The Senate

Economics References Committee

Milking it for all it's worth — competition and pricing in the Australian dairy industry

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Executive Summary

Senate inquiry into competition and pricing in the Australian dairy industry: milking it for all it's worth

This inquiry of the Senate Economics References Committee into competition and pricing in the Australian dairy industry follows a number of other investigations which the Committee has completed, which reflected on various aspects of Australian competition policy. Like those inquiries, the current examination of the dairy industry has raised issues concerning competition, including questions of market power, mergers and acquisitions, and the effectiveness of the Australian Competition and Consumer Commission. In light of these inquiries, and the experiences of the dairy industry brought to the Committee's awareness throughout this inquiry, the committee suggests that a broader review of national competition policy is currently warranted.

Recommendation 5

The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and publish its report by 30 April 2011.

Since its deregulation in 1999 the Australian dairy industry has evolved from a protected and regulated industry with many small farms, to one based on fewer but larger farms competing both nationally and internationally. During this period significant consolidation has also been occurring at the retail and processor levels, which are now dominated by two supermarket chains and a handful of (now mostly foreign owned) processors, placing the farmers at a competitive disadvantage. These structural changes were masked in the boom years. Indeed in 2007-08 Australia's dairy farmers were receiving record high farmgate prices for their milk and confidence was high – there was overconfidence in some industry advisors. That changed more or less overnight with a fall in the international commodity price which was followed by processors announcing price step-downs.

The reduction in farmgate prices for Australia's dairy farmers led the Senate to refer the matter for inquiry, with terms of reference particularly focussed on the impact of consolidation that has occurred within the dairy supply chain since deregulation of the industry in 1999 and the effectiveness of the *Trade Practices Act 1974*. The inquiry commenced at a time when dairy farmers were appealing to government that the larger players within the processing and retail sectors were taking advantage of their market power to 'milk them for all they were worth' in what was a volatile period in the global marketplace.

Historically, the market for which a farmer's milk is destined has determined the price received at the farmgate. Evidence taken at this inquiry, however, suggests that the farmgate price of milk is now determined more by the amount of competition (or lack thereof) between processors in the various dairying regions rather than the international commodity market. While it is hard to find precise data, it is evident that the retailers are making far more profit from the sale of drinking milk than are the farmers.

Recommendation 3

The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and publish the results of that review by 30 September 2010.

Recommendation 2

The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The committee also heard that the use of collective bargaining during the negotiation process has had some success in helping farmers achieve a better return. The Committee therefore sees merit in bolstering existing collective bargaining laws to ensure that parties to negotiations are on equal footing and cannot simply 'walk away' from negotiations.

Recommendation 12

The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and report by 30 April 2011.

Recommendation 13

In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- **allowing collective bargaining groups to merge to address imbalances in bargaining power;**
- **the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and**
- **the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.**

The Committee notes the success of farmer cooperatives in the past and the continuing strength of Murray Goulburn. The Committee questions the demise of these organisations and recommends investigating the need for reform to facilitate their increased use.

Recommendation 11

The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

In investigating the issue of farmgate price, the Committee considered the price being received at all points throughout the supply chain. The Committee notes with concern that the Australian retail grocery sector is dominated by the two major supermarket chains of Woolworths and Coles who, between them, have captured up to 80 per cent of the grocery market. This, together with the growth in the sale of generic milk (and generic products in general) led the Committee to investigate the relationship between the few large processors and these two supermarkets. The Committee also heard evidence suggesting that the supermarkets' increasing share of the milk market through the sale of generics is putting pressure on processors who are increasingly in the position of having to compete with their own branded goods.

What has been identified should, in the eyes of the Committee, be of concern to all Australians. The evidence suggests that section 46 of the Trade Practices Act is not operating effectively. Larger players are allowed to dictate terms to the weaker parties in the chain (ie the dairy farmers).

In light of this evidence, the Committee has recommended a raft of changes that are designed to enhance the effectiveness of the Trade Practices Act, particularly those provisions relating to misuse of market power, predatory pricing, mergers and creeping acquisitions and the need for anti-price discrimination legislation.

Recommendation 1

The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and considers reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

Recommendation 4

The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

Recommendation 6

The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

Recommendation 7

The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

Recommendation 8

The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

Recommendation 9

The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

Recommendation 10

The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

In recommending these changes the Committee also highlights the issue of food labelling. In the interests of consumer education and choice, the Committee strongly believes that, particularly where fresh products are involved, matters of provenance, additives and production should be made clear and urges the Australian and New Zealand Food Regulation Ministerial Council to consider these matters in its existing review.

Recommendation 16

The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

The evidence heard throughout the inquiry has identified the interrelated nature of the issues and problems within the Australian dairy industry. It is the view of the Committee that reform at each level within the chain is required and that such reform must be driven by government at a federal level. The Committee acknowledges that these issues are complex and will take time to address but urges the Government to address these matters at a federal level to ensure national consistency and commitment. It is only by a 'top-down' approach which addresses the problems evident at all levels of the chain that the future of the Australian dairy industry will be secured.

Recommendation 14

The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

Recommendation 15

In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

Chapter 1

Introduction

1.1 The retail market for milk in Australia has become more concentrated and, partly as a consequence, so has the wholesale market. This means that farmers, lacking countervailing market power, are at a competitive disadvantage. The result has been that retail prices for milk have increased while farmgate prices have been subdued, and in some recent cases pushed down to or below the cost of production. Concerns about Tasmanian dairy farmers apparently suffering from abuses of market power led to this inquiry. But while the impetus was the dairy industry, the issues are common to many other sectors of the economy where the retail market is also becoming increasingly dominated by generic products sold by the two main supermarket chains.

Referral of the inquiry

1.2 On 10 September 2009, the Senate agreed to refer the issue of competition and pricing in the Australian dairy industry to the Economics References Committee for inquiry. The terms of references were:

> The current circumstances of the varying prices being paid to dairy farmers in different Australian states, including:
>
> - the economic effect on the dairy industry of announced reductions in prices to be paid to producers by milk processors;
> - the impact of the concentration of ownership of milk processing facilities on milk market conditions in the dairy industry;
> - the impact of the consolidation of the ownership of the market or drinking milk sector with the manufacturing milk sector on milk market conditions in the dairy industry;
> - the impact of the concentration of supermarket supply contracts on milk market conditions;
> - whether aspects of the *Trade Practices Act 1974* are in need of review having regard to market conditions and industry sector concentration in this industry; and
> - any other related matters.

1.3 The Senate initially asked the Committee to report by 28 February 2010, but this was extended, initially to 18 March and finally to 13 May 2010.

Conduct of the inquiry

1.4 The inquiry was advertised in both *The Australian* and on the Committee's website. The Committee also wrote to a range of stakeholders inviting written submissions. The Committee received 34 submissions. The details of the organisations and individuals who made those submissions are listed at Appendix 1.

1.5 The Committee held five public hearings, in Launceston, Burnie, Melbourne, Perth and Canberra, at which it heard from all sectors of the industry including individual dairy farmers, dairy and retail industry associations, local, state and federal government representatives, academics with particular interest and expertise in dairying and competition policy, processors and the two major retailers. A full list of witnesses is at Appendix 2.

1.6 The Committee thanks all those individuals and organisations who contributed to and participated in the inquiry process for their valuable input.

1.7 Throughout the early stages of the Committee's inquiry, issues of interest were concurrently being considered by the Select Committee on Agricultural and Related Industries in its inquiry into food production in Australia. Their findings in relation to the dairy industry were tabled on Friday 27 November 2009 in a Third Interim Report. The material collated throughout the course of that inquiry and which relates to the terms of reference of this committee has also been referred to in this report.

Structure of the report

1.8 This report is divided into the following chapters:

- Chapter 2 sets the scene by describing the structure of the dairy industry in Australia;
- the pricing of milk, at the farmgate, wholesale and retail levels, is described in Chapter 3;
- competition issues are discussed in Chapter 4;
- arising from this, improvements are suggested to the negotiation processes between farmers and processors in Chapter 5; and
- other matters, including food security and strategic plans, are addressed in Chapter 6.

Chapter 2

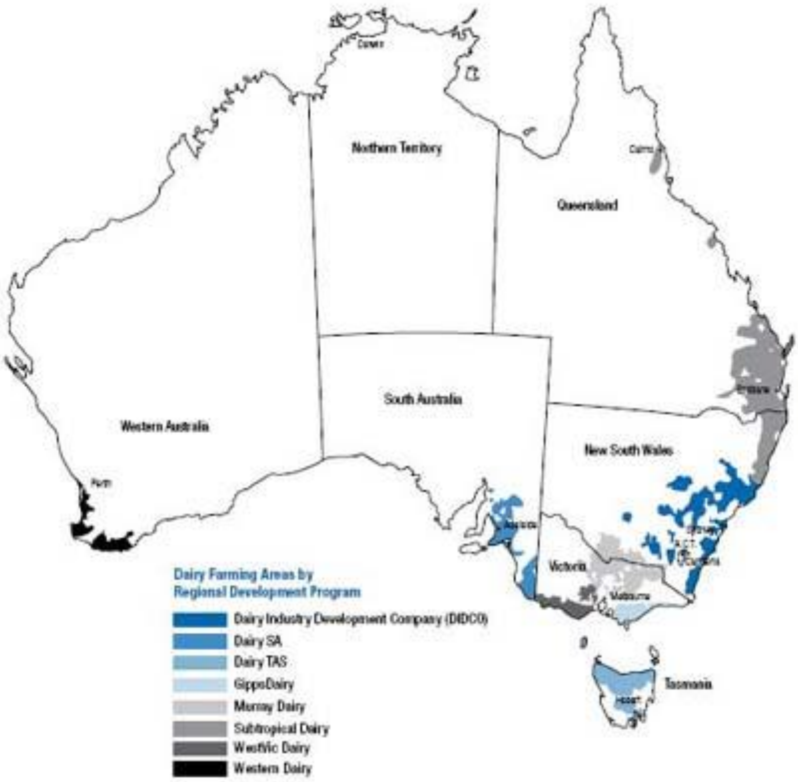
The Australian dairy industry

Description

2.1 The dairy industry is Australia's third largest rural industry. It consists of about 8,000 dairy farms and directly employs approximately 40,000 people.[1] It has a farmgate value of $4 billion.[2] A reduction in dairy farm numbers since deregulation of the industry has been more than offset by an increase in average herd size and productivity, the effect being that the volume of milk produced by the 8,000 farms in 2009 is over 70 per cent above the volume produced by the 22,000 farms in 1980.[3]

2.2 Australia's main dairying areas are identified on the map below.

Chart 2.1: Australian dairying regions



Source: www.dairyaustralia.com.au

1 Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. ii.

2 Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. ii.

3 Based on data in Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 9.

2.3 Over two-thirds of the 9.4 billion litres of milk produced in 2008-09 was produced in Victoria, 10 per cent in New South Wales and 7 per cent in Tasmania.[4] Dairying occupies a relatively large proportion of the agricultural sector in Tasmania.[5]

2.4 Australia's milk production sector is dominated by owner-operated farms (approximately 80 per cent).[6] Although these farmers operate efficiently they remain vulnerable to unstable climatic conditions which in turn affect their ability to successfully manage the costs of production. Milk production is highly seasonal, peaking in October and tapering off in the cooler months from April (Chart 2.3 below).

2.5 Just over half the milk produced in Australia during 2008-09 was consumed by the domestic market; the remainder being exported as either drinking milk or manufactured products.[7]

Recent developments

2.6 In 2008, Dairy Australia reported that the Australian dairy industry was 'enjoying the best world market conditions in decades…international dairy commodity prices rose to record levels through 2007', due to consistent strong demand and tight supplies, as well as the effects of exchange rates and cuts in export subsidies.[8] This led to higher farmgate milk prices for Australian dairy farmers – prices increasing by more than 50 per cent in southern regions during 2007-08 (see Chart 6.1).[9] Dairy Australia did note that despite the optimism, the industry 'remain[ed] constrained by the high cost and limited availability of production inputs, uncertain climatic conditions and reducing dairy herd numbers'.[10]

2.7 Higher farmgate prices continued into the 2008-09 season until, following the global financial crisis, milk processors reduced the price paid to farmers sharply.

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4 www.dairyaustralia.com.au *Milk Production Report*, viewed 16 February 2010.

5 In 2007–08 the value of Tasmania's livestock products (which mainly includes wool, milk and eggs) was $413 million. Of this amount $275 million was the estimated value of farmgate milk production (approximately 67 per cent). Source: Australian Bureau of Statistics 1307.6 – *Tasmanian State and Regional Indicators*, December 2009 – www.abs.gov.au; and www.dairyaustralia.com.au, *Dairy 2009 Situation and Outlook*, June 2009, p. 82.

6 Dairy Australia, *Industry Statistics – cows and farms*, www.dairyaustralia.com.au, viewed 8 March 2010.

7 About half of the domestic consumption is as drinking milk, the remainder being used in the production of cheeses, butter, and milk powders. Dairy Australia, *Dairy 2009: Situation and Outlook*, June 2009, www.dairyaustralia.com.au.

8 *Australian Dairy Industry in Focus 2008*, p. 3.

9 *Australian Dairy Industry in Focus 2008*, p. 3.

10 *Australian Dairy Industry in Focus 2008*, p. 3.

2.8 The reduction in price per litre paid to farmers was initiated by Murray Goulburn who announced a 'step-down' in response to the weakening international commodity market. Following Murray Goulburn's announcement, the remaining major milk processors also announced reductions in the price they would pay.

2.9 The economic effect on the dairy industry of these announced reductions in prices paid to farmers has been a focus of this inquiry, evidence gathered by the Committee indicating that the impact on dairy farmers and their communities has been severe:

> In July, August, September and October, suppliers have lost substantial income. I myself am losing in excess of $100,000 a month... There are individual examples of farmers having to sell furniture in order to put food on the table for their family and, in some circumstances, offering to hand their farms back to the bank. The first forced sale of a farm which supplies National Foods is taking place on 19 November.[11]
>
> Whilst we have had downturns of this nature to cope with practically ever since we have been involved in farming, this is by far the worst that we have ever had to deal with. I guess the main reason that it is the worst is that we were faced with a 40 per cent drop in milk price in January of last season. In terms of our operation, we are relatively big farmers, with 550 or 600 cows. That cut $380,000 worth of income out of the last half of our business last season.[12]
>
> On my calculations, losing 6c a litre equates to a combined loss of $7.8 million across 90 suppliers in Tasmania. If you add a conservative multiplier of 2.5 to that loss, that translates into a regional economic impact of minus $20 million. That is just a conservative estimate of economic loss. The social cost is almost impossible to quantify and the qualitative impact is real. It is not just employment loss; it is family breakdowns, bankruptcy and loss of life, sometimes in the most tragic circumstances.[13]
>
> The economic effect on the dairy industry of reductions in prices to be paid to producers will be devastating to the industry and may see further farmer numbers being reduced as farmers are unable to receive a reasonable return (cost plus margin) to survive. …farmers are being forced to supply the total Australian market at a price that relates to the conditions relative to commodity markets around the world…[14]

2.10 The step down in farmgate prices in 2008–09, the first such occurrence since 1973, led to a downturn in confidence within the industry from its 2008 optimism, albeit only back to somewhere around the longer-term average (Chart 2.2).

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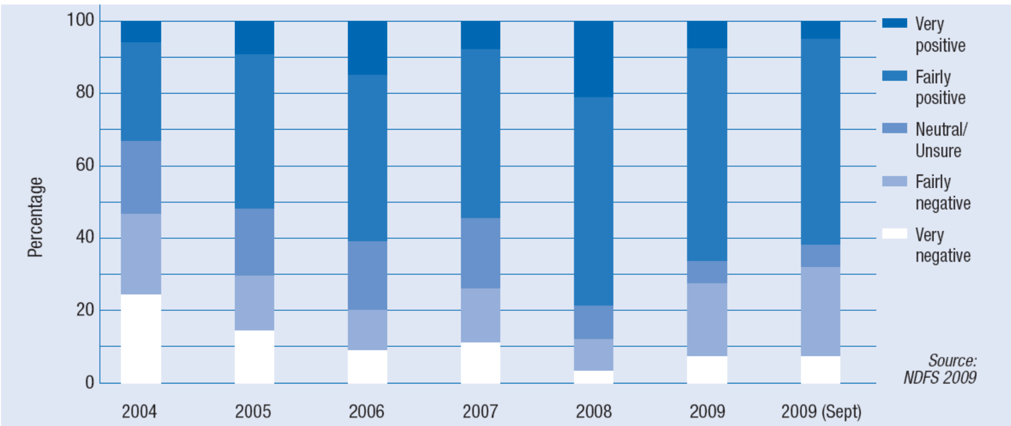
11 Mr Phil Beattie, Spokesman, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, Thursday 5 November 2009, p. 13.

12 Mr Wayne Tennant, *Committee Hansard*, Friday 6 November 2009, p. 48.

13 Dr Tony McCall, University of Tasmania, *Committee Hansard*, Thursday 5 November 2009, p. 41.

14 Amalgamated Milk Vendors Association Incorporated, *Submission 32*, p. 2.

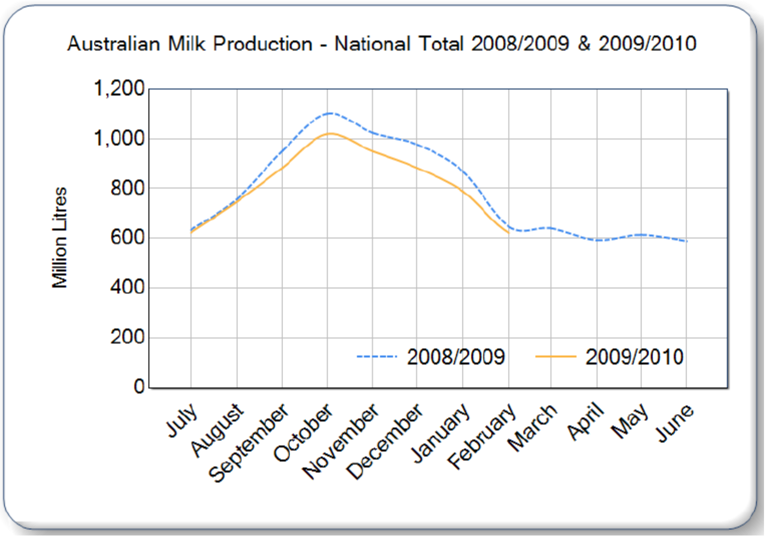
Chart 2.2: Farmers' attitude to the future of the dairy industry



Source: Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 5.

2.11 This has in turn been followed by a reduction in milk production.[15] This year's production levels are tracking lower (Chart 2.3) and annual production is expected to return to the level of 2007-08 due to the lower prices, reduced demand and the effects of both drought and flood.[16]

Chart 2.3: Monthly milk production



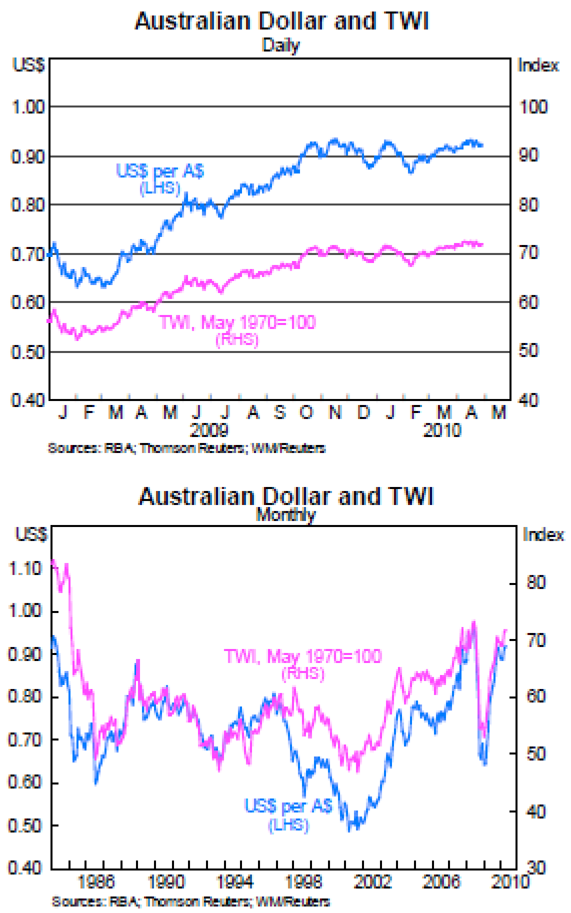
Source: Dairy Australia, www.dairyaustralia.com.au.

15 Dairy Australia notes that a large percentage of farmers affected by step downs intend to reduce their herd sizes and are likely to reduce their supplementary feeding. Dairy Australia also notes that in April 2009 cull or chopper sales increased for the 'fourth consecutive quarter…as farmers chose to offload livestock rather than go through autumn and winter with little feed and significantly reduced milk prices.' www.dairyaustralia.com.au, *Dairy 2009 Situation and Outlook*, June 2009, pp 63, 65, 76.

16 Dairy Australia, *The Dairy Australian*, September 2009, www.dairyaustralia.com.au.

2.12 Although the international market has shown signs of stabilising in recent months,[17] the continuing appreciation of the Australian dollar (Chart 2.4) represents an additional challenge for the Australian dairy industry putting downward pressure on export returns.

Chart 2.4: Exchange rates



Source: Reserve Bank of Australia, www.rba.gov.au.

2.13 Dairy Australia predicts that global dairy demand 'based on continued economic recovery is likely to continue to improve over the course of 2010 in most key markets; albeit at a slower pace.'[18] Caution remains however as any number of factors could negatively affect demand and cause a reduction in commodity prices.

17 Dairy Australia reports in their February 2010 update that both the United States and European Union have moved to remove export subsidies and have stopped buying local product to add to intervention stores.

18 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 6.

Committee view

2.14 The Committee recognises that the impact of the global financial crisis on the Australian dairy industry was severe. The Committee acknowledges that it will take some time for the industry, particularly dairy farmers, to recover and suggests that the Government consider its role in the industry's recovery particularly in terms of facilitating its long term sustainability.

2.15 The Committee has further considered these matters in Chapter 6 of this report.

Dairy industry deregulation

2.16 Until 2000, the Australian dairy industry was regulated. The price paid for manufacturing milk was determined by factors including world prices of manufactured dairy products, although support was provided through the use of national export pools that ensured farmers received an average pool price for their product regardless of its quality, use and destination.[19] State authorities set the farmgate price for fresh drinking milk to ensure the additional costs of year round supply were covered. Today, however, Australia's dairy farmers operate in a deregulated and open market; the determination of prices is described in Chapter 3.

2.17 Steps towards market deregulation commenced in the mid 1980s and continued throughout the 1990s. Deregulation was largely driven by the dairy industry itself as participants sought opportunities for growth. On 28 September 1999 a government support package was announced to support all states in deregulating their dairy industries from 1 July 2000.[20]

2.18 At the time deregulation was being considered, the Senate Rural and Regional Affairs and Transport References Committee investigated the domestic dairy industry with particular reference to market conditions, competitiveness, regulatory arrangements and measures that the government could take to facilitate a transition to a less regulated environment.[21] Their comprehensive report, *Deregulation of the Australian Dairy Industry*, concluded that 'sooner rather than later the market [would] force deregulation and that a managed outcome with a soft landing [was] preferable to a commercially driven crash.'[22] In their findings however, they also noted that of serious concern was the suggestion that the control regulation provided would 'shift to

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19 Joint committee of the South Australian House of Assembly and the Legislative Council, *Joint committee on the impact of dairy deregulation in South Australia*, May 2003, p. 5.

20 Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999.

21 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

22 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

processors and large retailers who would then be able to dictate terms to the industry and marketplace.'[23]

2.19 Following deregulation, the reduction in dairy farm numbers was coupled with an increase in herd sizes and milk yields per cow as farmers sought to benefit from the efficiencies of larger operating systems.[24] Similarly, there has been considerable consolidation within the processing sector as processors have experienced sustained pressure to reduce costs.[25]

Increased concentration of processors

2.20 The manufacturing sector of the Australian dairy industry has become more concentrated since the first stages of deregulation in the late 1980s; the outcome being increased foreign ownership and a reduction in the market share of farmer owned cooperatives. The five major companies have increased their milk processing capacity from 50 per cent to 75 per cent of the market.

2.21 In 1999, the five largest milk manufacturers in Australia were Murray Goulburn, Bonlac, Dairy Farmers Group (all three entities were cooperatives), National Foods Ltd and Pauls/Parmalat.[26] Pauls/Parmalat, National Foods and Dairy Farmers Group dominated the market for drinking milk sales (cumulatively they held an 80 per cent share of this market) while the cooperatives of Murray Goulburn and Bonlac dominated the manufacturing milk market, the two entities responsible for processing 55 per cent of all Australia's manufacturing milk.[27]

2.22 Today, Bonlac is owned by Fonterra, and the Dairy Farmers Group has been acquired by National Foods. Fonterra (20 per cent),together with Murray Goulburn (the largest remaining farmer owned cooperative, supplying 37 per cent of Australia's milk) are the prominent market players in the manufacturing milk market (Chart 2.5).

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23 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

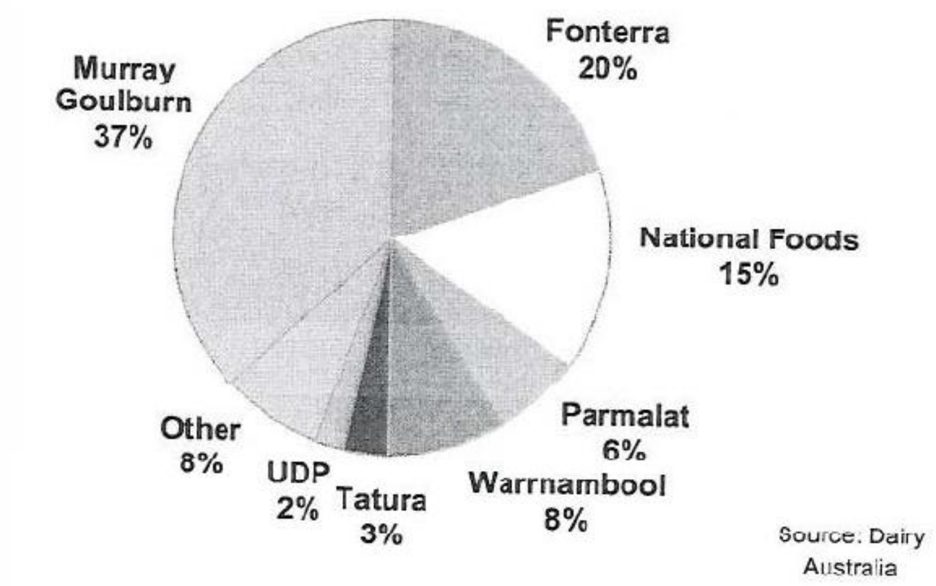
24 Dairy Australia, *Australian Dairy Industry in Focus 2009*, www.dairyaustralia.com.au.

25 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 11.

26 Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999, p. 8.

27 *Deregulation of the Australian Dairy Industry*, October 1999, p. 19.

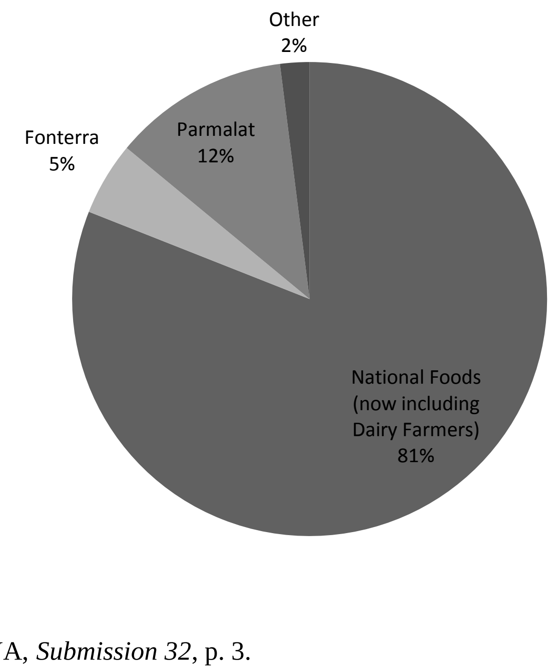
Chart 2.5: Market share of milk volume (2008-09)



Source: Fonterra, *Submission 10*, Attachment 1, p. 2.

2.23 The remaining milk produced in Australia is sold into the domestic drinking milk market which, like the manufacturing milk market, is dominated by two players – National Foods and Parmalat (Chart 2.6).

Chart 2.6: Share of drinking milk market



Source: Figures from AMVA, *Submission 32*, p. 3.

2.24 Milk sold into the drinking milk market is marketed through various channels including fast food outlets, supermarkets, independent grocers, corner stores, and service stations. However, the sale of milk through the supermarket channel has slowly been increasing; Dairy Australia noting a recent change in the behaviour of the two large chains – they have embarked on a marketing campaign encouraging consumers to make comparisons between their own generic branded milk with that of branded products.[28] Dairy Australia comment that although this behaviour is 'unlikely to affect the volume of dairy products consumed there may be an impact on the channel and value of dairy sales as consumers seek greater value in their purchases' and move to generic labelled and price discounted branded products.[29]

Committee view

2.25 The Committee notes with concern the increasing market share of the major retailers in the drinking milk market through their sale of generic milk. The Committee wishes to bring this situation to the attention of the Government, particularly as the processors dominating the fresh milk market are directly competing with their own products as they also supply Woolworths and Coles with their generic branded milk. This situation suggests to this Committee that the 'serious concern' of the Senate Select Committee which undertook the 1999 inquiry into deregulation of the industry that the control regulation provided would 'shift to processors and large retailers who would then be able to dictate terms to the industry and marketplace'[30] has been realised to the detriment of the industry as a whole and the consumer. The Committee has further explored these issues with a view to addressing the concerns in Chapters 3, 4 and 5.

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28 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 12.

29 www.dairyaustralia.com.au, *Dairy 2010 – Situation and Outlook – February 2010 Update*, viewed 14 April 2010, p. 12.

30 *Deregulation of the Australian Dairy Industry*, October 1999, p. 170.

Chapter 3

The price of milk

Retail prices

3.1 The Australian grocery market is dominated by the two major supermarket chains, Coles and Woolworths. They have a combined market share in the total grocery market variously estimated at 55–80 per cent.[1] Their market share for drinking milk is somewhat lower, perhaps 50 per cent, reflecting the large numbers of milk bars and convenience stores which also sell milk.[2] However the major chains still dominate the retail pricing of milk, as their 'deep pockets' would deter small local stores from starting a 'price war' for milk.

3.2 The major supermarket chains sell milk in two formats: 'generic' milk (also variously known as 'home brand', 'store brand' or 'private label'[3]) which usually carries the name of the supermarket selling it and 'branded' milk which usually carries the name of the processor.[4] Taking the common two–litre container of standard full cream milk in a major suburban supermarket,[5] a typical price is around \$1.75 per litre for a branded product and \$1.25 per litre for a generic. Just over half of the milk sold in Australia is now generic (Table 3.4 below).

3.3 The labels on branded milk (and other branded products) tend to be more colourful and there is pervasive advertising, designed to create the impression that the branded milk is a superior product. Under questioning by the Committee, the processors and retailers, somewhat reluctantly, conceded that the branded and generic (full cream) milk were in substance the same product:

> Senator MILNE—… Is there any difference between a litre of full-cream milk that is branded and a litre of full-cream milk that is a home brand?

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1 The ACCC observe 'regular statements being made by industry commentators that the two largest retailers, Coles and Woolworths, account for 80 per cent of retail sales', but their own view is that they 'account for between 55 per cent and 60 per cent of consumer expenditure on grocery items'; *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp 45-48. A media release by Dr Emerson (18 September 2009) refers to the two chains having a combined 78 per cent share of packaged groceries.

2 Mr Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 38. The Queensland Dairyfarmers Organisation puts the share of the two major chains at 57 per cent; *Submission 30*, p. 8.

3 Examples include You'llLoveColes, Homebrand, Smartbuy and Black & Gold.

4 Examples include Pura, Dairy Farmers, Pauls, Harvey Fresh, Canberra Milk, Norco and Brownes. Some of these are the names of formerly independent processors which have been retained when they have been taken over by large foreign companies.

5 Coles told the committee that the 2 litre pack is the biggest seller (Answers to questions on notice, 12 February 2010) and casual inspection of supermarket shelves supports this.

> Mr Brennen—No. The national health standard…sets the standard and you cannot adulterate white, liquid, fresh milk. You can take a bit of the cream out and standardise it. You cannot put protein in—it is illegal and it will not be done anywhere in Australia.[6]
>
> Senator COLBECK—… the stock standard Pura milk in the blue carton, versus the generic Woolworths brand or the generic Coles brand. What is the difference in the products?
>
> Mr O'Malley—To the best of my knowledge they are broadly the same.[7]
>
> Senator MILNE—… Is there any difference in a generic brand, a house brand product in the fresh milk market in the same category? Let's say we are talking about full-cream milk. Have we got exactly the same product in the packet, whether it is branded or non-branded?
>
> Mr Mara—…They may have some minor specification differences…
>
> Senator MILNE—So as far as you are concerned the home brand product and the branded product are exactly the same and if there are additives added or anything changed, that is not something you know about or have specifications for?
>
> Mr Mara—We may have specifications. I am not the buyer of the milk, but if there are different specifications that we have, we are happy to share them with you.[8]

3.4 The perception of a difference between generic and branded milk, however, allows the retailers to engage in price discrimination. The market is segmented into the more price-conscious/ lower income/ better informed consumers who buy the generic product and the less price-sensitive/higher income/ status conscious consumers who buy the branded product. The latter are then charged a higher price for their milk.

3.5 Prior to the repeal of section 49 of the *Trade Practices Act 1974*, corporations were prohibited from discriminating between buyers of goods of like grade and quality in relation to the price of those goods if that discrimination was of such a degree or a recurring or systemic nature that it would have the effect or be likely to have the effect of substantially lessening competition in the market.[9] Section 49 was repealed in 1995; the view at the time being that price discrimination would still be able to be regulated under other provisions of the *Trade Practices Act 1974* for

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6 Mr Brennen, Challenge Dairy, *Committee Hansard*, 29 January 2010, p. 7.

7 Mr O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 89.

8 Mr Chris Mara, Adviser, Government Affairs, Coles, *Committee Hansard*, 4 February 2010, pp 3–4.

9 Steinwall, R., *Annotated Trade Practices Act 1974*, 2004 Edition, Reed International Books, paragraph 71,805, p. 188.

example, sections 45 and 46 of Part IV.[10] (The issue of price discrimination is covered in more depth in Chapter 4.)

3.6 It was suggested to the Committee that the differential between the branded price and generic price (ie the extent of price discrimination) is higher for milk than for other products:

> That 33 per cent difference does not occur in any other generic product…[11]

> …of all the home brands of products which are shelved in the supermarket, milk appears to be the one with the highest margin.[12]

3.7 Table 3.1 shows the differences between branded and generic versions of a range of products. In many cases there are now two generic versions. From this admittedly small sample, the price differences between the generic and branded product do not seem larger for milk than for other products (although there may be larger quality differences between generic and branded products for other goods).

Table 3.1: Generic price as per cent of branded product price

Major supermarket chain, Canberra, 6-12 March 2010

Milk	57-67	Toilet paper	54-72
Butter	52-80	Pasta	26-73
Yoghurt	76-92	Corn flakes	57-86
Cheese (cheddar)	61-86	Weetbix	42-83
Bread	28-69	Tuna	30-92
Sugar	45-75	Tomatoes (diced)	41-65
Flour	37-84	Beetroot (sliced)	43-66
Juice (fresh)	28-47	Baked beans	43-70
Juice	54-70	Soda water	53

Source: Secretariat.

The demand for milk

3.8 The total demand for milk is quite stable and predictable. The demand for milk at an individual store or chain may be more elastic to the extent that customers are able or willing to shop around. While milk is only one of a large number of products sold by supermarkets, it is a staple product that most customers buy.

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10 Steinwall, R., *Annotated Trade Practices Act 1974*, 2004 Edition, Reed International Books Australia Pty Limited trading as LexisNexis, Australia, 2004, paragraph 71,805, p. 188.

11 Mr John Cummings, National Association of Retail Grocers of Australia, *Committee Hansard*, 4 February 2010, p. 14.

12 Ms Nola Marino MHR, *Committee Hansard*, 29 January 2010, p. 9.

Supermarkets then need to think about whether high milk prices may deter customers from shopping at the store and thereby lower overall sales.

3.9 A UK study found that, once in a given store, the own–price elasticity of milk is -0.6. (By comparison, the demand for other goods is around -1, suggesting milk has a relatively inelastic demand.) As milk constitutes around 5 per cent of the value of the average British supermarket shopper's basket or trolley, the effect of milk prices on the choice of store is not large, but including this effect raises the total elasticity to -0.8.[13]

Competition

3.10 As well as the elasticity of customer demand, the retail price will depend on whether there is any collusion between supermarkets. A UK study concluded that supermarket prices for milk there were consistent with what estimated elasticities would imply would occur in a competitive market.[14] This may not necessarily translate into the Australian environment as the UK has many supermarket chains with a significant market share whereas Australia has essentially only two. As noted in Table 3. 6 below, retail prices for branded milk are higher in Australia than in the UK.

Variations in retail prices

3.11 Retail milk prices differ across states, as discussed further below (Tables 3.8 and 3.9). Prices also vary to a lesser extent across outlets within cities (Table 3.2), and differ between different sizes of milk cartons (Table 3.3) and across varieties of milk (Table 3.4).

Table 3.2: Retail milk prices across Canberra

(cents per litre for 'Canberra milk', 2 litre; 10 October 2009)

One major supermarket chain		Other major supermarket chain		Independent stores	
Gungahlin	184	Gungahlin	187	Civic	189
Manuka	184	Dickson	187	Kingston	185
Jamison	184	Kippax	187	Florey	197
Belconnen	184	Belconnen	187		
Curtin	184	Kambah	187		

Source: survey by Secretariat

13 Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, p. 36.

14 Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, p. 7.

3.12 The variation across outlets within a city has diminished as the major chains have responded to pressure to reduce geographic price discrimination.[15]

3.13 Milk (like most products) is cheaper when bought in larger quantities. This is at least partly a reflection of cost differences: the packaging and handling costs per litre are higher for smaller containers. Whether the cost differences are as large as the price differences is open to question. It may be the case that this is another form of price discrimination.

Table 3.3: Retail full cream milk prices by quantity

(a major supermarket in Canberra, 26 January 2010, cents per litre)

	Branded milk	Generic
300 ml	320	
600 ml	222	
1 litre	197	137
2 litres	184	124
3 litres	176	122

Source: Secretariat

3.14 Similarly, higher prices are charged for milk with various additives such as omega 3, calcium and flavouring, or with less fat (Table 3.4). It is questionable whether the cost of additives such as flavouring is anywhere near as much as the difference in price. This may again be a matter of using the additives to sort consumers into those who are price–responsive and charged a lower price and those who are less price–sensitive and are charged a higher price.

Table 3.4: Retail milk prices by type, 2008-09

	Branded milk		***Generic milk***	
	Price (cpl)	(% of market)	Price (cpl)	(% of market)
Regular whole	186	(14)	118	(32)
Reduced fat	210	(16)	135	(15)
No/low fat	214	(5)	164	(0)
Flavoured	371	(6)	212	(0)
UHT	190	(8)	119	(4)

Source: Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 43.

15 Geographic price discrimination is discussed in the Senate Economics Legislation Committee's report *Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices - Blacktown Amendment) Bill 2009*, November 2009.

Milk as a 'loss leader'

3.15 Some witnesses claim milk is used as a 'loss leader'; sold under cost to attract customers into stores:

> We also see widespread smaller retailers using the two litre milk as a discount leader to try to get more people through their stores. Milk being the product that it is, basically purchased every day in every household, is an attraction for a retailer or a major fruit shop to put a big sign out the front, saying, 'Cheap milk: come and get the cheap milk.' That milk is sometimes sold under cost price to that outlet. It is sold to the outlet and the outlet will sell it under cost price.[16]

> The other thing certain stores do is to look at a product like milk as a way of building traffic, so once you are in the store you buy other things which are at a higher margin.[17]

> …I got some prices today from one of the major retail outlets in Brisbane, and one has just announced a price reduction on the weekend for a two-litre bottle of whole milk down to $2.09 for their private brand and the advertising was structured in a way that you could possibly term it as a loss leader strategy in terms of marketing as a reduction to get people through the front door of the supermarket.[18]

3.16 In Western Australia milk is sometimes sold at less than a dollar per litre.[19]

3.17 The major supermarkets denied using milk as a 'loss leader':

> Senator MILNE—…Can you tell me: do you ever use milk as a loss leader to attract customers to Coles?

> Mr Mara—Not to my knowledge.[20]

> Senator O'BRIEN—Does Woolworths use milk as a loss leader?

> Mr Dunn—No, not at all.[21]

3.18 They do, however, claim that others engage in the practice:

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16 Mr Colin Lawson, Amalgamated Milk Vendors Association, *Committee Hansard*, 18 January 2010, p. 15. A similar point is made by Julie Gration, *Submission 6*, p. 4.

17 Mr Gerard van Rijswijk, National Association of Retail Grocers of Australia, *Committee Hansard*, 4 February 2010, p.19.

18 Mr Robert Peake, Queensland Dairyfarmers Association, *Committee Hansard*, 4 February 2010, p. 44.

19 This 'deep discounting' was criticised by Mr Peter Evans, Western Australian Farmers' Federation, *Committee Hansard*, 29 January 2010, p. 16.

20 Mr Chris Mara, Coles, *Committee Hansard*, 4 February 2010, p. 5.

21 Mr Ian Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 41.

> Packaged milk products are now used in many segments of the non-supermarket retail as a loss leader – to attract customers to make other store purchases.[22]

Wholesale prices

3.19 The supermarket chains buy milk from the processors. The prices paid by the supermarkets, and consequently the profits earned by the processors, are quite different for branded and generic milk but, as noted below, both processors and retailers were reluctant to provide much information about the difference.

3.20 Supermarkets typically have tenders to determine from which processors they will buy the generic milk. The contracts typically run for two to three years.[23] The large supermarket chains generally prefer a single processor for each state or region, or perhaps even a single national supplier.[24] Combined with there only being two major supermarket chains, this preference encourages consolidation within the processing sector as only large processors can credibly bid for the contracts and without any such contract half the drinking milk market is effectively closed to a processor.

3.21 It may be the case that small processors would lack the economies of scale to put in competitive tenders to supply even some of the generic milk for supermarkets in a region. In addition, the scale of the contracts make it very difficult for some smaller processors to participate.

3.22 The highest price processors can secure is limited by the supermarkets' ability to source milk from the next closest source of supply.[25] The lowest price the supermarkets can extract is the marginal cost of producing milk. Where the price settles between these limits will depend on the relative bargaining power of the processors and the supermarkets.

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22 Coles, *Submission to ACCC Grocery Inquiry*, 2008, p. 57.

23 Mr Mara, Coles, *Committee Hansard*, 4 February 2010, p. 10; Mr Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 28. In the UK the typical contracts are rolling with notice periods of only three months, so supermarkets can switch suppliers fairly quickly; Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, pp 10–11.

24 Woolworths has a national contract, with National Foods supplying their Home Brand generic milk while Coles has tenders on a state-by-state basis; Mr O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 87. The same occurs in the United Kingdom, although there are more large supermarket chains there.

25 It is not related to the retail price.

3.23 The outcome of the tendering process is that the wholesale price for generic milk may be 20-40 per cent lower than for branded milk, and processors are less able to pass on cost increases to the supermarkets for generic milk than for branded milk.[26]

3.24 Processors prefer to concentrate on making their own branded products, on which they earn much higher profits, and would not bid for a generic contract if it meant reducing production of the branded product.[27] As the retail markets increasingly move towards sales of generic milk, however, they may not be able to sell their whole production run as branded product and the generic milk contracts will become ever more important to them.

3.25 A UK study looked at the market for generic milk and concluded the large supermarkets have substantial buying power due to the existence of substantial economies of scale.[28] The presence of large powerful supermarkets encourages processors to install technology with increasing returns to scale, in turn making smaller supermarkets less attractive customers for the processors.

Slotting charges

3.26 It is advantageous for the processors to have their branded milk prominently displayed at eye-level on supermarket shelves. This may be achieved by the processors paying an explicit 'slotting' fee to the supermarkets for favourable product placement:

> The ACCC in their grocery inquiry recognised that the chains charged slotting fees—that is, if you want to slot your product on their shelf, you pay them.[29]
>
> If you are selling you own product that is a different story because, there, you are placing your product on the shelf and you would do your normal negotiations with the buyer. In those negotiations you would have your pricing and there would be a little bit of negotiation on promotions, ullage, shelf space and all the other things that go along.[30]

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26 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp 234–5.

27 Mr Mallison, Fonterra, *Committee Hansard*, 18 January 2010, p. 67.

28 Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, p. 4. The study suggested/assumed that mergers between processors would increase the size of the margins earned by the processors at the expense of the supermarkets but would not necessarily affect the retail prices (p. 11).

29 Mr Cummings, NARGA, *Committee Hansard*, 4 February 2010, p. 13.

30 Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 39.

> …joining the retail business and seeing how supermarkets operate, is that if you really want to sell your product you have to promote it heavily and pay massive promotions back to them…[31]

3.27 Woolworths denied such explicit fees existed:

> The suggestion, for instance, that there are slotting fees in the marketplace: as far as Woolworths is concerned, that was specifically stated not to be the case to the ACCC…[32]

3.28 Alternatively, the same effect could be achieved implicitly by processors being granted more favourable placement on the shelves in return for offering their branded milk at a lower price to the supermarkets.

3.29 More controversially, favourable placement on supermarket shelves for branded milk may be conditional on providing generic milk to the supermarkets at a low price. If this occurs, it would represent an exercise (arguably an abuse) of the market power of the major supermarkets.

'Waterbedding' effect

3.30 It has been suggested that the market power of the major supermarket chains means that they can force down the price they pay processors for generic milk, and that this leads to the processor charging a higher price on its other sales: generic milk to other retailers, branded milk and other products such as yoghurt.

3.31 This is termed the 'waterbedding effect':

> The 'waterbed effect' is the term used to describe the result when a large player in a market demands lower wholesale prices from suppliers, forcing those suppliers to increase prices to other customers to bring earnings back to a sustainable level. The large body in the middle of the waterbed forces up smaller bodies on the sides.[33]

3.32 It has been described as follows:

> A typical explanation for this is a cost shifting narrative. This explanation relies on suppliers incurring certain fixed costs. If the suppliers recover fewer of these fixed costs from the large buyer (which forced their input price down by bargaining power) or none of them if the powerful buyer negotiates to pay marginal costs, according to the argument the suppliers must recover more of these fixed costs from other buyers. It is argued that

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31 Mr Larry Brennen, Executive Chairman, Challenge Dairy, *Committee Hansard*, 29 January 2010, p. 6.

32 Mr Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 33.

33 NARGA, cited in *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 353.

> the suppliers must shift more or all of their fixed costs onto smaller/weaker buyers, thereby increasing the total price paid by those weaker buyers.[34]

3.33 The ACCC, however, argue there is a logical flaw in the waterbedding argument:

> A common objection is that this sort of cost-shifting violates standard axioms of profit maximisation – if the supplier is able to charge higher prices of the smaller retailers after the decrease in price charged of the powerful buyer, why didn't they do so before?[35]

3.34 The ACCC also point out:

> Further, even if a waterbed type effect exists and results in weaker retailers paying higher input prices, it is far from clear from the economic modelling what the impact will be on downstream prices. This…will depend partly on the state of competition in the downstream retail sector.[36]

3.35 Independent retailers, however, told the Committee they believed this effect operated:

> …the waterbedding effect in the dairy industry…has worked in two ways: I pay more than the contract price for house brand milk to Fonterra and to National Foods. They have to charge me more so that they can, at the end of the day, make money. I am, in effect, subsidising the supply of house brand milk to those people [major supermarket chains]… I believe we are [also] seeing this waterbed effect in other dairy products.[37]

> The track record of private label milk is that its price growth has been less than inflation. The track record of branded milk price is that it is higher than inflation…The waterbed effect is demonstrated by that graph. But, as Mr Cummings said, it is also demonstrated by the fact that the price of other dairy products—the yoghurts and cheese and so on—have also gone up.[38]

3.36 Some independent witnesses' study of the dairy industry led them to the same conclusion:

> …the removal of the Price Discrimination provisions of the Trade Practices Act… enabled the major supermarket chains to force their milk suppliers to supply their home brand milk at a considerably lower cost than for branded

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34 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 321.

35 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 321.

36 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 321.

37 Mr Cummings, NARGA, *Committee Hansard*, 4 February 2010, p. 13. See also NARGA, *Submission 13*, pp 2–3, 6–7.

38 Mr Ken Henrick, NARGA, *Committee Hansard*, 4 February 2010, p. 23.

milk, which…seems to result in a "waterbed effect" and growing price differential between branded and generic products.[39]

Clearly, there is a level of return that a milk processor requires and, therefore, the lower the prices paid by Coles and Woolworths for generic milk, the higher the prices that milk processor will charge smaller retailers for branded milk to make up for the lower returns or shortfall from Coles and Woolworths.[40]

3.37 Despite the ACCC refuting the occurrence of waterbedding, both Fonterra and National Foods gave evidence that suggests it is a reality in the dairy industry:

Senator COLBECK—…Is there a balancing act, if you like, that has to be conducted with respect to returns that you are going to get on the house-branded produced versus your brands?

Mr Mallinson—Ultimately, we will value the import price of the milk going in and what we get on a global quantity basis. So it would have to be a value over and above a global commodity sale. When we look at house brand contracts, we will look at our factory capacity—in particular, with cheese and butter—and whether we can actually produce that sort of volume.

Senator COLBECK—So it almost can be done on a marginal price rather than a base price?

Mr Mallinson—Yes.

Senator COLBECK—…I am just trying to get a sense of those processes…the power to draw through and the cost to the overall business of drawing through on that marginal cost of production and who actually ends up paying that price. It has an impact across the entire business, doesn't it?

Mr Mallinson—Yes.

Senator COLBECK—If you are getting a flat rate of margin across all products—and I know that it is going to vary depending on the product margin—and you are putting one particular chunk through at a marginal rate, that has to be made up in other areas.

Mr Mallinson—Without giving too much away, we will never do a house brand where we have only enough capacity to do our own brands.

…

Mr Mallinson—It will always be secondary or subservient.[41]

39 Ms Dee Margetts, *Submission 15*, p. 3.

40 Associate Professor Frank Zumbo, *Submission 34*, p. 9.

41 *Proof Committee Hansard*, 18 January 2010, pp 66–67.

> Senator COLBECK—…a fair proportion of your product must be going through into those generic brands because it is a large chunk of what the supermarkets are selling. So that premium obviously impacts across the rest of the business and it has to be recouped in some way...how that is amortised across the business and what the cost of that is to the other product. We heard evidence before—and I know you are in a slightly different situation—that a decision was made not to sell a generic product in a circumstance where they had a quality brand product. You are in a very different situation because you are trying to do both.
>
> Mr Evans—I think, again, as Mr O'Malley has suggested, there is a portfolio of brands that we make available to retailers and obviously some will be more profitable than others, but obviously to give detail on that is obviously highly sensitive.[42]

3.38 It is also noted that in responding to questions on notice at Estimates on 'waterbedding', the ACCC provided conflicting opinion when the organisation replied:

> During the course of the ACCC's 2008 Grocery Inquiry, the ACCC received mixed evidence of the extent to which processors increased the price of branded products to offset cost increases associated with providing private label products. Some processors indicated that they did not engage in this practice. However, others indicated that increased costs for branded products have been able to be recovered in a 'more timely manner' and that prices of branded products have sometimes been increased to offset overall cost increases, both for branded and private label products.[43]

Price discrimination

3.39 It is argued that it is unfair, and potentially detrimental to consumers, that processors sell at lower prices to the major supermarket chains than to other retailers (or to vendors who on–sell the milk to small retailers):

> Clearly, there is a very real danger that price discrimination in the market for milk is deterring or preventing competitive conduct within that market in a way that is substantially detrimental to consumers. In short, price discrimination can be anti-competitive in that a smaller retailer is simply unable to compete as aggressively as possible in the market because of the price discrimination it faces. Consequently, consumers are denied the benefits of vigorous competition between large and small retailers. Needless to say, if smaller retailers are unable to be competitive because of higher milk prices they pay in comparison to Coles and Woolworths, there is a further and very real danger that the smaller retailers will go out of business, thereby further reducing competition.[44]

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42 *Proof Committee Hansard*, 18 January 2010, pp 91–92.

43 ACCC, answer to questions on notice, 10–11 February 2010, Received 1 April 2010.

44 Associate Professor Frank Zumbo, *Submission 34*, p. 9.

3.40 The Committee also received evidence from a Dairy Farmers' (affiliated with National Foods) franchisee outlining that their 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; and
- competes against us (Coles, Woolies and Foodservice) and offers better terms, product range and pricing.[45]

3.41 NARGA also reflected that competition may be improved by the restoration of prohibitions on price discrimination in the *Trade Practices Act 1974*.[46] This is discussed further in Chapter 4.

3.42 Looking ahead, some witnesses feared that generics could ultimately displace branded milk from supermarket shelves as the price difference between them widens:

> So there is quite a significant price differential and that differential now, with this latest marketing strategy by the major retailers, is actually increasing. So that is a real concern for us, because at the end of the day, as that major supermarket chain share increases and more milk goes into the private label volume away from proprietary brands, it means that there is less return back down the value chain to the processor and thus back down the value chain to the farm gate. That situation is an extreme concern for us and we question whether it is sustainable long term. If you were to ultimately follow that sort of branding strategy through to where potentially proprietary brands were not viable any more, the consumer actually could be faced with the situation of having a reduced choice and one could also ask the question about what would happen to the actual pricing to the consumer if there were not a choice and it was only a choice between a number of supermarket brands on the shelf. We do not know the answer to that, but it is certainly a question we would like to see the ACCC investigate more.[47]

Committee view

3.43 The Committee, in its deliberations, noted with concern the apparent discriminatory practices that are occurring in the sale of generic and branded milk in Australia's supermarkets. The Committee is of the view that the long term viability of the domestic dairy industry may be in jeopardy if steps are not taken to curb these practices, although it recognises the complexities associated with government intervention in the market.

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45 Ms Julie Gration, *Submission 6*, p. 6.

46 Mr Cummings, NARGA, *Committee Hansard*, 4 February 2010, pp 16, 18.

47 Mr Robert Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 4 February 2010, p. 44. See also their *Submission 30*, p. 9.

Recommendation 1

3.44 The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and consider reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

Farmgate prices

3.45 Processors buy their milk from the farmers. In some cases the prices are negotiated with individual farmers and in some cases with collective bargaining groups. Years ago, many of the processors were cooperatives owned by farmers which would just be aiming to cover the processing costs. Murray Goulburn remains a cooperative, but most of the processors are now foreign-owned companies seeking to maximise their profits.

3.46 For ease of comparison with retail prices, milk prices in this chapter are quoted in cents per litre. As a rule of thumb, a farmgate price of 50 cents a litre is equivalent to a price of around $6.75 per kilogram of milk solids.[48]

3.47 In the short run the marginal cost of milk is almost zero in the sense that a farmer's costs do not drop if his milk is not sold as he cannot 'turn off' the cows. Thus in the short term the market power is all with the processors.

3.48 In the medium term, the market power of the milk processors over the farmers is limited by the farmers not only selling milk to the drinking milk processors. In addition to these sales of what is often termed 'market milk', farmers sell a significant proportion of their milk as 'manufacturing milk', used in the production of cheeses, milk powders, butter and dairy spreads, primarily for export. The proportions differ across the country, as those areas better suited to dairying (mostly in the southern states) will tend to produce more milk than needed for local drinking milk.

3.49 In the former, heavily regulated, market it was possible for the prices for market and manufacturing milk to be quite disconnected, with the former reacting to domestic conditions and government preferences and the latter to global commodity prices. In the current deregulated market, the prices should be much closer, although there will be a premium paid by the drinking milk processors to ensure that they receive a steady supply of milk throughout the year.

48 Most milk prices are determined by an equation that measures the weight of the solid components of the milk – i.e. the butter fat and protein components and then applies volume and quality incentives and penalties. National Foods defines a standard litre as having 4 per cent fat and 3.2 per cent protein; Mr Beattie, Tasmanian Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 26.

3.50 While deregulated, the market for milk is far from perfectly competitive due to the limited (and diminishing) number of processors (as discussed further in Chapter 4).

3.51 The Committee heard claims that the farmgate price is set in global markets and has little to do with domestic conditions:

> About half of Australia's milk production is exported and, as a result, the Australian farmgate price for milk is directly set off the world market price.[49]
>
> The decline in farm–gate prices in Australia reflects lower international dairy prices in the wake of the global financial crisis, and the reintroduction of export refunds by the European Union in January 2009.[50]
>
> The pricing structure in Australia domestically is as much driven by international factors.[51]
>
> The price is set as an international commodity price…[52]
>
> Milk prices in Tasmania are linked to the international market, despite the fact that the majority of milk products are sold nationally.[53]
>
> If you look at what is driving it [the Tasmanian farmgate price], which is what the international commodity prices have done in the last two months…they pretty well correlate… It is not driven off what happens in Tasmania; it is driven off what happens in Victoria. Victoria is two–thirds of the national milk production where most of the milk goes into export markets, driven off international prices, and that just flows through.[54]
>
> …since deregulation, as you would have expected, prices received by dairy farmers are more closely aligned with what is happening in international markets.[55]
>
> …the Australian dairy industry is integrated into the global market. The main influence on the manufacturing milk price that companies like

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49 Mr Wesley Judd, Chair, Australian Dairy Industry Council, *Committee Hansard*, 18 January 2010, p.2.

50 Dr Robert Rouda, Western Australian Department of Agriculture and Food, *Committee Hansard*, 29 January 2010, p. 25.

51 Mr Pearson, Australian Competition and Consumer Commission, *Committee Hansard*, 18 January 2010, p. 76. Similarly, ACCC had earlier concluded 'the ability to transport fresh or processed milk domestically and internationally has the result that farmgate prices in south–east Australia broadly reflect the prevailing international price of milk; ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 381.

52 Mr Chris Mara, Coles, *Committee Hansard*, 4 February 2010, p. 10.

53 Tasmanian Department of Primary Industries Parks, Water and Environment, *Submission 12*, p. 9.

54 Mr Mark Smith, Dairy Tasmania, *Committee Hansard*, 6 November 2009, pp 26–8.

55 Dr Terry Sheales, Deputy Executive Director, ABARE, *Committee Hansard*, 18 January 2010, p. 33.

Fonterra can offer farmers is the global price of commodities set in US dollars.[56]

3.52 This is hard to reconcile with the differences in farmgate prices across the country (Table 3.7). It was also vehemently rejected by some witnesses and treated sceptically by others:

…it is an absolute anachronism that you expect returns at farmgate in Australia to be benchmarked to the vagaries of the international pricing. This is ridiculous.[57]

…it is not a global milk commodity price. It is a localised regional price that obviously is largely driven not by international price demands but by regional price changes and supply and demand in the region.[58]

Mr Tennant—…The company are referencing export prices as a basis for setting the prices that they actually pay us. I understand that [although] in Fonterra's case somewhere between 60 and 65 per cent of their production actually goes into the domestic market….The price is always quoted on the basis of the export market price.

Senator O'BRIEN—I can tell you that Fonterra say that end of the market is, in their view, an international price competitive sector because they compete with imports.

Mr Tennant—I think they should be made to prove that. I think it should be a visible process.[59]

…in a state where the vast majority of your product is for domestic fresh milk production, the fact that it is artificially linked to one of the lowest farmgate milk prices in the world is an indication of market and market power abuse.[60]

3.53 Dairy Australia comment in their annual review that 'international markets prices are the major factor determining the price received by farmers for their milk' but immediately below Chart 3.1 shows large divergences between farmgate prices across countries, with Australian farmers generally being paid less than those in other advanced economies.[61]

56 Mr Bruce Donnison, Managing Director, Fonterra Ingredients, *Committee Hansard*, 18 January 2010, p. 52.

57 Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 31.

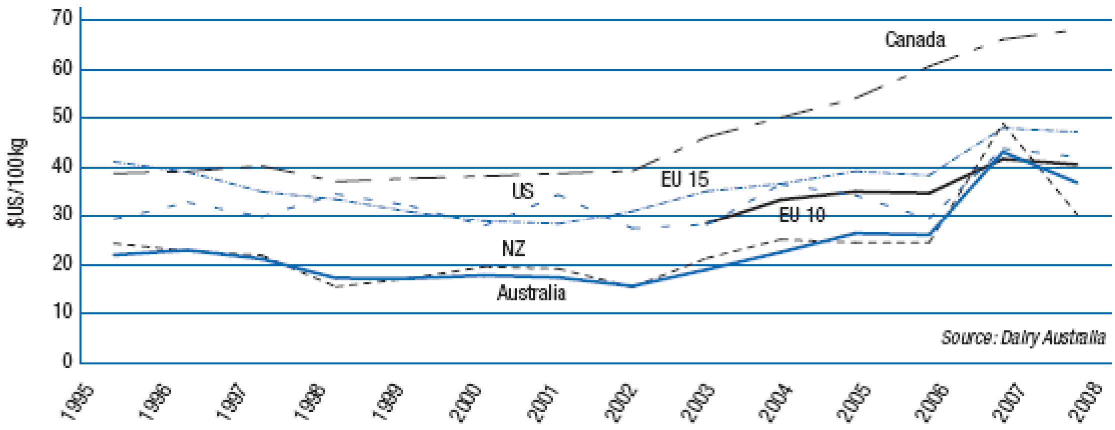
58 Dr McCall, *Committee Hansard*, 5 November 2009, p. 46.

59 Mr Wayne Tennant, Tasmanian dairy farmer, *Committee Hansard*, 6 November 2009, p. 52.

60 Ms Dee Margetts, *Committee Hansard*, 29 January 2010, p. 43.

61 Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 10.

Chart 3.1: International farmgate milk prices



Source: Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 10.

3.54 It may be more useful to think of the global price (after allowing for transport costs) as setting both bounds on the price that farmers will accept in the medium term for their milk and that processors will pay. If the sum of the world price plus the cost of shipping milk offshore (either directly or after transformation into products such as cheese) is greater than domestic processors will pay, then the farmers will not supply milk to the processors. Conversely if the price demanded by the farmer is greater than the world price plus the cost of importing milk, the processors will import milk rather than buy from domestic farmers.

3.55 Whereabouts the price settles between these bounds in the medium term will depend on the relative bargaining power of the processors and farmers. When, as for example in Tasmania, one or two processors face large numbers of farmers, the bargaining power of the processors is much higher and the price is likely to settle closer to the lower bound. In the UK, a study concluded that milk processors have more bargaining power than farmers' cooperatives, with the processor securing twice as much margin as the farmers.[62]

3.56 In practice, it is unlikely to be economic for processors to import raw milk. Currently the only dairy product imported in any significant quantity is cheese.[63] The effective ceiling on the farmgate milk price is the maximum price that the supermarkets are willing to pay the processor.

3.57 The Committee was intrigued by the way price–setting was described. National Foods appeared to set their prices based on those set by Fonterra, who in turn had based their prices on those set by Murray Goulburn:

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62 Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, p. 4.

63 Dr Sheales, ABARE, *Committee Hansard*, 18 January 2010, p. 28.

> …normally Murray Goulburn sets the base price and everyone else pays a cent or half a cent more.[64]

3.58 This system of 'cascading' prices does not sound very competitive. It appears the followers are effectively promising Murray Goulburn that their rivals will not attempt to outbid them thereby enabling Murray Goulburn to be more conservative in the opening price they offer farmers.

3.59 Questioned about this, the Australian Competition and Consumer Commission reflected:

> Where you have a market or somebody like Fonterra with that much of the market that it is buying into it, it would not be at all unusual to see that. Again, the collusion issue would be much more obvious if they got together and talked about keeping their price down…It is something that you would see across a range of industries given some of the market dynamics. I would not see it as a form of collusion but there is no doubt that it is the result of the market structure…[65]

3.60 The Committee again noted with interest the ACCC's response when asked at Additional Senate Estimates in February 2010 to clarify the difference between price leadership and predatory pricing to which they responded:

> Price leadership is a general economic term used to refer to pricing behaviour of a dominant firm.
>
> Price leadership is not of itself likely to raise TPA concerns unless the pricing behaviour satisfies the elements of the prohibition against predatory pricing…or is undertaken in contravention of other TPA provisions prohibiting anticompetitive agreements.[66]

3.61 These concerns have been exacerbated as the processing industry has become more concentrated (the challenges this poses are discussed further in the following chapter). As Associate Professor Zumbo puts it:

> …mergers are typically justified on the basis of allowing efficiencies or a reduction in costs to be achieved, but such efficiencies, if any, will only be beneficial to consumers if they are passed onto them. Indeed, the danger of mergers is that any efficiencies or reduction in costs that may be realised through a merger will not be passed onto consumers for the simple reason that as mergers remove competitors from the market, there will be fewer competitors left to take an independent stance to drive down prices to consumers…[67]

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64 Mr McKenzie, *Committee Hansard*, 18 January 2010, p. 28.

65 Mr Pearson, ACCC, *Committee Hansard*, 18 January 2010, p. 80.

66 ACCC answers to questions on notice, 10–11 February 2010.

67 Associate Professor Frank Zumbo, *Submission 34*, p. 5.

Who bears the risk of price fluctuations?

3.62 The preceding analysis implicitly assumed global and domestic demand and supply was quite stable. When there are fluctuations in supply (due for example to drought) or demand (due for example to recessions), the price in a spot market for farm milk would fluctuate. This volatility in prices, which could be followed by volatility in the domestic demand for and supply of milk, could make forward planning difficult for both farmers and processors. In practice, therefore processors have longer term contracts with their supplying farmers.

3.63 The question in designing these contracts is whether these contracts should specify a fixed price for the coming year (in which case the farmer has more certainty and the processor bears the risk); or whether the contracts should allow for prices to vary (giving the processor more certainty of profit and shifting the risk onto the farmer).

3.64 It might be argued that the small number of large processors are much better placed than the many individual farmers to manage risks. As well as having operations diversified across the world, and large capital reserves, the processors are able to access derivatives markets to manage risk.

3.65 In practice, contracts seem to be a mix of the two. The Committee heard in Tasmania that there was a base price which could be 'stepped up' if global demand and prices rose. It may also be 'stepped down' in certain circumstances. The problem was that the conditions that trigger these movements did not appear to be very clear.

3.66 As discussed further in Chapter 5, the Committee found that the distribution of risk was obscured further in the Tasmanian market by the complexity of the contractual arrangements with features such as 'model farms',[68] 28 or 35 day months, differing regimes for different half-years, prices paid by one processor tied in complicated ways to those paid by other processors, actual versus theoretical litres, bonuses and penalties, conditional retrospective payments and so forth, which a number of witnesses characterised as 'smoke and mirrors'.[69]

Recommendation 2

3.67 The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

3.68 The terms of negotiation between farmers and processors are discussed further in Chapter 5.

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68 The concept of a 'model farm' unique to National Foods' contracts has subsequently been abandoned.

69 See, for example, Mr Grant Rogers, a Tasmanian farmer, *Committee Hansard*, 5 November 2009, pp 2–3, 9; Mr Beattie, Tasmanian Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 14.

Costs faced by farmers

3.69 The seasonal nature of dairy farming conflicts with the need for year round milk supply for drinking milk, the tension between these factors significantly affecting the cost of production for dairy farmers and resulting in discrepancies between the different regions.

3.70 The Tasmanian Suppliers Collective Bargaining Group provided the Committee with evidence from a number of sources that typical costs for farmers in that state were around 40 cents per litre.[70] It was suggested that costs on Tasmanian dairy farms vary within a range of between 32 and 45 cents per litre.[71] One reason is some farmers are supplying milk all year round (for the drinking milk market) while others vary production (for the manufacturing milk market).

3.71 A breakdown of costs was provided to the Committee by the Tasmanian Government, shown in Table 3.5.

Table 3.5: Costs and profitability of Tasmanian dairy farms (cents per litre)

	2005-06	2007-08	2009-10(f)
Animal costs	3	3	3
Feed costs	13	19	16
Overhead costs	14	15	15
Finance costs	3	5	4
Production costs	**32**	**42**	**38**
Milk price	34	49	31
Other income	3	2	2
Total income	**38**	**52**	**33**
Earnings before tax	6	9	-5

Source: Tasmanian Department of Primary Industries, Parks, Water and Environment, *Submission 12*, p. 6.

3.72 Costs are generally lower in Tasmania than elsewhere:

> There is absolutely no question that our input costs to produce milk are among the best in the world in terms of being low. We have a climate that can grow grass. We have very good farmers. They are extremely well

70 Mr Phil Beattie, *Committee Hansard*, 5 November 2009, pp 12-13, and the Group's *Submission 27*.

71 Mr Fergusson, *Committee Hansard*, 6 November 2009, p. 67.

> organised and they are switched on. We have had a lot of people come to Tasmania because of this.[72]
>
> Tasmania is the most competitive dairy region in the country in terms of its production cost.[73]
>
> Tasmania is an ideal dairy area. It is the best dairy area in Australia bar none. We have got good water resources and we have got good land soils…[74]
>
> Tasmanian dairy farmers also have the lowest cost of production in Australia.[75]

3.73 The small Western Australian dairy farming region is also claimed to be more efficient than the northern regions, but views differ about how this translates into farm costs:

> We have a fantastic climate and a fantastic amount of land. We can produce milk here at a cost–effective price compared with just about anywhere else in the world…the cost of production for our farm is 28c a litre.[76]
>
> In Western Australia, we are producing one of the best quality milk products in the world…I understand the average cost of production in Western Australia under Red Sky was 35c a litre.[77]
>
> At the farm level, the costs of production are similar to elsewhere in Australia.[78]

3.74 Queensland is acknowledged as less suitable for dairying:

> We do get paid on average more money than the southern producers, but running a farm in our part of the world is a higher cost system…[79]

3.75 Therefore, although it is less suitable for dairy farming, arguably as the supply is predominantly for the drinking milk market, the fewer dairy farmers receive a higher price to produce milk on a year round basis.

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72 Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p 36.

73 Mr Mark Smith, Dairy Tasmania, *Committee Hansard*, 6 November 2009, p. 25.

74 Mr Wayne Tennant, Tasmanian dairy farmer, *Committee Hansard*, 6 November 2009, p 53.

75 Tasmanian Department of Primary Industries, Parks, Water and Environment, *Submission 12*, p. 5.

76 Mr Larry Brennen, Executive Chairman, Challenge Dairy, *Committee Hansard*, 29 January 2010, pp 4–5.

77 Ms Nola Marino MHR, *Committee Hansard*, 29 January 2010, pp 10-11.

78 Mr Andrew Weinert, Western Australian Department of Agriculture and Food, *Committee Hansard*, 29 January 2010, p. 26.

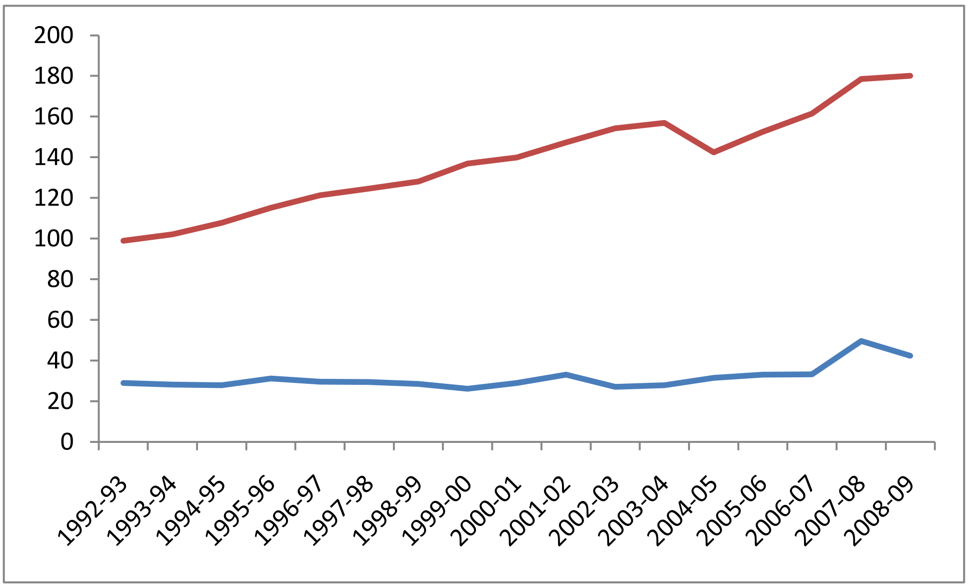
79 Mr Robert Peake, Chief Executive Officer, Queensland Dairyfarmers Organisation, *Committee Hansard*, 4 February 2010, p. 47.

3.76 Some South Australian dairy farmers estimated their costs at around 36 cents per litre.[80]

Quantifying the shares of the milk price

3.77 The ratio of the farmgate price (lower line in Chart 3.2) to the retail price (upper line) has declined over time.

Chart 3.2: Retail and farmgate milk prices (cents per litre)



Retail price is simple average of prices in Sydney and Melbourne. Source: Secretariat, based on data from ABARE, *Australian Commodity Statistics 2009*, tables 81 and 82.

3.78 It is not an easy matter to apportion the typical supermarket price of milk (around $1.75 per litre for a branded product and $1.25 per litre for a generic) between the costs and profit margins of the various players in the chain. Key witnesses such as National Foods were notably silent when asked about this.[81]

3.79 The most useful piece of information was provided by Coles. They gave an estimate by FreshLogic that as of 2008, around 20 per cent of the retail price accrued to the retailer, 45 per cent to the processor and 35 per cent to the farmer.[82]

3.80 Based on this and various other estimates provided to the Committee, Table 3.5 represents the Secretariat's attempt at allocating the supermarket shelf price.

80 Barossa Mid–North Co-operative Dairymen Limited, *Submission 7*, p. 1.

81 Mr Paul Evans, National Foods, *Committee Hansard*, 18 January 2010, p. 93.

82 Coles, Answers to questions on notice, 12 February 2010. Coles gave similar estimates at a hearing, and suggested these proportions referred to generic milk; Mr Mara, *Committee Hansard*, 4 February 2010, pp 3, 5. When Mr Mara was directly asked about the price Coles paid the processors for milk, however, he instead gave the retail price; *Committee Hansard*, 4 February 2010, p. 3.

It was not possible from the information provided to allocate the components fully. There was a residual 'unclaimed' component to the price; a kind of commercial 'dark matter'. (If this is accruing to the participant with most market power, then it is likely the supermarkets' profits are being understated in the table. An odd result is that the numbers in the table suggest that the supermarkets are making less from generic than from branded products, which seems inconsistent with their push towards generics.)

3.81 The Committee is aware that processors and/or retailers may disagree with these estimates but the onus is then on them to provide the actual numbers.[83] This would then form the basis for a better informed discussion.

3.82 Better disclosure of this information would be welcomed by many witnesses:

> Transparency would go a long way [towards a fairer distribution of market power]. For instance, I would love the fresh food people to tell us how much they make out of a litre of milk and how much the farmer and the processor make. Then we would see what the public reaction is.[84]
>
> …there has to be some way that the consumer realises that the $2 per litre that they are paying for liquid milk is broken up into those four sectors: farm, processor, distribution and retail sectors.[85]
>
> So I agree with those people who say we should require the ACCC to use their prices surveillance powers to check the margins in the supply sector, especially of the dairy industry but also of other industries.[86]

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83 Some of these estimates have already been made public during the Committee's inquiry (for example, by Sen. Colbeck, *Committee Hansard*, 18 January 2010, pp 43, 93) and not challenged.

84 Mr Rogers, *Committee Hansard*, 5 November 2009, p. 10.

85 Mr Wilson, *Committee Hansard*, 5 November 2009, p. 37.

86 Ms Dee Margetts, *Committee Hansard*, 29 January 2010, p. 42.

Table 3.5: Estimated components of the cost of full cream milk (cents per litre)

in south-east Australia, late 2009/early 2010

	Branded product	Generic product
Farmers' costs	40[a]	40[a]
Farmers' profit	2[b]	2[b]
Transport costs – farm to processor	3[c]	3[c]
Processing costs – packaging	20[d]	19[e]
Processors' costs – other processing	15[f]	15[f]
Processors' costs – advertising	3[g]	0
Processors' profit	30[h]	1[i]
Transport costs – processor to supermarket	2[j]	2[j]
Supermarket operating costs	21[k]	21[k]
Supermarket profit	14[m]	4[l]
Unallocated residual	*25*	*18*
Supermarket shelf price	175[n]	125[n]

Sources: [a]Tasmanian Suppliers Collective Bargaining Group, *Submission 27*; an estimate of 32-45 cpl was provided by Mr Mark Fergusson of the Tasmanian Institute of Agricultural Research, *Committee Hansard*, 6 November 2009, p. 67. [b]Dairy Australia, *Australian Dairy Industry in Focus 2009*, p. 14 says the typical farmgate price in 2008-09 was 42 cpl. [c]Mr Kevin Tesselaar, Australian Milk Producers Association, *Committee Hansard*, 18 January 2010, p. 22; and Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 38. [d]Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 38. Mr Richard Bovill estimates the distribution cost as 'less than 20 cpl'; *Committee Hansard*, 6 November 2009, p. 5. [e]The cost is assumed to be a little less for generic milk as the labels are simpler. [f]Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 38. Mr Richard Bovill estimates the distribution cost as 'less than 15 cpl'; *Committee Hansard*, 6 November 2009, p. 5. [g]Murray Goulburn spend the equivalent of 4 per cent of sales on advertising, according to their 2009 annual report. [h]Mr Richard Bovill estimates 'National Foods' margin on Pura milk to be somewhere in excess of 70c a litre'; *Committee Hansard*, 6 November 2009, p. 6. [i]Based on accounts in ACCC (2008, p. 384) and elsewhere that profit margins are generally very low on generic milk. Mr Bovill said that National Foods' 'margin' is 30 to 50 cpl; *Committee Hansard*, 6 November 2009. If this is taken to refer to the difference between the farmgate price and the wholesale price, it would be consistent with this estimate. It is also consistent with the estimate from Mr Cummings, NARGA, *Committee Hansard*, 4 February 2010, p. 13 that the contract price for 2 litre milk was 'slightly less than $1.70' and his view that there is not a processor who can afford to just sell generic milk (p. 17). Mr Lawson referred to processors selling generic milk at a 'break-even price'; *Committee Hansard*, 18 January 2010, p. 15. [j]Mr Richard Bovill estimates the distribution cost as 'less than 5 cpl'; *Committee Hansard*, 6 November 2009, p. 5. [k]Woolworths' overall selling, general and administrative expenses plus rent were the equivalent of 19 per cent of sales in 2009. The average milk retail price of $1.50 multiplied by 19% gives 28 cents. Milk is refrigerated but not freezed, handled in bulk and while it possibly has a below average value/shelf space, it turns over rapidly so operating costs are likely to below the average for total supermarket sales. For this table, it is assumed they are three-quarters (if they are less, then supermarket profit is understated in the table). [l]Coles and Woolworths both claim they have a gross profit margin on generic milk of around 24-25 per cent; Mr Dunn, Woolworths, *Committee Hansard*, 4 February 2010, pp 32, 39; Mr Mara, Coles, *Committee Hansard*, 4 February 2010, p. 7. [m]Woolworths said 'we make a very similar gross profit margin…on branded products and on private label products'. This is assumed to refer to a percentage mark-up rather than an amount in cents. [n]Table 3.9.

Recommendation 3

3.83 The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and requests that the results of that review be published by 30 September 2010.

Committee view

3.84 Notwithstanding the degree of uncertainty around the estimates, it seems clear that the farmers' profits from sales of drinking milk are much smaller than those accruing to the supermarkets (especially for generics) and the processors (especially for branded products). This does not seem a fair reflection of the effort required and risks undertaken by the various parties involved in producing the milk which consumers buy at a supermarket.

3.85 The difference between the price of branded and generic milk also seems much larger than can be explained by differences in marketing and labelling costs or economies of scale. The difference appears symptomatic of the exercise of market power by the major supermarket chains, as discussed further in the following chapter.

3.86 The Committee is sympathetic to the views on relative market power expressed by a witness as follows:

> The national tendering process and the amount of volume sold through the big supermarkets enables supermarkets to squeeze the processors, because with that volume it becomes an imperative part of those processors' business to ensure that they do not lose those tenders…The only thing left for the processors to do then is to in turn squeeze the dairy farmer, and the only thing left for the farmers to squeeze is the cow's tit.[87]

International comparison

3.87 Comparing Australia to the United Kingdom (Table 3.6), farmgate prices are similar, but the costs and/or profits of processors and retailers appear to be considerably higher. Similarly, the Southern Sydney Retailers Association argues that while farmgate prices are higher in the United States than in Australia, American retail prices are lower.[88]

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87 Mr Philip Depiazzi, Western Australian Farmers' Federation, *Committee Hansard*, 29 January 2010, p. 17.

88 Southern Sydney Retailers' Association, *Submission 2*.

Table 3.6: Comparison of branded full cream milk (cents per litre)

	Australia	United Kingdom
Farmgate price	42	44
Processing costs – packaging, bottling	20	9
Processing costs - other	15	6
Transport costs – farm to processor	3	5
Transport costs – processor to supermarket	2	9
Processors' profit	30	3
Supermarket gross margin (residual)	63	45
Supermarket shelf price	175	121

Sources: For Australia, Table 3.5; for UK, mostly pence per litre in 2005 from Howard Smith and John Thanassoulis, *The Milk Supply Chain Project*, January 2008, University of Oxford, pp 20, 23, 31 scaled up by 8 per cent for inflation from 2005 to 2009 and multiplied by exchange rate of 1.80 cents per penny; farmgate price from UK Department for Environment, Food and Rural Affairs; retail price from my.supermarket.co.uk.

Price controls and supports

3.88 While the best longer term response to the simultaneous existence of low farmgate prices and high retail prices for milk is increasing the competition between retailers and between processors, in the medium term a possible response would be to cap the retail price and possibly relate it to the farmgate price. It has been suggested for example that it would be reasonable to limit the retail price to a maximum of three times the farmgate price, as is done in New York.[89]

3.89 The simplest form this could take would be a price ceiling on retail milk, which could be varied annually depending on the average farmgate price in the previous year. This would be subject to the usual arguments about the welfare losses resulting from price controls. It might keep prices down for consumers but would not increase prices for farmers.

3.90 A more complex approach, with more subtle effects, would be to tie the retail price of individual supermarket chains to the farmgate prices paid by the processors who supply them. This would introduce a new dynamic whereby a supermarket would prefer to buy from a processor that pays a higher farmgate price. This may then lead to both lower prices for consumers and higher prices for farmers, at the expense of retailers and processors.

3.91 An alternative approach would be to impose a levy on the retail price and funnel that back to the farmers. A similar scheme was in place for a number of years after deregulation:

89 'Under 396–rr of New York State’s General Business Law, the price is deemed to be “unconscionably excessive” if the retail price of milk is greater than 3 times the farmgate price'; Southern Sydney Retailers' Association, *Submission 2*, p. 10.

> If you go back a little bit, we had a system here in the Australian industry of having a support, a market milk levy, which assisted farmers that were being driven out of the industry by drought and deregulation. That levy was administered at a federal level, and the levy was some 11c a litre on all market milk. It was in place for a period of years. In my experience of many years, that has been one of the easiest mechanisms to comply with, as a processor. It worked well. It was audited well. The price gained at retail was brought back and paid back into the industry, to farmers. If you were to look at something similar, to support what I am saying, to get a better yield out of the Australian market, you would have to look at that sort of mechanism.[90]

3.92 A levy was supported by some witnesses:

> …I would support a levy and that it should be set up over about a four-year period. But, to stop people coming in to make a killing on the side when they are not entitled to, you would need to base it on the production of, say, the 2008–09 season.[91]

3.93 The levy would be likely to be borne partly by retailers and partly by consumers, and perhaps to some extent passed back to processors. The experience of the earlier levy was that it did not affect farmgate prices.[92]

3.94 Another approach would be to set a floor on the farmgate price.[93] Just banning sales at below a certain price may make matters worse for farmers if it meant that their milk was not being sold at all.

3.95 Alternatively there could be a price/income stabilisation fund, as has been used in the past for agricultural commodities, where farmers pay in during good years and receive support in bad years. A variant would be a loan scheme for farmers with milk price-contingent repayments. A problem with such schemes is that they require a good estimate of the long-run trend in prices to determine whether a fall in price represents a short-term or long-term event. (Chart 6.1 shows that forecasting longer-term prices is, to put it mildly, an inexact science. The spike in milk prices in 2008 was unexpected, and once it occurred it was erroneously expected to continue.)

3.96 An example of such a proposal, which could be run by Dairy Australia or a similar body, was set out by a Victorian dairy farmer:

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90 Mr Robert Wilson, *Committee Hansard*, 5 November 2009, p. 37.

91 Mr John Oldaker, *Committee Hansard*, 6 November 2009, p. 12.

92 'There was no impact on the farmgate price up or down' according to Mr Wesley Judd, Chairman, Australian Dairy Industry Council, *Committee Hansard*, 18 January 2010, p. 9.

93 Dairy Australia note that there are legislative controls over the price milk processing companies pay farmers for their milk in many countries around the world; *Australian Dairy Industry in Focus 2009*, p. 12.

> All product consumed domestically…would have a pricing structure completely separate from the exported product. The authority would set a minimum pricing structure to apply to all domestic product. The authority would determine from the amount of milk that is produced…the component that was consumed within Australia…and this would set the percentage or the amount of the farmer's production to be paid at the rate set by the authority…It would be done in a similar way to the way that the Dairy Structural Adjustment Program Scheme was struck, so that it does not allow people to suddenly come in and flood the market and receive a high percentage. A compulsory levy would be applied to all dairy farmers to help fund the operation of the authority. This is not unusual; it is similar to the research and development levy that currently applies through Dairy Australia. Therefore, this mechanism would be less dependent on government funding for its operation. A farmer could produce as much milk as he chose to, but only a component would be paid at a rate to reflect that consumed domestically.[94]

3.97 In the short to medium term the government could boost the returns to dairy farmers by buying milk, converting it to powder, and providing it to poor and/or drought-afflicted countries in exchange for commitments by them to environmentally sustainable practices. This would have a budgetary cost but could achieve simultaneously a number of objectives. A proposal along these lines was presented to the Committee by some South Australian farmers:

> We note AusAid is currently at $3.7b. The inclusion of dairy product, i.e. skim milk powder could give the government an opportunity to underpin the industry without it being seen as a subsidy.[95]

Committee view

3.98 The Committee is concerned about the increases in milk prices that do not seem to reflect farmgate prices, or be obviously related to other cost increases. At present, however, the Committee believes this can be better addressed by improving competition in markets rather than by direct regulation of retail prices. Should alternative approaches fail, the Committee believes that price controls could be reconsidered.

3.99 The Committee observed the UK model which relies on a formula to set the retail price although ruled out such a response in Australia given the prohibitive level of regulation it would introduce and the different composition of the Australian market.

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94 Ms Judith Clements, *Committee Hansard*, 18 January 2010, p. 48. See also her *Submission 19.*

95 Barossa Mid-North Co-Operative Dairymen Ltd, *Submission 7*, p. 2.

Varying prices in different states

3.100 Both retail and farmgate prices vary across the country, but not in a directly related way. The variation in farmgate prices is shown in Table 3.7. Over the medium term, prices tend to be lower in the southern states where climatic conditions are more conducive to dairy farming.[96]

Table 3.7: Typical farmgate prices (cents per litre)

	2008–09	Average 2002–03 to 2008–09
Queensland	57	41
New South Wales	52	38
South Australia	45	35
Tasmania	41	35
Victoria	39	34
Western Australia	49	33

Source: derived from data in Dairy Australia, *Australian Dairy Industry in 2009*, p. 14.

3.101 The prices received across states may also vary according to how the milk is used in the market place:

> …if you are in an area which supplies mainly drinking milk then prices tend to be higher—for example, in northern New South Wales and southern Queensland. If you are in an area where the preponderance or the bulk of the production is manufacturing milk that will ultimately go to export, then prices tend to reflect what is happening more closely with what is happening in the world market.[97]

> In Queensland there has been a contraction of farms and milk over the last 10 years since deregulation. It has only been in the last year that that decline in milk, which was compounding at about six per cent per year, has actually started to come back up. Now, obviously, pricing signals needed to be put in place in those areas to ensure that there was a fresh milk supply in Queensland for everyday milk. In the Queensland market, most of the manufacturing capability in that state has now ceased and it is really a market milk, predominantly state.[98]

> Queensland milk producers have received higher prices…than their southern counterparts because of the nature of the Queensland industry. The

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96 As Chart 2.1 shows, dairying in Western Australia is concentrated in the south-west corner.

97 Dr Sheales, ABARE, Committee Hansard, 18 January 2010, p. 34. See also Senate Select Committee on Agriculture and Related Industries, *Food production in Australia, Third interim report*, November 2009, p. 3.

98 Mr Jeffrey, National Foods, *Committee Hansard*, 18 January 2010, p. 96. See also National Foods, *Submission 11*, p. 7.

industry is structured around the fresh milk market and is not strongly influenced by export market fluctuations.[99]

3.102 However this interpretation was also questioned by one witness:

> Yes, one price buys all milk. We do not get differential pricing. It is interesting: if companies are in different products, you would think there might be a variation of farm-gate price, but there is not.[100]

3.103 One interpretation was that the differences reflected previous attempts to lock in longer term contracts:

> …one of the issues that we have been well aware has been brought up in this discussion has been where one region has been paid substantially more than another. That is not necessarily driven by the circumstances of today but by the circumstances of 18 months or two years ago, where some of those regions were experiencing very harsh seasonal conditions and the companies made judgments about their long–term ability to source milk. Out of the discussions and negotiations at that time they went into contractual arrangements, which is not uncommon. They went in in good faith in that discussion with the producers and the groups involved in the companies and put contracts on the table for a period of time which they felt secured a base in their milk supply.[101]

3.104 In the shorter term, farmgate prices will reflect differences in the keenness of competition. The Committee heard that National Foods was offering farmers in New South Wales 44 cents per litre while only offering Tasmanian farmers 33 cents per litre.[102] A Tasmanian expert gave the following explanation:

> Mr Smith—The costs of production are probably higher in New South Wales because they are generally having to bring in more feed. We can grow feed more cheaply here.
>
> Senator MILNE—So you think it is because there is competition in the marketplace in New South Wales [that prices there are higher].
>
> Mr Smith—Yes.[103]

3.105 National Foods also referred to differences in competition, albeit somewhat more obliquely:

> …in Tasmania, Victoria or South Australia it is a different competitive set in terms of procuring milk…[104]

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99 Hon Tim Mulherin, Queensland Minister for Primary Industries and Fisheries, *Submission 24*, p. 1.

100 Mr Harris, *Committee Hansard*, 29 January 2010, p. 39.

101 Mr Judd, Australian Dairy Industry Council, *Committee Hansard*, 18 January 2010, p. 6.

102 Mr Richard Bovill, *Committee Hansard*, 6 November 2009, p. 2.

103 Mr Mark Smith, Dairy Tasmania, *Committee Hansard*, 6 November 2009, p. 26.

3.106 The Australian Bureau of Statistics measure average retail prices for milk in the capital cities, shown in Table 3.8. It is notable that the lower farmgate prices in the southern states appear not to be translated into lower retail prices.

Table 3.8: Retail milk prices across cities

(cents per litre for 2 litres whole milk; December quarter 2009)

Sydney	174	Perth	158
Melbourne	179	Hobart	185
Brisbane	159	Canberra	186
Adelaide	172	Darwin	213

Source: ABS, *Average Retail Prices of Selected Items, Eight Capital Cities*.

3.107 The ABS data in Table 3.8 refers to the average price paid for milk so will be influenced by differences in the proportions of branded and the cheaper generic milk in each city; and differences between the proportions of milk sold in supermarkets as opposed to convenience stores, milk bars and service stations.

3.108 Alternative sources, distinguishing between the prices of branded and generic milk, and not subject to these compositional effects, were used to compile Tables 3.9 and 3.10.

Table 3.9: Retail milk prices across cities

(cents per litre for 2 litres full cream milk; 7 February 2010)

	One major chain		Other major chain	
	Generic milk	Branded milk	Generic milk	Branded milk
Sydney	124	188 (df)	133	199 (pr)
Newcastle	124	188 (df)	124	177 (pr)
Canberra	124	188 (df)	124	187 (cm)
Melbourne	124	170 (pl)	133	186 (pr)
Brisbane	124	159 (df)	124	170 (df)
Cairns	na	na	124	175 (pl)
Adelaide	124	173 (df)	na	na
Perth	124	176 (hf)	na	na
Hobart	na	na	120	187 (pr)
Launceston	na	na	120	187 (pr)

df: Dairy Farmers; pl: Pauls; hf; Harvey Fresh; pr: Pura; cm: Canberra Milk.
Source: Secretariat based on supermarkets' online shopping websites.

104 Mr O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 96.

Table 3.10: Retail milk prices across cities

(cents for 1 litre full cream milk; February — April 2010)

	One major chain		Other major chain	
	Generic milk	Branded milk	Generic milk	Branded milk
Sydney	137	224df	137	224df
Melbourne			137	239re
Brisbane			137	191pl
Perth	137	218pr	137	218pr
Adelaide			137	208pr
Hobart			137	208pr
Darwin	137	219pl	137	227pl

df: Dairy Farmers; pl: Pauls; hf; Harvey Fresh; pr: Pura; re: REV. Source: visits to supermarkets.

3.109 There is still no clear pattern of milk being cheaper on the supermarket shelves in areas where the farmgate price is lower, suggesting it may be competition (or lack thereof) in various retail markets that determines the prices charged there. This was conceded by Woolworths:

> But the retail price will move more often in those three years than the cost price will and it will move between stores and between regions and between areas, even though the cost may not change. That is just an effect of competition.[105]

3.110 Questioned on the difference in prices between cities, Coles replied:

> …the major difference in state prices could be attributed to the different timing of contract negotiations which applies for us at different times in different states.[106]

Committee view

3.111 The Committee brings to the attention of government the inconsistencies in price setting at the farmgate and retail levels of the domestic drinking milk market.

3.112 Throughout the course of its inquiry the Committee heard evidence of the established practice of Murray Goulburn effectively acting as a price leader, announcing their farmgate price and then being followed by the remaining processors of National Foods and Fonterra despite the different markets to which the companies sell.

105 Mr Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 32.

106 Mr Hadler, Coles, *Committee Hansard*, 4 February 2010, p. 7.

Recommendation 4

3.113 The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

Chapter 4

Competition in the dairy industry

4.1 There has been a trend towards increased concentration among both processors and retailers of milk in Australia. This is not just a coincidence; the increase in concentration among retailers has been an important driver of the increased concentration among processors and this looks likely to continue. The victims of this increased concentration are the farmers and the consumers.

4.2 As stated in Chapter 1, this experience raises concerns much more broadly than just in the dairy industry, as similar problems have, or could, arise in other areas given the dominance of the two large supermarket chains in the retail sales of so many products.

Competition in the retail and wholesale markets

4.3 As noted in previous chapters, the two major supermarket chains, Coles and Woolworths, sell about half the drinking milk sold to consumers, and over half of this is in the form of generic milk. Both these proportions appear to be increasing, with attendant risks to competition.

4.4 The provision of generic milk to supermarkets has become a very important component of sales for processors. As noted in the previous chapter, the large supermarket chains tend to want a single processor for each state or region, or perhaps even a single national supplier.[1] This preference encourages consolidation within the processing sector as only large processors can credibly bid for the contracts, and a processor without such a contract cannot realise economies of scale.

Possible policy responses

4.5 Removing this anti-competitive impetus requires reducing the dominance of the large supermarkets and/or reducing their use of generic milk and its impact on processors.

Reducing the dominance of the large supermarket chains

4.6 In Australia mergers which would lead to a 'substantial lessening of competition' are (supposed to be) prohibited by section 50 of the *Trade Practices Act*. This has not, however, prevented mergers such as the National Foods takeover of Dairy Farmers which, the Committee heard evidence, had substantially affected the competitive dynamics of the Tasmanian dairy market.

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1 Woolworths has a national contract, with National Foods supplying their Home Brand generic milk while Coles has tenders on a state-by-state basis; Mr O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 87.

4.7 This is because the courts have adopted a very demanding test of what constitutes a 'substantial lessening of competition', effectively requiring that after a merger the new company must be almost a monopoly. Associate Professor Zumbo submitted:

> The “substantial lessening of competition” test requires that in order for the merger or acquisition to be considered in breach of the test, the merged entity must have the ability to raise prices without losing business to rivals.[2]

4.8 Given the test is so demanding, it is unsurprising that the ACCC approves over 95 per cent of proposed mergers and acquisitions which it considers.

4.9 Even with its shortcomings, Section 50 would presumably prevent a merger between Coles and Woolworths, and probably prevent them taking over the Australian operations of ALDI or buying up simultaneously a large number of independent grocers. But preventing a substantial lessening of competition does nothing to deal with an existing state of inadequate competition. For this additional measures are required.

4.10 The most direct approach would be 'trust busting' – requiring divestiture by chains that have an 'excessive' market share or market power. As one witness put it:

> I think Senator Xenophon suggested they split the two majors into four—bloody good idea![3]

4.11 Associate Professor Frank Zumbo would like to:

> …amend the Trade Practices Act to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.[4]

4.12 He comments:

> Unlike the United Kingdom or the United States, Australia does not provide for a general divestiture power to deal with highly concentrated markets having characteristics that prevent, restrict or distort competition in those markets. In the United Kingdom a very sophisticated framework has been enacted to allow for highly concentrated markets to be reviewed with the purpose of assessing the level of competition in a market and for taking steps to remedy market distortions having a detrimental impact on competition and consumers.[5]

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2 Associate Professor Frank Zumbo, *Submission 34*, p. 6.

3 Mr Harris, *Committee Hansard*, 29 January 2010, p. 37.

4 Associate Professor Frank Zumbo, *Submission 34*, p. 11.

5 Associate Professor Frank Zumbo, *Submission 34*, p. 11.

4.13 A dissenting report by a minority of the Senate Standing Committee on Economics in 2008 suggested:

> We need to enact a divestiture power which allows the Court to break up corporations that dominate markets by acquiring a substantial market share to the detriment of small businesses and consumers…Consideration should be given to enacting a divestiture power under the *Trade Practices Act*.[6]

Creeping acquisitions

4.14 One way in which the major supermarkets increase their market share is through 'creeping acquisitions'; a series of takeovers, each of which is individually too small to 'substantially lessen competition' but which cumulatively may do so.

4.15 The Senate Economics References Committee examined this topic in the context of its report on the *Trade Practices Act 1974* in 2004 and concluded:

> The Committee considers that provisions should be introduced into the Act to ensure that the ACCC has powers to prevent creeping acquisitions which substantially lessen competition in a market.[7]

4.16 The ACCC's 2008 report on grocery prices noted that concerns about creeping acquisitions persisted in the supermarket sector. It conceded that its powers to prevent them may be limited:

> While s. 50 of the Act applies to individual acquisitions, the application to potential 'creeping acquisition' issues is more problematic. The ACCC takes the view that, while it can assess under s. 50 the competitive issues associated with an individual acquisition, s. 50 is unlikely to allow it to examine the cumulative impact of a series of acquisitions of smaller competitors over time that individually do not raise competition issues… The ACCC considers that the supermarket industry is one where creeping acquisitions could potentially become a concern…[8]

4.17 Shortly afterwards, the Senate Standing Committee on Economics revisited the topic while inquiring into the Trade Practices (Creeping Acquisitions) Amendment Bill. The bill sought to amend the *Trade Practices Act 1974* so that an acquisition would be deemed to lessen competition substantially if it and other acquisitions over the previous six years would have that effect. The Committee concluded:

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6 Senate Standing Committee on Economics, *Trade Practices (Creeping Acquisitions) Amendment Bill 2007 [2008]*, August 2008, p. 11.

7 Recommendation 12, Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 64.

8 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, August 2008, pp 532, 535.

> …concerns about the impact of 'creeping acquisitions' on competition are valid. It agrees that the current provisions of section 50 of the *Trade Practices Act* are insufficient to address the problem adequately.[9]

4.18 The majority of the Committee, however, preferred to defer consideration of the bill until the Government presented its own legislation. The Government subsequently released two discussion papers canvassing various options. But so far, the only legislative change the Government has foreshadowed is to clarify that substantial lessening of competition could refer to a *local* market, not just a *national* market.

4.19 A new investigation of creeping acquisitions is now being conducted by the Senate Economics Legislation Committee as part of its inquiry into the Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009.[10] This bill would amend section 50 of the TPA such that a corporation which already has a substantial *share of a market* must not directly or indirectly merge with or acquire shares or an asset which would have the effect of *lessening competition* in the market.

Committee view

4.20 In recent times the Committee has increasingly been referred inquiries which seek to examine issues concerning the operation of the *Trade Practices Act 1974*. The evidence that the Committee has collected throughout those inquiries together with the information that has been uncovered during the dairy inquiry has left the Committee with concerns and questions in relation to the state of competition in the Australian marketplace.

Recommendation 5

4.21 The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and requests that it publish its report by 30 April 2011.

Recommendation 6

4.22 The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

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9 Senate Standing Committee on Economics, *Trade Practices (Creeping Acquisitions) Amendment Bill 2007 [2008]*, August 2008, p. 9.

10 Associate Professor Frank Zumbo argues that this bill would address the problem of creeping acquisitions; *Submission 34*, pp 7-8.

Misuse of market power and price discrimination

4.23 Section 46 of the TPA aims to promote competition by preventing corporations who have substantial market power from abusing that power and specifically prohibiting those entities from using their market power to eliminate or damage a competitor, prevent entry of others into the market or prevent or deter others from engaging in competitive conduct in a market.[11]

4.24 As noted in Chapter 3, the processors provide milk at a lower price to the large supermarket chains than to smaller supermarkets. To some extent, this reflects economies of scale in dealing with the larger chains. It may also, however, reflect the market power of the large chains.

4.25 Similarly, the processors charge a lower price to the major supermarkets than they do to vendors who on-sell milk to small retailers such as milk bars, take-away food outlets and other small stores to whom milk is an ancillary line of business. One vendor told the Committee they paid around $1.40 a litre for milk.[12] This is more than the supermarket's shelf price for generic milk and more – probably considerably more – than the supermarkets pay the processors for branded milk.[13]

4.26 Similarly, another vendor submitted:

> National Foods were…responsible for the ordering, pricing, billing and collection of milk sold to customers who are delivered to by Parmalat Distributors in NSW. We can prove that these customers are paying less than our cost for product… General wholesale price for a two litre milk is $3.51…Given many coffee shops and small businesses can go to Woolies and Coles and but three litre generic milk for $3.16 – how can I compete with that?[14]

4.27 There are suggestions that the *Trade Practices Act* should be strengthened to prevent such price discrimination:

> With smaller retailers at a substantial competitive disadvantage because of the higher prices they pay for branded milk, Coles and Woolworths need not compete as aggressively on price as they would have to if the smaller retailers were able to provide a stronger competitive constraint on Coles and Woolworths… Where anti-competitive price discrimination is present, it should be dealt with under the Trade Practices Act. Given the continued ineffectiveness of s 46 it is appropriate to amend the Trade Practices Act to deal specifically with anticompetitive price discrimination. A number of

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11 Steinwall, R., *Annotated Trade Practices Act 1974*, 2004 Edition, Reed International Books Australia, paragraph 10,760.10, p. 270.

12 Mr Lawson, Amalgamated Milk Vendors Association, *Committee Hansard*, 18 January 2010, p. 15.

13 See Table 3.5.

14 Julie Gration and David White, *Submission 6*, pp 2 and 5.

> international precedents are available including the United States *Robinson-Patman Act of 1936* and s 18 of the United Kingdom *Competition Act 1998*.[15]

4.28 The TPA formerly included an explicit 'price discrimination' provision. Section 49(1) had stated:

> A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to
>
> (a) the prices charged for the goods;
>
> (b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of goods;
>
> (c) the provision of services in respect of the goods;
>
> (d) the making of payments for services provided in respect of the goods if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods.

4.29 Section 49(2) had listed two defences to 49(1). The first was where the price differences reflected differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the different places to which the goods are supplied to purchasers. The second defence was where the discrimination was constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier.

4.30 The repeal of section 49 was recommended by the Swanson Committee (1976), the Blunt Committee (1979) and the Hilmer Committee (1995) and it was repealed in 1995. In 2003, the Dawson Review recommended that the effect of price discrimination on competition be considered on a case-by-case basis, arguing that section 46 is the most appropriate means to tackle anti-competitive price discrimination. Further, the Review considered that there are reasons for differences in wholesale prices in the grocery industry which do not involve anti-competitive practices.[16]

4.31 A review into Parts IV and VII of the TPA in 2004 examined whether section 46 required amendment to deal better with price discrimination (previously addressed by section 49) and concluded that section 46 was adequate.[17]

4.32 The Senate Economics Legislation Committee again examined the operation of section 46 as part of its inquiry into the proposed Blacktown Amendment. A

15 Associate Professor Frank Zumbo, *Submission 34*, pp 9-10.

16 *Dawson Review*, 2003, pp. 96–97.

17 Senate Economics References Committee, *Effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 3.

number of submissions argued that, as interpreted by the courts, section 46 is ineffective in providing protection against anti-competitive conduct.[18] The Boral case, in particular, is widely seen as having vitiated section 46 by ruling that only conduct by a firm with 'substantial market power' is prohibited and then setting the standard for 'substantial market power' unrealistically high.

4.33 The ACCC Chairman, for example, commented:

> The High Court decision in the Boral case, in our view—and in the view of senior counsel—has given a legal interpretation to the wording of section 46, which indicates that parliament did not achieve its intention. The use of the words ‘substantial degree of market power’ did not lower the threshold below that of dominance…[19]

4.34 The restoration of an explicit provision against price discrimination in the TPA would empower the ACCC to act and the Australian Competition Tribunal to review. It is advocated by former senator Margetts:

> To remove the prices discrimination, as an example, from the *Trade Practices Act* and then have so much evidence provided to the ACCC grocery price inquiry about price discrimination that related to branded products, home brand products and the pressure that has been put on suppliers shows, in my view, that there is a clear problem with the removal of the prices discrimination provision.[20]

Committee view

4.35 From evidence taken during the course of its inquiry the Committee takes the view that the current operation of section 46 is inadequate and is not providing protection against price discrimination. The major supermarkets appear to be using their dominant market positions to drive down the farmgate price through the sale of generic products which puts pressure on processors who are forced to compete with their own products.

4.36 The Committee takes the view that this will negatively affect competition and therefore consumers as it will lead to less product choice and fears that the current interpretation of section 46 will enable these large players to escape allegations of misusing their market power.

4.37 The Committee considers that this situation needs to be addressed to ensure the long term viability of Australia's dairy industry.

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18 Senate Economics Legislation Committee, *Trade Practices Amendment (Guaranteed Lowest Prices - Blacktown Amendment) Bill 2009*, November 2009, pp 20-21.

19 Mr Graeme Samuel, cited in Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 9.

20 Ms Dee Margetts, *Committee Hansard*, 29 January 2010, p. 43.

4.38 The precursor to the Committee has weighed the advantages and disadvantages of using market share as a proxy measure of market power in an earlier report, concluding that it was justified.[21]

4.39 It is a matter for judgement what market share might be regarded as raising potential concerns about market power. The European Commission takes the view that a firm would *generally* have a *dominant* position once it reaches a market share of 40-45 per cent and *may* achieve a dominant position in the region of 20-40 per cent.[22]

4.40 This is broadly consistent with approaches in some individual European countries. The Austrian Cartel Act places the burden of proof on a company to show it is not dominant where its market share exceeds 30 per cent. In Germany a market share of a third is taken as indicating dominance. The corresponding threshold in Bulgaria is 35 per cent and in Croatia, Estonia, Lithuania, Poland and Serbia 40 per cent. In Malta a company with a 40 per cent market share is deemed dominant unless it provides evidence to the contrary. In Sweden a market share of 40 per cent is regarded as indicative of dominance. Latvia and Slovakia have removed their previous 40 per cent thresholds for defining dominance.[23] A firm would, of course, have some market power well before reaching dominance.

4.41 The US Department of Justice's benchmark for challenging mergers is where the sum of the squared percentage market shares of the merging companies exceeds 1800.[24] This would occur if two firms each having a 30 per cent market share wanted to merge; or a firm with a 40 per cent market share wanted to take over a competitor with a 14 per cent market share.

Recommendation 7

4.42 The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

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21 Senate Standing Committee on Economics, *Trade Practices Legislation Amendment Bill 2008 [Provisions]*, August 2008, pp 4–6.

22 Source: the widely cited study by Richard Whish, *Competition Law*, 1989, who cites the European Commission's *10th Report on Competition Policy*, p. 294.

23 The information in this paragraph is based on Institute of Competition Law, http://www.concurrences.com/nr_one_question.php3?id_rubrique=578#ancre12.

24 This criterion is based on the Herfindahl-Hirschman Index; Richard Whish, *Competition Law*, 1989, p. 697.

Contracts for generic milk

4.43 The Greens believe there is a strong case for banning large supermarket chains from selling generic milk (and other generic products). This should lead to branded products from a wider range of processors, large and small, jostling for space on the shelves and a more competitive processing industry.

4.44 The knee-jerk reaction to such a proposition is that it would be denying consumers access to the cheaper products. But this would only be an immediate reaction. Over time, the same price discrimination tactics applied by the supermarkets would be applied by (some) processors with some milk being packaged in a 'cheap and tatty' way and sold at a lower price and more prestigious brands (even if they are actually the same milk) being sold at a higher price. Consumers may end up in much the same position but with some of the profits from price discrimination being shifted from the supermarkets to the processors (and possibly on to the farmers). In the longer term, consumers may benefit by avoiding a situation where there is little competition as each supermarket offers only its own generic products.

4.45 A milder step would be to continue allowing supermarkets to sell generic milk but require them to have multiple tenders, accepting bids from more and smaller processors.

4.46 The ACCC told the Committee they had not looked into generic milk contracts in depth.[25]

Committee view

4.47 The Committee is concerned by the growing market share being acquired by supermarkets through the sale of their own brand generic products. The Committee recognises that this trend is occurring across the majority of grocery items, not just drinking milk, and given the evidence it has heard from dairy farmers throughout this inquiry believes the effect this practice is having on other primary industries should be thoroughly investigated.

Recommendation 8

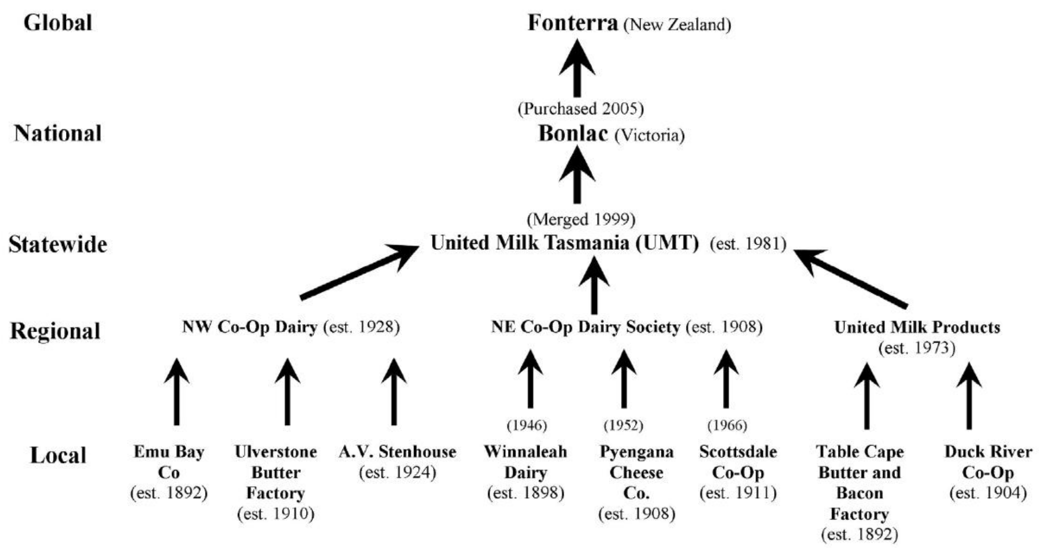
4.48 The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

25 Mr Mark Pearson, ACCC, *Committee Hansard*, 18 January 2010, p. 84.

Competition in the market for raw milk

4.49 As described in Chapter 2, the number of processors has reduced over time. From a variety of local processors, often co-operatives, the market is now dominated by subsidiaries of international corporations (Chart 4.1).

Chart 4.1: Consolidation of dairy processing operations



Source: Dr Shane Broad, *Submission 5*, p. 3.

4.50 This has left some farmers facing an effective monopsony:

> In the south of the state, Fonterra will not come down and pick up our milk…We have one option in the south of the state—National Foods.[26]

> There really are only two processors for liquid milk in Tasmania, National Foods and Betta Milk. Betta Milk were supplied by Lactos, the cheese makers, prior to National Foods buying Lactos. So we had a situation where the only competitor to National Foods was being supplied with its liquid milk by National Foods…the fewer the number of processors in Tasmania the greater is their power.[27]

4.51 The vastly unequal bargaining power that results leads to problems in negotiating price. The negotiations themselves are discussed in the following chapter. This chapter is concerned with trying to even up the bargaining power.

4.52 The Committee heard a lot of criticism of the ACCC for allowing National Foods to take over Dairy Farmers. Notwithstanding some required divestitures, this has resulted in a significant reduction in competition, notably in Tasmania:

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26 Mr Grant Rogers, *Committee Hansard*, 5 November 2009, p, 3.

27 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 15.

> Who in their right mind would approve National Foods taking over Dairy Farmers? …That would have to be the biggest blunder that has ever happened to the Australian dairy industry.[28]
>
> …it seems extraordinary to us as ordinary dairy farmers that the ACCC allowed the takeover of Dairy Farmers by National Foods, which in a sense is almost creating a monopoly.[29]
>
> …that Dairy Farmers acquisition which really leaves huge questions for the ACCC to answer.[30]
>
> …quite frankly I think the ACCC, through Mr Graeme Samuels, was really asleep at the wheel in allowing National Foods to buy Dairy Farmers in the first place, as it was a direct competitor to them in the marketplace… He was also asleep at the wheel when he allowed National Foods to buy Lactos.[31]
>
> We never envisaged, because of the dominance of National Foods and Dairy Farmers in that state, that the ACCC would allow one to buy the other.[32]

4.53 Asked about this approval, the ACCC replied:

> We conducted a very extensive review into that matter and found that there were going to be substantial competition problems that would breach the act in South Australia and in New South Wales in a number of markets, including the supply of fresh whole milk, the supply of flavoured milks and also in relation to a market for the acquisition of milk from dairy farmers in central New South Wales and South Australia. So we would have opposed that merger but for a divestiture that was forced upon National Foods. It was required to divest some processing facilities, depots, brands and licences to enable another competitor to restore the competition that would have otherwise been lost in those markets…Following the undertaking, the commission was satisfied that there was not going to be any substantial lessening of competition in those markets where it found that it would have otherwise occurred.[33]

4.54 After the Committee's public hearings were concluded, the ACCC released a 'statement of issues' concerning the proposed acquisition of Warrnambool Cheese and Butter by Murray Goulburn Co-operative, expressing the view that it would be likely

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28 Mr Grant Rogers, Tasmanian farmer, *Committee Hansard*, 5 November 2009, p. 11.

29 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 24.

30 Mr Bovill, *Committee Hansard*, 6 November 2009, p. 6.

31 Mr John Oldaker, Chairman, Cadbury Suppliers, *Committee Hansard*, 6 November 2009, p.7.

32 Mr Lawson, *Committee Hansard*, 18 January 2010, p. 17.

33 Mr Grimwade, ACCC, *Committee Hansard*, 18 January 2010, p. 74.

to substantially lessen competition and estimating that 'establishing a new plant of a size that could constrain the merged entity would cost in excess of $100 million'.[34]

4.55 Some of those who criticise the National Foods takeover of Dairy Farmers want legislative changes that would prevent any such mergers in the future. Associate Professor Frank Zumbo recommends amending the TPA so that instead of preventing takeovers which *substantially* lessen competition, the bar be lowered to preventing mergers which *materially* lessen competition.[35]

4.56 Professor Zumbo's suggestion is encompassed in the Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009, which is currently the subject of an inquiry by the Senate Economics Legislation Committee. Some evidence before that inquiry raises doubts about whether courts may distinguish between 'material' and 'substantial' changes to competition; suggesting that either an alternative wording may be needed or the intention spelled out very clearly in the legislation and/or explanatory memorandum.

4.57 A problem identified in the operation of the ACCC is that it is both umpire and player. It approves a merger and then assesses whether competition is adequate after the merger:

> 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…The ACCC is a stay-at-home policeman, only called out after the crime has been alleged or committed.[36]
>
> Senator MILNE—…that the ACCC's powers be divided so that, if they stay as the approving body for mergers, the adjudication on the impacts of mergers be taken to another administrative body. Would you support that?...
>
> Mr Oldaker—Yes, …They need to be made accountable, and if that is what you have to do then that is what has to happen.[37]

4.58 The ACCC replied:

> We would not see such a conflict of roles…In most competition law enforcement authorities there is a combination of a merger function and an enforcement function. They are necessarily different because one is forward looking and one is backwards looking. But they are two tools to achieve essentially the same goal, which is to enhance the welfare of Australian consumers. So, rather than being in conflict, they complement each other. I

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34 See especially paragraphs 70 and 84 of ACCC, 22 April 2010, http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D10+3542719.pdf&trimFileTitle=D10+3542719.pdf&trimFileFromVersionId=924920

35 Associate Professor Frank Zumbo, *Submission 34*, pp 6–7.

36 Dr McCall, cited in Select Committee on Agricultural and Related Industries, *Food Production in Australia: Third Interim Report*, November 2009, p. 26.

37 Mr John Oldaker, Chairman, Cadbury Suppliers, *Committee Hansard*, 6 November 2009, p.12.

> should say that the staff who conduct the merger reviews are wholly separate to the staff who conduct the enforcement activities of the commission. They sit in separate divisions. [38]

4.59 It has also been suggested that the ACCC should have a dedicated small business branch.

4.60 The Committee also asked the ACCC about barriers to new processors entering the market. Their view was:

> We would like to think that in general the barriers to entry are reasonably low. For a participant who is serious about entering the market there are no real legal barriers, but you have to get the plant and manufacturing processes. I think one of the biggest barriers would be getting the contracts from farmers. A lot of those are sewn up. We do not try to make light of those problems but the barriers to entry are probably not as high as we see in some of the other sectors.[39]

Committee view

4.61 The Committee expresses grave concerns about claims of anti-competitive conduct by supermarkets. In particular, it appears that the growing dominance of generic products in the retail market is having detrimental effects on both consumers and farmers.

4.62 A combination of narrow interpretations by the courts of expressions in the *Trade Practices Act 1974* and the repeal of section 49 mean that the Act fails to provide adequate protection against excessive market concentration and abuse of market power. There is inadequate assessment of whether markets have become excessively concentrated because the agency assessing this (the ACCC) is the same agency that approved the mergers leading to the high degree of concentration. The Committee is also concerned that the 'public interest' which the ACCC seeks to protect appears to be restricted to consumers and it does not pay sufficient attention to ensuring that farmers get a fair deal.

4.63 The Committee would like to see restrictions placed on creeping acquisitions by the major supermarket chains, but will leave to the current inquiry by the Senate Economics Legislation Committee whether this should be by the proposed Richmond Amendment or legislation shortly to be introduced by the Government.

4.64 The majority of the Committee is reticent to interfere in commercial decisions to the extent of banning the sale of generic products by the major supermarket chains, and would prefer its concerns be addressed by other measures to promote competition. If the large supermarket chains continue to sell generic products, the Committee would like to see smaller processors able to bid to supply them.

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38 Mr Timothy Grimwade, ACCC, *Committee Hansard*, 18 January 2010, p. 75.

39 Mr Mark Pearson, ACCC, *Committee Hansard*, 18 January 2010, p. 76.

Recommendation 9

4.65 The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

Recommendation 10

4.66 The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

Chapter 5

Negotiations between farmers and processors

5.1 The Committee heard during the hearings in Tasmania about the fraught negotiations between Tasmanian dairy farmers and National Foods in 2009. While this particular matter has now been settled, it raises broader issues of how negotiations between farmers and processors could best be structured.

Farmers' cooperatives

5.2 As noted earlier, the Australian dairy industry has moved from a position where many processors were farmers' cooperatives (acting in the interests of farmers) to the current situation where most processors are subsidiaries of foreign corporations.

5.3 This has made negotiations on prices much harder work for the farmers:

> …we are dealing with a multinational corporation whose executives get paid bonuses for keeping prices down, so it is hard yakka.[1]

5.4 While cooperatives are somewhat out of fashion, the Committee heard evidence that with good management they can work well:

> …cooperatives work like any other business—if they do not have a proper business model they will fall over. Again, it is the Europeans, the Canadians and the US based cooperatives which have shown how good business models can produce value adding because of the obvious advantages that collaborative business models have for the value adding of the operation. It allows individual milk suppliers to continue to do what they have done.[2]

Committee view

5.5 The interests of farmers would be better served if there were more processors and preferably more of them in the form of cooperatives.

Recommendation 11

5.6 The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

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1 Mr Grant Rogers, *Committee Hansard*, 5 November 2009, p. 5.

2 Dr Tony McCall, *Committee Hansard*, 5 November 2009, p. 50.

Collective bargaining groups

5.7 When large multinational companies negotiate with individual farmers, particularly small family farms, there is obviously a marked imbalance in bargaining power. This is especially the case when there is only one processor in the area. The Committee heard, for example, that in southern Tasmania the only buyer of milk is National Foods. A farmer there described the negotiation process:

> Until we formed the collective bargaining group, every year we basically were given a contract and they said: 'This is what we are going to pay you. Sign it.'[3]

5.8 In an attempt to improve their comparative bargaining position, some farmers have sought to engage in collective bargaining with processors.

5.9 Collective bargaining arrangements[4] are available to dairy farmers pursuant to section 93AB of the *Trade Practices Act 1974*, which enables those involved to seek authorisation from the ACCC.

5.10 Within the Australian dairy industry there are 16 collective bargaining groups operating, representing approximately 530 farmers.[5] Collective bargaining extends beyond price, also including transport arrangements, quality and supply. The results of these negotiations remain confidential between the groups and processor.[6]

5.11 A Tasmanian farmer described how the group there works:

> Initially we had a vote to elect six members of an executive…Obviously you cannot have 91 people negotiating…so we have gone into the negotiations representing our members and then we have gone back to the members in a full meeting and have said, 'This is what we have been negotiating about. These are the terms that we have been offered. We believe it is a fair offer, but it is up to you to vote on it.' [7]

5.12 The attitude of processors towards collective bargaining is unclear. National Foods submitted that:

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3 Mr Rogers, *Committee Hansard*, 5 November 2009, p. 4.

4 Collective bargaining – where two or more competitors in an industry come together to negotiate terms and conditions with a supplier or customer – behaviour would, if not authorised by section 93AB, raise concerns under the competition provisions of the *Trade Practices Act 1974*.

5 Australian Dairy Farmers, Additional Information, 29 January 2010, p. 1.

6 Australian Dairy Farmers, Additional Information, 29 January 2010, p. 2.

7 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 20.

> National Foods believes these arrangements are appropriate and has worked cooperatively with collective bargaining groups…[8]
>
> National Foods welcomes working with collective bargaining groups.[9]

5.13 On the other hand, another submission stated that when the ACCC granted authorisation for their formation, National Foods appealed against the decision.[10]

Tasmanian experience in 2009

5.14 The Tasmanian Suppliers Collective Bargaining Group is a collective of 86 dairy farmers supplying milk to National Foods. It was established and registered with the ACCC in 2006.

5.15 In 2009 National Foods offered the Group a price of 29 cpl, later increased to 33 cpl. This compared to 49 cpl the previous year and average costs for farmers of around 40 cpl (see Chapter 3).

5.16 In October 2009 National Foods announced that negotiations had broken down and they would bargain only with individual farmers.

5.17 For reasons never made clear, the Tasmanian Farmers and Graziers Association initially advised farmers to accept National Foods' early offers of prices well below the cost of production, and the Association held negotiations with National Foods in Melbourne without discussing first with the Bargaining Group.[11]

5.18 The Tasmanian dairy farmers were assisted in their battle by 'people power'. Many of the Tasmanian community rallied behind the farmers and demonstrated their disapproval of National Foods' hardline approach by boycotting their products.

5.19 It appears that the short-term loss of sales, the longer term damage to their brand from the adverse publicity and perhaps fears of further deterioration in their reputation once Senate committees reported, led National Foods to settle with the Group in November 2009. As National Foods themselves put it:

> ACTING CHAIR—…the recent dispute with the collective bargaining group in Tasmania was difficult for farmers and not helpful to your business, at least in the short term. Is that right?

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8 National Foods, *Submission 11*, p. 11.

9 Mr Conor O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 93.

10 Anonymous Queensland dairy farmer, *Submission 9*, p. 3.

11 For an example of the disappointment of farmers with this behaviour, see Mr Rogers, *Committee Hansard*, 5 November 2009, p. 8 and Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 23. The Association's obfuscations about their behaviour are at *Committee Hansard*, 6 November 2009, pp 31-36.

> Mr Evans—Yes—particularly the calls from some quarters for product boycotts. That is damage that we are working hard on and making progress—
>
> …Mr Jeffrey—…We as a business have realised that we had an issue in Tasmania…We will put a lot of things in place between now and the next 12 months to get on top of those.[12]

5.20 The Committee heard that National Foods, while negotiating with the Tasmanian Suppliers Collective Bargaining Group in late 2009, had also approached individual farmers in what seemed to be an attempt to undermine the unity of the bargaining group. As the Group asked:

> How can farmers negotiate with a giant multinational company if every time the company feels like it they can abandon the process?[13]

Committee view

5.21 Irrespective of the legality of such action, the Committee regards National Foods' approaches to individual farmers while involved in collective bargaining as a breach of good faith negotiating.

Collective bargaining in Queensland

5.22 Farmers' representatives from Queensland told the Committee:

> We have some really successful examples of collective bargaining groups in Queensland…not just in terms of working with the processor on the issue of price but on a much broader basis in terms of getting a better understanding between the producer group and the needs of the processor …They have managed to negotiate not just on price but also on supply conditions, terms of contract and a range of other issues, including transportation, testing et cetera. That relationship has matured over time, and…when they managed to negotiate longer term contracts, it did have a positive effect on arrangements with other producers and processors.[14]

Need for larger collective bargaining groups

5.23 As processors merge, there may be a need for bargaining groups to do so too:

> …the collective bargaining groups that currently exist with authorisations under the ACCC need to be allowed to expand their farmer base representation and geographic areas to enable them to keep up with what is happening at the next level in the value chain. At the moment there is a

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12 Mr Evans and Mr Jeffrey, National Foods, *Committee Hansard*, 18 January 2009, p. 92.

13 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, pp 17, 25.

14 Mr Robert Peake, Chief Executive Officer, Queensland Dairyfarmers Organisation, *Committee Hansard*, 4 February 2010, pp 44-5.

> disparity that has occurred, and there needs to be the opportunity for the collective bargaining groups of farmers to rectify that by being able to expand their representation.[15]

5.24 An impediment to this may be the need for ACCC authorisation. The ACCC recently refused to allow a group to expand its regional coverage.[16]

Training

5.25 Collective bargaining groups may be more effective with more training, given they are negotiating with large companies with specialised staff:

> …we would like to see additional resources provided for training and professional advice to these groups. A lot of these groups are made up of people who are professional farmers but they are not professional negotiators and they are in an environment where they are having to negotiate with highly skilled and very experienced people in the processing sector of the food industry. We have seen the positive results that training and support can provide to collective bargaining groups…[17]
>
> From the experience that I have seen in Tasmania, I think that, maybe with training and support earlier on, that situation could have been avoided…from what we have seen of the differences between a number of collective bargaining groups, the ones that have got the professional advice and training have certainly developed a much more professional and effective relationship with their processor than the ones that have not. [18]

Committee view

5.26 The Committee is disappointed by the behaviour by National Foods while negotiating with dairy farmers in Tasmania. The Committee is concerned that this behaviour has not been confined to Tasmania but has extended to other dairy regions within Australia.

5.27 The Committee considers that the ability of large companies to 'walk away from the table' undermines the collective bargaining provisions of the TPA and enables the more powerful participant in a negotiation to dictate the terms of trade.

An honest broker

5.28 The Committee heard suggestions that negotiations between farmers or bargaining groups and the processors may go better if there is assistance from a

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15 Mr Robert Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 4 February 2010, p. 45.

16 Mr Robert Peake, *Committee Hansard*, 4 February 2010, p. 46.

17 Mr Robert Peake, *Committee Hansard*, 4 February 2010, p. 45.

18 Mr Robert Peake, *Committee Hansard*, 4 February 2010, p. 46.

facilitator, mediator or conciliator; or if agreement cannot be reached the involvement of an arbitrator.

5.29 The Tasmanian Suppliers Collective Bargaining Group commented:

> A solution to the problem of having to battle over milk price with National Foods every year is the next thing we are seeking. We suggest this should be through arbitration or mediation, with an independent third party participating.[19]

5.30 They warned this may need to be some form of compulsory arbitration:

> It is our belief that a previous collective bargaining group in another part of Australia asked for arbitration and National Foods rejected it. [20]

5.31 A Tasmanian expert, Dr Broad, also supported some compulsory adjudication or arbitration.[21]

5.32 By contrast the Tasmanian Farmers and Graziers Association supported conciliation but not arbitration:

> If there was a system of third-party conciliation that is something that intuitively I think is a good idea, but the arbitration issue becomes far more difficult… conciliation would be a wise step. The arbitration thing would worry me, as it would worry a lot of people.[22]

5.33 National Foods rejected suggestions that an arbitrator or moderator may have made the process of reaching an agreement with the Tasmanian farmers much easier, and less damaging to the company's brand. The most they would concede was:

> …with hindsight, if someone had come in at a point in time and both parties had agreed to that and if there had been a willingness of both parties to accept rules of engagement, both parties would have had to—dare I say it?—almost create something from scratch, and that might have facilitated an outcome. But that is a hypothetical answer I am trying to give.[23]

5.34 A Dairy Industry Ombudsman is advocated by Associate Professor Frank Zumbo. He envisages the Ombudsman as a:

> …suitable qualified and independent person with specific responsibility for (i) researching and identifying existing and emerging areas of disputation

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19 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 12.

20 Mr Phil Beattie, Tasmanian Suppliers Collective Bargaining Group, *Committee Hansard*, 5 November 2009, p. 20.

21 Dr Shane Broad, *Committee Hansard*, 6 November 2009, p. 18.

22 Mr Chris Oldfield, Tasmanian Farmers and Graziers, *Committee Hansard*, 6 November 2009, p. 32.

23 Mr Conor O'Malley, National Foods, *Committee Hansard*, 18 January 2010, p. 94.

> with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes…who would systematically investigate new and emerging areas of disputation in the Australian dairy industry with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.[24]

Recommendation 12

5.35 The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and requests that it report by 30 April 2011.

Recommendation 13

5.36 In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- **allowing collective bargaining groups to merge to address imbalances in bargaining power;**
- **the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and**
- **the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.**

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24 Associate Professor Frank Zumbo, *Submission 34*, p. 4.

Chapter 6

Other matters

6.1 This chapter considers other matters raised during the course of the inquiry, relating to the sustainable development of the dairy industry and the adequacy of information provided to consumers.

Food security

6.2 Some witnesses fear that the challenges facing the dairy industry are so severe as to threaten its viability in Australia and leave Australia dependant on imports for a key food item. This would be particularly worrisome in the context of growing concerns around *global* 'food security' – the availability of affordable food – reflected in the surge in global prices of agricultural commodities in the late 2000s.[1]

6.3 Dr McCall raised the issue of food security at the Committee's first hearing:

> …instead of ridiculing the likes of the European Union, which value the contribution of food production and food producers, we should also value it and embrace it within what I would describe as a food security policy and make it just as important as national security. In the age of scarcity and uncertainty that we are likely to confront over the next 15 to 20 years, that policy framework needs to be an imperative…In Australia we need to acknowledge this reality as a risk assessment for policymaking into the future and develop a similar policy response to the European Union, where there are intervention thresholds around price for suppliers.[2]

6.4 Other submitters also expressed concerns:

> Food security is becoming an important issue throughout the world as food producers are being encouraged to increase production to meet the needs of a growing population. However, unless appropriate returns are available to the farmers our food production may suffer a huge shortfall as many farmers are forced out of agriculture... as food security has become an important worldwide issue we need to put appropriate measures in place to support the Australian dairy industry. [3]

> …we have to be able to work through it [drought] so we can retain as many farming families and communities. These are the people who supply food to this country and many other people from other nations. We can make a difference if as a nation more help and protection is given to the people who

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1 Sheales, T and Gunning-Trant, C, 'Global food security and Australia', *ABARE Issues Insights 09.8*, Australian Bureau of Agricultural and Resource Economics.

2 Dr Tony McCall, *Committee Hansard*, 5 November 2009, pp 42–43.

3 Amalgamated Milk Vendors Association, *Submission 32*, pp 3, 5.

work hard supplying food. Give us the right to pass on our legitimate expenses. If not, this nation will experience food shortages in the future.[4]

6.5 A number of farmers' representatives also referred to it:

…as less of the world's land is dedicated to agriculture, maintaining a robust dairy sector in Australia is vitally important.[5]

Somehow this country needs to implement a system that recognises the costs of food production and ensures adequate returns are achieved for farmers' produce. Otherwise, we will surely see the demise of an industry that makes a vital contribution to the wealth of this nation, putting at risk Australians' ability to purchase safe, locally produced food.[6]

Global demand for dairy products is still strong and likely to remain so with rising world population, little or no new land available for agriculture and increasing concerns over global food security.[7]

6.6 Mr Danny Harris, a Western Australian farmer, warned:

I am seeing the mood change and I am seeing that there could be some exodus. There is a lot of cash tied up in dairy farms. If they have not got a willing next generation, they are going to cash them in very quickly. Why wouldn't they? Would I ever dare to say it—it can never work, but re-regulating the WA dairy industry is on the cards to safeguard daily fresh milk… I read Dick Smith's comments the other day—and I know they were fairly outlandish—about moving to 40 million people or something or other and we would all starve. I reckon governments need to take notice of that. That is the peak of the worst-case scenario but I reckon we need to start taking notice because it is a mess and unless we can get some power back at the farm gate for all products we are in trouble.[8]

6.7 Among retailers, NARGA also expressed concern about the longer–term viability of the dairy, and other agricultural, industry in Australia:

It is not beyond question that we will not see the dairy industry in a few years time. I think that, in a lot of instances with food production, we have gone too far. I do not think you will be able to buy a can of Australian canned tomatoes in five years if we do not do something soon. I am still disappointed every day when I look out and I see that we live in a country with the cleanest paddocks in the world and we are sourcing more and more of our product from China and overseas. I do not see the sense of it. I do not

4 Mr Malcolm Fechner, *Submission 33*, p. 2.

5 Australian Dairy Farmers Ltd, *Submission 16*, p. 3.

6 Mr Philip Depiazzi, Western Australian Farmers Federation, *Committee Hansard*, 29 January 2010, p. 17.

7 Victorian Farmers Federation, *Submission 18*, p. 4.

8 Mr Danny Harris, *Committee Hansard*, 29 January 2010, p. 37.

> see where we are going. We are fundamentally going down the wrong road.[9]

6.8 In reply, Woolworths felt such concerns were exaggerated:

> I think that, if 76 per cent of current production is devoted to manufacturing, to food service, to the production of product for further manufacturing and for export, there is a long way to go before there is a specific problem in milk, if there is going to be a problem in milk.[10]

6.9 Ms Nola Marino MHR argued that where the *Trade Practices Act 1974* refers to the 'public benefit', this should encompass not just price but also the maintenance of food security:

> The ACCC should be able to utilise a broader definition of public interests rather than simply…retail price…Take into consideration whether the industry structure would result in the loss of food production and whether that loss of local food production is in the public interest. The ACCC should be specifically charged with joint responsibility with the other relevant Government Departments and Agencies for ensuring Australia's future food security if that security is threatened by current industry practices.[11]

6.10 In a similar vein, Dr McCall believes 'competition' is being accorded undue primacy over food security:

> Competition as a policy mantra confines farmers to being winners or losers rather than guardians of food security for Australia in a world where scarcity will be the new currency of value.[12]

Strategic dairy plans and overproduction

6.11 In principle, concerns about food security could argue for the development of strategic plans. In practice, however, what the Committee heard about strategic plans suggests they need to be adequately thought out.

6.12 The Committee considered the development and operation of the Tasmanian dairy industry strategic five–year plan. The plan, developed by both industry (processors and farmers) and government, was launched in August 2006 by the Minister for Primary Industries and Water, the Hon David Llewellyn,[13] and was described as follows by a proponent:

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9 Mr John Cummings, NARGA, *Committee Hansard*, 4 February 2010, p. 19.

10 Mr Ian Dunn, Woolworths, *Committee Hansard*, 4 February 2010, p. 34.

11 Ms Nola Marino MHR, *Submission 22*, p. 11. See also her comments in *Committee Hansard*, 29 January 2010, pp 10-12.

12 Mr McCall, *Submission 8*, p. 7.

13 http://www.dairytas.com.au/files/STRATEGIC_PLAN.pdf, accessed 6 May 2010.

> That plan has a basis of growth. It is there to support farmers to improve their business operations but it also has an underpinning driver of seeking to grow the dairy industry on the basis that we believe a larger dairy industry in Tasmania is a stronger dairy industry.[14]

6.13 In the early stages, production was ahead of the plan's target but has since dropped below and looks likely to be well below in 2010 (Table 6.1).

Table 6.1: Tasmanian strategic plan: Milk production (m litres)

	Target	**Actual**
2005	600	600
2006	610	622
2007	640	644
2008	680	662
2009	720	708
2010	750	

Source: DairyTas, *Submission 31*, p. 6.

6.14 Some Committee members are concerned that the plan encouraged farmers to increase their capacity (which may involve taking on large debts) without sounding cautionary notes about possible changes in market conditions.

6.15 At the hearing, DairyTas's representative said:

> I think it is unfortunate that we have got to this particular season with that milk price and with that capacity situation happening at the same time. It is causing a lot of our problem right now. I hope that in the next 12 months that will turn around significantly with the international milk price pickup through commodity prices… Hopefully, Fonterra will announce that they are going to go ahead with their investment, free up that capacity situation, take on additional milk supply and get our industry back into a reasonable path of certainty for our farmers so investors will come into it again.[15]

6.16 It is now recognised by DairyTas that a new processor needs to locate in Tasmania to meet the goals, and this is far from assured:

> Tasmania can produce milk at a very competitive cost of production and has the potential to grow further as water resources are secured and new farms convert to dairy. But this production potential requires a milk processor that has the capacity and interest to invest in Tasmania. The ownership and decision making of all of the main milk processors is outside

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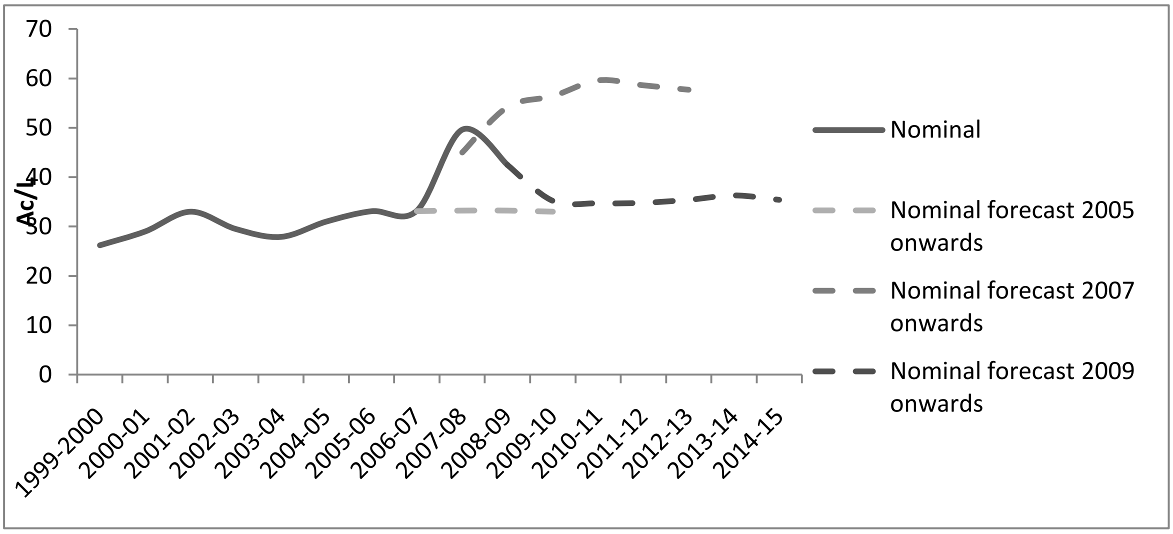
14 Mr Mark Smith, Executive Officer, DairyTas, *Committee Hansard*, 6 November 2009, p. 20.

15 Mr Mark Smith, Executive Officer, DairyTas, *Committee Hansard*, 6 November 2009, p. 21. The Committee notes that Fonterra has now decided to go ahead with that investment.

Tasmania and overseas meaning that local interests will not be part of this decision making.[16]

6.17 Formulating a useful strategic plan requires a degree of ability to forecast future trends in the industry. This is a difficult task as shown by Chart 6.1. When prices had been around 30 cpl for years in 2005–06, ABARE expected they would stay there (as shown by the lowest dashed line). When prices shot up to 50 cpl in 2007-08, ABARE expected them to keep rising (the higher dashed line). Both forecasts proved wide of the mark, and ABARE are now forecasting prices to stabilise around 30 cpl (the final dashed line).[17] (The Committee is using ABARE as an example; it is not saying their forecasts are less accurate than those of other forecasters.)

Chart 6.1: Farmgate prices: actual and forecast



Source: Based on data from ABARE, *AustralianCommodities*, March quarter 2010, March quarter 2008, March quarter 2006.

6.18 Given the difficulty in forecasting demand and prices, there are risks for farmers in encouraging them to increase their productive capacity. This was put to DairyTas at the hearing in Burnie:

> Senator MILNE—What is bothering me here is that the whole strategic plan is based on increasing production without any guarantee that you have a market to sell that additional volume—only that Fonterra said they were interested in supporting expansion…At the time you locked this in there were no guarantees at all, were there, that anybody would pick up the extra milk? So you actually encouraged farmers to get into debt and expand production, and there is no market for it.

16 DairyTas, *Submission 31*, p. 6.

17 Similarly their forecasts of export volumes for whole milk powder have proved overoptimistic.

> Mr Smith—No, I would not agree with that. Certainly the plan encourages and supports growth, but it does not do any more than that except try to put a positive framework around our industry to encourage growth. There are no guarantees…Our understanding, though, was that Tasmanian dairy farmers can produce milk at a very competitive cost of production and that, provided we have a good processing market, that milk will find a market internationally into the future. [18]

6.19 The Tasmanian Institute of Agricultural Research gave reasons for supporting the projections in the plan.

> Senator MILNE—Isn't it taking an incredibly high risk to develop a strategic plan to encourage people to expand supply and borrow vast amounts of money to do so in this case? And all you have got is a verbal undertaking from a company that they will expand—no guarantees, nothing—and it is only one company, not even a few out there as possibilities. If they then renege on the deal, everybody is left—I am astounded that there is not more to it than that.
>
> Mr Fergusson—There is also a track record of them having done that. They have expanded their factories over the last 20 years, and even over the last few years their factory throughputs have increased. So it is their verbal comments plus their track record which lie behind the growth strategy…. One other thing lying behind the growth strategy is what is happening in the international market for dairy products. Up until the global financial crisis the demand for dairy products throughout the world was steadily increasing.[19]

6.20 As well as DairyTas, some processors have encouraged farmers to increase production, which is clearly in the processors' interests but may not be in the interests of the farmers:

> In the mid-1970s farms were single blocks on soldier settlement places, milking 80 cows. They amalgamated because the call was to get bigger or get out. We saw that happen and it has gradually increased. In the early 1980s the average herd size in Tasmania was about 90. It is now about 330. People with two blocks are now milking 280, and we have got some of them milking 400 on those blocks. Everybody has encouraged it. It does not matter whether it is Fonterra or National Foods. They have all had their names on the bottom of that 'dairy farmer of the year' thing, which is an encouragement to increase your production. That is the way you can beat the cost, they said.[20]
>
> There has been a definite desire out there, on the part of Fonterra anyway, to increase milk production …It is all right to say more, more, more, and

18 Mr Mark Smith, Executive Officer, DairyTas, *Committee Hansard*, 6 November 2009, p. 21.

19 Mr Mark Fergusson, Dairy adviser, Tasmanian Institute of Agricultural Research, *Committee Hansard*, 6 November, pp 69–70.

20 Mr John Oldaker, *Committee Hansard*, 6 November 2009, p. 11.

> selling the milk may well be profitable for the company because they can absorb more of their overheads, they got more volume going through their plants. From their point of view they see it as being very profitable. But from the actual farmers' point of view it weakens our price situation because it creates more milk than they say they can market on our behalf at a profitable level for us.[21]

Committee view

6.21 The Committee acknowledges the concern within the dairy industry that the current circumstances are putting at risk the future viability and sustainability of this industry. The Committee agrees that this industry is vital to Australia's food security and appeals to the Government to take action at a national level to address the systemic problems that are putting dairy farmers at risk.

6.22 The Committee takes the view that the issues of food security and future sustainability need to be addressed at a federal level to ensure that state and territory agencies and organisations are engaged and appropriate strategic plans developed.

6.23 From the evidence received throughout its inquiry, some members of the Committee are of the view that the current Tasmanian strategic plan was over-optimistic and, to a degree, reckless. Others view it as reasonable, given that the disruption to demand associated with the global financial crisis could not have been foreseen, and the targets set in place have been met prior to the effect of the crisis.

6.24 The Committee agreed that processors' agents should not encourage farmers to increase production unless they intend to increase purchases from them.

Recommendation 14

6.25 The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

Recommendation 15

6.26 In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

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21 Mr Wayne Tennant, *Committee Hansard*, 6 November 2009, p. 50.

Labelling laws

6.27 Some witnesses argued that milk sold in shops should be more clearly labelled to give more information about its nature and provenance.

6.28 Ms Dee Margetts referred to 'the necessity for better labelling for local production'.[22] Mr McCall referred to:

> …appallingly weak labelling regulations, regarded as being too costly for those with market power—the retailers and the processors—they would not have to clearly identify where the product was sourced from.[23]

6.29 There is also a case for labelling on generic milk to disclose the processor involved so that consumers can make a more informed choice between generic and branded milk.

6.30 Ms Nola Marino MHR is concerned that:

> Milk labelling does not require processors to disclose top up using permeate…[24]

6.31 She argued:

> Food labelling should require a clear definition of fresh whole milk and the disclosure of milk additives…The ACCC should be able to utilise a broader definition of public interests…Public interest should include the right to have foods properly labelled so that consumers are properly informed of the product they are buying. [25]

6.32 The issue of permeate being added to fresh milk as well as the reconstitution of powdered milk being sold as 'fresh' milk are of concern to the Western Australian dairy industry, particularly given in geographic remoteness and the difficulties associated with transporting fresh milk long distances.

> They would have got some milk from other companies, but they were the first to start bringing in powdered milk. I presume it was from Victoria, because that is the only state that has excess milk. They would have reconstituted it. I do not know whether they just added it to fresh milk for flavoured milks or whether it was complete. That is not at all illegal but I think it is highly immoral when you have an industry that is struggling to get a farm-gate price.
>
> People should not fool themselves. Those products—UHTs, cheeses and powders—could easily come in here. But when it comes to the fresh products that appear on the shelf every day, we are protected by distance.

22 Ms Dee Margetts, *Committee Hansard*, 29 January 2010, p. 43.

23 Mr McCall, *Committee Hansard*, 5 November 2009, p. 42.

24 Ms Nola Marino, *Submission 22*, p. 4.

25 Ms Nola Marino MHR, *Submission 22*, pp 10–11.

> However, as I said, it is highly immoral. There should be an investigation into that because, although the use of powder is not illegal, it is highly immoral. There is nothing on those cartons that says 'reconstituted'. It does not say that it is fresh but it does not say that it is reconstituted. It does not have to say anything, but this public has been brought up to believe that these are all fresh products. I can be challenged on that because I have not got absolute and accurate pieces of paper sitting in front of me. I am saying to you that they are my assumptions and that is what I believe is occurring…
>
> Not only have they put powder into flavoured milks and sold it off—immoral, I believe—they are now in a position to control the farmgate buy price. They have created surpluses in milk in this state that are fictitious. They are not surpluses at all…they do not have to buy that milk and they can put powder in it, the ACCC can go and investigate it, because I believe that is controlling the farmgate milk price and I think that is illegal… I might add that that surplus milk has been fictitiously created because of the powder usage. There is about 80 million but there is not 120 million.[26]

6.33 Food labelling was recently examined by the Senate Economics Legislation Committee in its report on the Food Standards Amendment (Truth in Labelling Laws) Bill 2009. The report particularly examines the distinctions between products being described as 'product of Australia' or 'made in Australia'.

6.34 That committee is now inquiring into the Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010, which provides a specific methodology for determining whether claims about the country of origin of goods are false, misleading or deceptive.

Committee view

6.35 The Committee notes that the Australia and New Zealand Food Regulation Ministerial Council has commissioned an independent comprehensive review of food labelling law and policy, and believes this is the appropriate venue in which to pursue this issue.

Recommendation 16

6.36 The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

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26 Mr Danny Harris, a dairy farmer, *Committee Hansard*, 29 January 2010, pp 36–38.

Senator Alan Eggleston
Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Stephen and Fiona Waters
2	Southern Sydney Retailers Association
3	Hon Will Hodgman MP, State Opposition in Tasmania
4	C & J FitzGerald
5	Dr Shane Broad
6	Ms Julie Gration
7	Barossa Mid-North Co-operative Dairymen Limited
8	Dr Tony McCall, University of Tasmania
9	Name Withheld
10	Fonterra Australia
11	National Foods Limited
12	Tasmanian Government
13	National Association of Retail Grocers of Australia
14	Cadbury Pty Ltd
15	Ms Dee Margetts
16	Australian Dairy Farmers Ltd
17	Riverina Regional Dairy Network
18	United Dairyfarmers of Victoria
19	Ashley Park Farm Pty Ltd
20	Tasmanian Farmers and Graziers
21	Australian Milk Producers Association (AMPA)
22	Ms Nola Marino MP
23	Bonlac Supply Company
24	The Hon Tim Mulherin, Queensland Government
25	Mr/Mrs Wayne and Marilyn Tennant
26	Davey and Maynard
27	Tasmanian Suppliers Collective Bargaining Group (TSCBG)
28	Confidential
29	The Western Australian Farmers Federation (Inc)
30	Queensland Dairyfarmers' Organisation
31	DairyTas
32	Amalgamated Milk Vendors Association Inc
33	Mr Malcolm Fechner
34	Associate professor Frank Zumbo

Additional Information Received

- Answers to Questions on Notice taken at a public hearing in Melbourne on 18 January 2010; received from Mr Kevin Tesselaar.
- Answers to Questions on Notice taken at a public hearing in Canberra on 4 February 2010; received from Queensland Dairyfarmers' Organisation.
- Answers to Questions on Notice taken at a public hearing in Melbourne on 18 January 2010; received from the Australian Competition and Consumer Commission.
- Answers to Questions on Notice taken at a public hearing in Melbourne on 18 January 2010; received from Lion Nathan Ltd.
- Answers to Questions on Notice taken at a public hearing in Canberra on 4 February 2010; received from Coles Supermarkets Australia Pty Ltd.
- Answers to Questions on Notice taken at a public hearing in Canberra on 4 February 2010; received from National Association of Retail Grocers of Australia.

TABLED DOCUMENTS

PERTH, 29 January 2010

- Graph tabled by the Western Australian Farmers Federation, *'Supermarket Fresh White Milk pricing - $ / litre'*

APPENDIX 2

Public Hearing and Witnesses

LAUNCESTON, Thursday 5 November 2009

BARKER, Mr John, consultant,
Tasmanian Suppliers Collective Bargaining Group

BEATTIE, Mr Phil, spokesman,
Tasmanian Suppliers Collective Bargaining Group

McCALL, Dr Tony, Lecturer, School of Government,
University of Tasmania

ROGERS, Mr Grant William,
Private capacity

WILSON, Mr Robert Thomas,
Private capacity

BURNIE, Friday 6 November 2009

BOVILL, Mr Richard,
Private capacity

BROAD, Dr Shane,
Private Capacity

FERGUSSON, Mr Mark Francis, Dairy Adviser,
Tasmanian Institute of Agricultural Research

MORRIS, Miss Nicola, Chief Executive Officer,
Van Diemen's Land Company

OLDAKER, Mr John Henry, Chairman,
Cadbury Suppliers

OLDFIELD, Mr Christopher, Chief Executive Officer,
Tasmanian Farmers and Graziers Association

QUILLIAM, Councillor Daryl Herbert, Mayor,
Circular Head Council

SMART, Mr Anthony Charles (Tony), Assistant General Manager,
Circular Head Council

SMITH, Mr Mark, Executive Officer,
DairyTas Board

TENNANT, Mr Wayne,
Private capacity

TENNANT, Mrs Marilyn,
Private capacity

MELBOURNE, MONDAY 18 JANUARY 2010

CLEMENTS, Ms Judith Ann,
Private capacity

COLLARD, Ms Natalie, General Manager, Strategic Initiatives and Industry Development, Australian Dairy Farmers Ltd

DONNISON, Mr Bruce, Managing Director,
Fonterra Ingredients Australia Pty Ltd

EVANS, Mr Paul, Director, Government and Regulation,
Lion Nathan National Foods

GRANT, Mr Allen, Executive Manager Agricultural Productivity Division,
Department of Agriculture, Fisheries and Forestry

GREGSON, Mr Scott, Group General Manager, Enforcement Operations,
Australian Competition and Consumer Commission

GRIFFIN, Mr Chris, President,
United Dairyfarmers of Victoria

GRIMWADE, Mr Timothy, Executive General Manager, Mergers and Acquisitions Group, Australian Competition and Consumer Commission

JEFFREY, Mr Murray, General Manager, Milk Procurement and Inbound Logistics,
Lion Nathan National Foods

JUDD, Mr Wesley, President, Australian Dairy Farmers Ltd, and Chairman,
Australian Dairy Industry Council

LAWSON, Mr Colin Wayne, Industry Relations Manager,
Amalgamated Milk Vendors Association

MALLINSON, Mr David, Chief Financial Officer, Australia and New Zealand,
Fonterra Australia Pty Ltd

McKENZIE, Mr Alex, Representative,
Australian Milk Producers Association

MURNANE, Mr Simon, General Manager, Agricultural Productivity Division,
Department of Agriculture, Fisheries and Forestry

O'MALLEY, Mr Conor, Group Executive, Corporate Services and Logistics,
Lion Nathan National Foods

PEARSON, Mr Mark, Executive General Manager, Regulatory Affairs Division,
Australian Competition and Consumer Commission

SHEALES, Dr Terry, Deputy Executive Director, ABARE,
Department of Agriculture, Fisheries and Forestry

TESSELAAR, Mr Kevin Joseph, Representative,
Australian Milk Producers Association

WING, Mr Anthony, General Manager, Transport and General Prices Oversight,
Australian Competition and Consumer Commission

PERTH, FRIDAY 29 JANUARY 2010

BRENNEN, Mr Larry James, Executive Chairman,
Challenge Dairy Cooperative

DEPIAZZI, Mr Philip Leslie, Senior Vice President,
Western Australian Farmers Federation

EVANS, Mr Peter David, President, Dairy Section,
Western Australian Farmers Federation

HARRIS, Mr Laurence Daniel (Danny),
Private capacity

MARGETTS, Ms Diane Elizabeth (Dee),
Private capacity

MARINO, Ms Nola Bethwyn, Member for Forrest,
Commonwealth Parliament

ROUDA, Dr Robert, Senior Policy Officer, Livestock Industry Development,
Department of Agriculture and Food, Western Australia

WEINERT, Mr Andrew Sutherland, Manager, Regional Food Industry Development,
Department of Agriculture and Food, Western Australia

CANBERRA, THURSDAY 4 FEBRUARY 2010

CUMMINGS, Mr John,
National Association of Retail Grocers of Australia

DUNN, Mr Ian, Senior Business Manager, Trade Relations,
Woolworths

HADLER, Mr Rob, General Manager, Corporate Affairs,
Coles

HENRICK, Mr Ken, Chief Executive Officer,
National Association of Retail Grocers of Australia

MARA, Mr Chris, Adviser, Government Affairs,
Coles

PEAKE, Mr Robert Adrian Bowen, Chief Executive Officer,
Queensland Dairyfarmers Organisation

SAMIA, Ms Nathalie, Group Manager, Government Relations,
Woolworths

TESSMANN, Mr Brian Arnold, President,
Queensland Dairyfarmers Organisation

van RIJSWIJK, Mr Gerard, Senior Policy Adviser,
National Association of Retail Grocers of Australia

Glossary

ABARE	Australian Bureau of Agricultural and Resource Economics
ACCC	Australian Competition and Consumer Commission; Australia's trade practices authority
Bargaining group	Group of farmers who bargain collectively rather than individually with a processor
Branded milk	Milk sold under the processor's brand name
Cascading	Practice of a number of firms successively setting prices based on other firms' prices
Cooperative	Processor jointly owned by a group of farmers
cpl	Cents per litre
DairyTas	Tasmanian service delivery arm of Dairy Australia, investing farmer levies and other funds to support the Tasmanian Dairy Industry
Drinking milk	Milk sold for drinking as opposed to having been used to make butter or cheese
Elastic	More responsive to price changes
Farmgate price	Price paid by processors to farmers
Food security	The physical availability and access to food as well as its affordability
Generic milk	Milk sold in supermarkets under the supermarket's brand name
Home brand	Another term for 'generic milk'
Loss leader	Product sold below cost to attract customers into a store
Market milk	Raw milk used to make drinking milk
Manufacturing milk	Raw milk used to make cheese, butter, yoghurt etc
Monopsony	A market situation where there is a single buyer of a product or service from a large number of sellers
NARGA	National Association of Retail Grocers of Australia; industry body representing small grocery stores

Permeate	Milk that has been filtered through a very fine ‘sieve’ to separate the milk-sugar (lactose) and minerals from the milk protein
Price discrimination	Charging different prices to different buyers
Private label	Another term for 'generic milk'
Processors	Manufacturers who make dairy products from raw milk
Slotting fee	Payment by processor to supermarket to have their product displayed prominently in supermarket stores
Step down	Feature in a contract between processor and farmer when under certain conditions the price paid will be increased
Step up	Feature in a contract between processor and farmer when under certain conditions the price paid will be increased
TIAR	Tasmanian Institute of Agricultural Research
TPA	*Trade Practices Act*, legislation governing competition in Australia
Waterbedding	Situation when a buyer with market power forces down the price they pay and this forces up price charged to other buyers
Wholesale price	Price paid by supermarkets to processors. Differs between generic and labelled milk.