued by the Economics Committee.

Senator the Hon Bill Heffernan

Chair