

PUBLIC SUBMISSION

to

SENATE ECONOMICS COMMITTEE

INQUIRY INTO COMPETITION AND
PRICING IN THE AUSTRALIAN DAIRY
INDUSTRY

BY

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(Dairy Farmers Limited is a division of National Foods)

*The Secretary
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Introduction

Our names are Julie Gration and David White. We are Dairy Farmers Limited Franchise Owners, delivering milk to general route customers. We have 4 children – Matthew, 9, Thomas, 7, Ryan, 4 and Lachlan 18 months. Currently, we service approximately 150 customers in the Macarthur region. We employ two local people to drive for us.

Five years ago we bought a Dairy Farmers Franchise – in the hope of owning our own business and creating a bright future for our children. We have invested in our business approximately \$300,000 and work seven days a week. Through our franchise we have had the opportunity to interact, and become friends with many of the local farmers who supply the processor and regularly discuss milk pricing and the industry. They too, are appalled at the system and cannot understand why we are paying \$2.77 for a two litre bottle wholesale.

We felt compelled to make a submission, as it seems that the farmers, franchise owners and consumers seem to get the rough end of the stick, price wise, in the milk industry. Prior to now we have lobbied the ACCC to investigate the milk industry and the price the consumer is paying for the product versus the price paid to farmers at the farm gate. We applaud the Senate for taking the time to ensure that answers are provided by, what has now become a virtual monopoly in the drinking milk market.

We urge the Senate to find out, through this enquiry:

- How much does it cost – from Farm to Franchisee to consumer – to produce a litre of milk
- Is there a difference between Generic and Branded product in quality
- Have the processors breached the Trade Practices Act in relation to Price fixing, Resale Price Maintenance, cartel provisions and acted unconscionably in relation to the price the end consumer pays for Milk
- If the current Franchise system we operate under disadvantages the consumer
- How the processors can justify the outrageous price consumers pay for milk in Australia compared with other countries

National Foods acquiring Dairy Farmers (Australian Cooperative Foods Limited)

The ACCC is supposedly "promoting competition and fair trade in the market place to benefit consumers, businesses and the community". Yet this body approved the merger of the two biggest drinking milk manufacturers in Australia. Would the ACCC have let Ford Motor Company buy Holden in Australia – answer – NO WAY! But they have allowed National Foods, in the past, to have a virtual monopoly in the Juice market, so it is not surprising.

Undertakings made by National Foods were made – these were court enforceable. They also made subsequent "commercial decisions" - the sale of the Perfection brand and contractors in NSW, which were not competitively assessed by the ACCC and not part of original undertakings.

What no one bothered to look at was the Franchise system that Dairy Farmers had in place. So when National Foods had to divest the brands and maintain an independent business until the divested assets were sold, our Franchisor actively competed with us in the market place. During the divestment period, National Foods were (and still are in regards to some customers) responsible for the ordering, pricing, billing and collection of milk sold to customers who are delivered to by Parmalat Distributors in NSW¹. We can prove that these customers are paying less than our cost for product². The excuse used prior to the sale to Parmalat was National Foods had to maintain a viable business to sell – but what is the excuse now? There is no excuse and the ACCC don't care.

In the divestment period it was "hands off" Pura customers – but free reign on ours! National Foods Sales Team was instructed not to approach these customers to switch brands, as they had to sell a "viable business". This practice was to the detriment of the independent retailers, who did not have the opportunity to source alternate supply in the white milk and impulse milk market. This in turn disadvantaged the consumers, as National Foods were the owners of most of the impulse and white milk market in NSW.

We spoke to various people in the ACCC regarding this (in both Franchising and Mergers), as National Foods continually blamed the ACCC and the undertakings made. The ACCC however stated it was not at their instruction that this was happening, and we should direct our complaints to National Foods. We did this, and National Foods blamed the ACCC³. So basically – we had to cop it, as did the consumer.

The ACCC have a lot to answer for when it comes to allowing this merge and the sweetheart "commercial deals" that were made behind the scenes. They are supposedly the body that looks after competition – but allowed National Foods to have a monopoly for 6 months. Going forward, National Foods own most of the cheese brands, juice brands and generic milk brands that you see on supermarket shelves. We urge you – next time you are in Coles or Woolworths, pick up cheese or juice and have a look at the manufacturer – and 8 times out of 10, it will be a company owned by National Foods (refer to National Foods website www.natfoods.com.au).

Milk pricing at Wholesale Level compared to Farm Gate

¹ See attachment titled "Sale Agreement with Parmalat" - author Gary McMahon, National CFS Distribution Manager, National Foods.

² See attachment titled "Customer Invoice 27042009" as obtained from a customer receiving milk from Divestment Company but invoiced by National Foods.

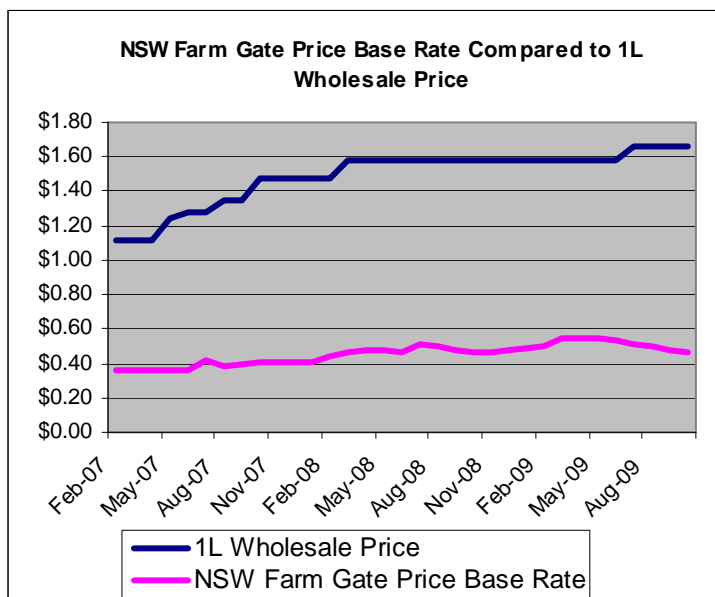
³ See attachment titled "Letter from Eddie Ambrosius 03032009" – author Eddie Ambrosius, National Franchise Development Manager, National Foods

We will try to explain, in depth the different pricing structures that exists within the Franchise system. This is a very complex structure and one, which we have always believed, is a breach of the Trade Practices Act. 1974 – in some form. This may explain to the senate enquiry why the price of milk seems to rise so often to consumers – in particular the outlets that are not part of the Coles and Woolworths duopoly. In the five years we have owned a Franchise, we have implemented no less than 7 price increases at the peril of Dairy Farmers/National Foods⁴. NO SUPERMARKET has had to endure these price increases – only route customers, Franchisees customers. As per an open letter from Ashley Waugh CEO National Foods, Supermarket pricing for private label milk rose but has since dropped⁵.

We, as Franchise Owners sell milk to general route customers, service stations, corner stores etc for Dairy Farmers Limited (a division of National Foods) under a Franchise Agreement. For us to buy a one litre branded whole milk from our Franchisor it costs \$1.66. We are “independent” businesses. However, all customers can be categorised into one of the following groups:

- 1 Dairy Farmers Negotiated Rebate Customers
- 2. Key Account Customers
- 3. General Route Rebate Customers
- 4. General Route Customers

We have prepared a graph showing the NSW Dairy Farmers Milk Co-operative (DFMC) Farm Gate base rate⁶ versus the price increases imposed on the Franchise Network from February 2007 to October 2009. This has a flow on effect to any consumer that buys milk somewhere other than Coles or Woolworths. This may explain to the committee, why the milk price is constantly on the rise. As per DFMC website, the minimum base rate for NSW is only going down which will make the gap wider, going forward.



1. Dairy Farmers Negotiated Rebate Customers

These are customers such as Caltex, Mobil, Michels, McDonalds, who negotiate directly with Dairy Farmers in relation to pricing, but we invoice and hold the account for. These customers are offered discounts, to the point where the cost to these customers buy milk less than

⁴ See numerous attachments regarding price increases to NSW Franchisees
⁵ See attachment titled “Open Letter regarding Tasmanian Milk Pricing” – Author Ashley Waugh, CEO, National Foods
⁶ As obtained from Dairy Farmers Milk Co-operative, Dairy Farmers Website and other sources

the cost to the Franchisee who delivers it. There are 55 customer groups who we MUST charge less than our cost (and the number of groups grows weekly). The pricing offered to these customers varies, but starts at \$1.82 for two litres of milk. For the customers where we MUST sell less than our cost, we are offered a "Rebate". A Rebate is where Dairy Farmers Limited will reimburse you back to the cost of the milk, as well as a small amount (on average 15 cents per litre (30 cents on a 2L bottle) as a "delivery cost".

We have raised this as an issue with both the ACCC and National Foods. Because they set the "maximum" sell price, they believe it is not price fixing/resale price maintenance. However, when the maximum sell price is below our cost, you would think this was anti competitive behaviour.

2. Key Account Customers

These are customers where pricing, invoicing and collection is done by Dairy Farmers. An example of these customers would be Coles Express Service Stations. We deliver to these customers and Dairy Farmers pay us a flat rate for delivery depending on the product. This equates to 16.2 cents a litre (32.4 cents a unit) on a two litre Dairy Farmers branded whole milk. Generic milks are considerably less (about 8 cents a litre) whilst flavoured milk and dairy is more (about 48 cents per litre).

I have spoken to the ACCC about loss leading. For example, Coles Express Service Stations buy the two litre "You'll Love Coles" whole and lite milk for \$1.85 per bottle. For the last 18 months, they have had a permanent special on in store, two units of two litre milk for \$5.00. No one knows how much it costs for the processors to bottle a two litre milk. We have farm gate pricing available to us, and it is roughly costing National Foods between \$0.40 and \$0.50 cents per litre at the Farm Gate (depending on the farm region). But Dairy Farmers Limited often tell us as Franchisees, that it is not viable to offer customers milk for less than \$2.40 for a two litre bottle. So if this is correct, how many customers do they loss lead with?

3. General Route Rebate Customers

These are customers that we have full responsibility for (as Franchisees), however they require some form of discount below our cost. We then have to go back to Dairy Farmers Limited and ask them if this customer can be accommodated. This is at Dairy Farmers Limited absolute discretion. A Rebate is where Dairy Farmers Limited will reimburse you back to the cost of the milk, as well as a small amount (on average 11 cents per litre (22 cents on a two litre whole milk bottle)) as a "delivery cost".

4. General Route Customers

These are the poor customers that we determine their pricing. They buy their milk with no discount and endure endless price increases at Dairy Farmers Limited peril. General wholesale price for a two litre milk is \$3.51 and the recommended retail price (there is no obligation for them to comply with it), is \$4.00. In order to keep a viable business as a Franchisee, we have to try our hardest to keep shops on this pricing. Given many coffee shops and small business can go to Woolies or Coles and buy three litre generic milk for \$3.16 – how can I compete with that – they are getting an extra litre of milk 45 cents cheaper. It benefits consumers – hell yes, but makes my "independent business" unable to compete. All these customers are allocated by our Franchisor, which may be in breach of the new Cartel provisions under the Trade Practices Act.

Franchising and National Foods

National Foods originally had a contractor distribution system. However they inherited a Franchise system in acquiring Australian Cooperative Foods. The Dairy Farmers Limited Franchise system, in NSW alone, purchased in excess of 340 million dollars worth of milk (07/08 financial year). We cannot compete, when the terms and pricing offered to us by the

Franchisor, are harsh and oppressive in comparison to their other customers. We sign agreements to be exclusive (for which they do not have exclusive dealings authorisations lodged with the ACCC), yet are constantly subjected to price increases at Dairy Farmers Limited peril – whilst Food Service, Supermarkets and Key Account Customers buy product cheaper than us and on better terms, which in turn, disadvantages the consumer and is to Coles and Woolies advantage.

A group of vendors tried to negotiate in relation to pricing, terms and other matters with Dairy Farmers Limited, to allow us to compete (see attachment 2). However we subsequently had to lodge it with the Office of Mediation, as they would not commit to timeframes for review. They would not attend mediation with us as a group and required we negotiate separately – at a cost of \$1400 each. Many Franchisees do not have the funds or the skills to negotiate with a multi national company. No one has the funds to challenge Dairy Farmers Limited a division of National Foods (a wholly owned subsidiary of Kirin Holdings) in court regarding the agreement, pricing or anything else.

I have instances where they have breached the Franchising Code of Conduct in relation to providing disclosure documents, non disclosure of materially relevant terms of the agreement, unilateral variation of the agreement and non compliance of issuing marketing fund statements. All of which has been forwarded to the ACCC – but to date, remain unpunished.

The Kirin Holdings bandwagon keeps rolling with the imminent merger of Lion Nathan and National Foods. We recently obtained a disclosure document – which virtually spells out the demise of the Franchise System as it is today. What is in store for our future? – your guess is as good as mine. The independent corner store will either become extinct, or will be forced to align themselves with a multi national brand (eg. Lucky 7, Seven Eleven) in order to compete and obtain product at a reasonable price. With customers moving to centralised distribution and big business making deals, it seems that my business will become extinct not to mention the deals already made with Linfox for distribution.

Our Franchisor claims to be “open and transparent” in their dealings with the Franchisees. However no one will answer why most brands we now distribute are owned by National Foods and only licenced to my Franchisor, Dairy Farmers Limited.

We as an independent business are bound by the Franchise Agreement, where Dairy Farmers Limited forces us to sell milk less than our cost. 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 CONSUMER WHO CHOOSES TO SUPPORT LOCAL BUSINESS. The “Milko” is on the verge of extinction.

Conclusion

OUR FRANCHISOR

- FORCES US TO SELL MILK CHEAPER THAN WE BUY IT FOR
- FORCES US TO BREACH THE TRADE PRACTICES ACT – AS FRANCHISEES WE COLLUDE IN REGARDS TO PRICING FOR DAIRY FARMERS NEGOTIATED REBATE CUSTOMERS

- USES US TO PROP UP THEIR LOSSES IN OTHER PARTS OF THEIR BUSINESS,
- COMPETES AGAINST US (COLES, WOOLIES AND FOODSERVICE) AND OFFERS BETTER TERMS, PRODUCT RANGE AND PRICING

And we make less than the farmers in some instances.

The ACCC don't care, and, eventually the only people who will win out, is big business. As a Franchise system, in the current format, we are unable to compete with the supermarket giants – even though as a franchise network collectively should have buying power. This has a major impact on the consumers who don't shop at Coles and Woolies, and are trying to do the right thing by supporting their local corner store, small independent supermarket or local service station etc.

Let's give small Australian business, farmers and shop owners a fair go when it comes to milk and implement the following:

- A Franchising Ombudsman – specifically to handle Franchisors and Franchisees
- A system where the large processors allows their distributors/franchisees to compete when selling milk or buy back the Franchise agreements and turn us into distributors
- Investigation of possible breaches of the Trade Practices Act 1974 in relation to
 - Loss leading
 - Deceptive and misleading conduct
 - Price discrimination
 - Price fixing

In closing, the grocery trade, price discrimination and cross subsidisation by the processors and the processors hiding behind unfair Franchise agreements are adversely affecting route trade Franchisees. This in turn, severely impacts the level of competition and the unrealistic pricing in the retail small business sector and the inability to compete with the likes of Coles and Woolworths. We would be only too happy to attend and give evidence to the enquiry, in order for a fairer system for all concerned – in particular Franchisees, Farmers and ultimately the Australian consumers.

Kind Regards

Julie Gration and David White
Independent Dairy Farmers Franchisee