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ACCC Dairy Inquiry
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Date: 19th December 2016

Subject: **Western Australian Collective Bargaining Group Submission to:**
ACCC Inquiry into the Australian Dairy Industry – Issues Paper [8th November 2016]

Introduction

Australian competition law treats farms as any other small business, ignoring the structural weakness in bargaining power that farmers experience in agricultural markets. The market power imbalance is particularly acute in the case of producers of raw, perishable products, where farmers have few realistic alternative sales channels.

The Australian Competition Law allows the Australian Competition and Consumer Commission ('ACCC') to grant protection from liability concerning anti-competitive behaviour to any number of businesses including farms that seek to negotiate agreements as a group. One of the policy ideas of the Agricultural Competitiveness Green Paper ('The Green Paper') is to strengthen competition law to ensure firms act in a competitive manner.

It states that 'the farm sector has a disproportionately low use of collective bargaining provisions compared to other sectors of the economy' (Agricultural Competitive Taskforce – Green Paper 2014, p. 26). Historically low farmgate returns in many agribusiness sectors compel consideration for change and/or modification of competition policy and laws in relation to agriculture and food.

Producers are often 'price-takers', particularly in an environment of ongoing processor consolidation. The Competition Policy Review (the 'Harper Report') also calls for reform of the current collective bargaining and collective boycott regimes. One of the areas of focus identified in the terms of reference is to 'examine the competition provisions and the special protections for small business to ensure these businesses can compete effectively and have incentives to invest and innovate for the future' (Harper et al. 2015, p. 4). Collective bargaining provisions can potentially support a more competitive agricultural market by strengthening the bargaining power of farmers, thus improving returns on their capital assets and increasing the scope for farm innovation and investment.

Findings and Discussions

State and National Representative Bodies are supportive of collective bargaining arrangements as a means to assist in balancing the market power of processors, although there are ways they could be improved.

In many cases individual dairy farmers are placed at a significant disadvantage in negotiations due to their limited bargaining power, negotiation skills and limited ability to utilise the information available to them as they do not have the resources or time to do so, particularly when compared to processors or retailers. The fact that through a successful and transparent collective bargaining process, both parties are better informed and this leads to better outcomes with significantly less scope for misunderstandings.

Western Australia is not self-sufficient in dairy products. Currently, the state imports (interstate transfer) approximately 35,000 tonnes of cheese, 10,000 tonnes of butter, up to 45 million litres of ice cream, a significant volume of UHT milk and about half, if not more of the yoghurt consumed.

Demand for milk is growing by 2% per year. The WA population is growing by 1.2% per year. This means an extra 14.4 million litres of milk is consumed each year, but the industry is declining. Processors are not renewing supplier contracts because of the spring flush oversupply of milk although come summer there will actually be a deficit of milk demanding greater reliance on the imports of dairy products from interstate.

In 2015, there was a shortfall of 400 million litres of milk in WA. 787 million litres of milk was used to produce all the dairy products consumed in WA, but only 387 million litres of milk were produced in the state. Nevertheless processors still chose to terminate existing supply contracts to force a decrease in prices paid to dairy farmers still in contract. This could represent unconscionable conduct.

The WA Collection Bargaining Group (CBG) welcomes the opportunity to submit a response to this inquiry and want to submit the following comments for consideration.

Key issues to be considered in the Inquiry:

1. Competition between milk processors

There are currently approximately 142 dairy farming businesses in Western Australia all competing for supply contracts with the three main processing companies in WA, including Parmalat (Harvey Fresh), Brownes and Lions Food. Given supply curves around production cycles, the processing sector needs to deal with milk supply peaks and troughs particularly around the spring flush supply of milk and the lack of manufacturing capacity to absorb this increased production at this time. This situation allows the three main processing companies to redefine supply contract terms which are not conducive to positive outcomes for dairy farmers particularly in terms of price negotiations and contract terms and conditions.

For some time now milk processors have encouraged dairy farmers to meet growth targets without considering milk supply balancing requirements or investing in long term strategic investment plans. The majority of milk produced on farms in WA is sold as white milk as there is virtually no manufacturing capacity left in the State to add value to the spring produced milk.

Dairy processors in WA over the past two years have encouraged farmers to increase production by paying summer premiums and providing other incentives. Over this period, production has increased from 327 million litres to 387 million litres. The maximum demand for milk on the domestic market in WA is approximately 287 million litres, so affectively this encouragement has resulted in a seasonal over-supply issue of approximately 100 million litres of milk, which processors could not handle or sell.

As a result, two processors gave termination notices to selected farmers saying they would not renew their contracts. This situation has never occurred in WA before and could be considered as unconscionable conduct and a breach of good faith.

The WA Collective Bargaining Group were disappointed the processors didn't come to the table to discuss the problem in a constructive manner in accordance with the principles of collective bargaining arrangements, before issuing termination notices. This action has caused enormous damage to the WA Dairy industry as it is now seen as an unreliable industry to invest in, or for young farmers to be involved with.

Effectively, the spring flush supply of milk creates an oversupply issue of approximately 50-100 million litres per annum, but a milk supply shortage at other times of the year. This window provides an opportunity for milk processors to realign contracts forcing downward pressure on farm gate milk prices within new contract arrangements.

There is anecdotal evidence suggesting milk trading does occur between the three main processing companies during the spring period in an attempt to absorb the quantity of milk produced, given the restricted market capacity. Although, ironically one milk processor chose to terminate its arrangement to supply milk to small boutique businesses in WA producing local cheeses.

Dairy farmers are at a significant disadvantage relative to dairy processors as they often have little choice of processor, which leaves farmers with virtually no bargaining power and making them the ultimate price takers.

The CBG arrangements have been reasonably well accepted by two processors in WA, but one processor has been unwilling to engage with the CBG since its inception in WA.

2. The effect of private label products, including pricing, on the industry

The private labelling of products by supermarkets allows them to negotiate a much lower price from the dairy processors by tendering between the supplier processors. This process is engineered by the supermarkets playing one dairy processors off against the other tendering to acquire the product at a lower price to a long term supply contract containing terms and conditions balanced in favour of the processor. This discount is then averaged across the dairy farmer suppliers.

Milk supply contracts in WA generally contain clauses that permit processors to terminate the contract in a given time. The termination notice varies depending on the processor, for example one processor uses a seven day notice period, another uses a three month notice period and so forth. However, this provision is not applicable to farming businesses, who must meet supply obligations for the duration of the contract regardless of the contracts length or term. The farmer is only permitted to supply one processor. Current contracts offer a base price (cents per litre) for a given period with growth and quality conditions contained within the contract that are not sufficient enough to create a profit margin for reinvestment opportunities on the farm. This acts as a disincentive to encourage new young entrants into the industry.

3. Contracting practices

The current ADF authorisation only permits dairy farmers to collectively negotiate with processors, not retailers or other third parties. So the collective bargaining authorisation makes it even more imperative to have a mandatory supermarket code and strong ombudsman across the entire value chain.

We note that processor contracts being offered to farmers are significantly different from what they were in the past with more complexity and less transparency. As a result, farmers need more expertise and stronger negotiating skills, to allow them to deal with professional negotiators who have a strong bargaining position. They also need legal assistance to help them understand contractual terms.

There are legitimate concerns among producers that processors are 'picking-off' individual farming businesses to help them manage their annual supply with demand trends. Again, ironically the dairy farming businesses that did not have their contracts renewed in 2016/17 in Western Australia, were the very business that had a good understanding of their on-farm cost structures and were able to negotiate a better price per litre over the term of their original contracts. This targeted approach to eliminate selected farmers from the industry by two processors could be considered unconscionable conduct.

There must be transparency in price to ensure confidence with farmers that they are being treated fairly and milk processing is susceptible to 'special deals'.

Larger farmers receive generous production bonuses to the disadvantage of the smaller dairy farmers, up to 3 cents per litre in some cases. It could be argued smaller farmers are subsidising the larger farmers, which means the larger farmers are more profitable than the smaller producers.

In WA, in contrast to the standard contracts terms accepted in the eastern States, the standard contract term, until very recently, has been for a three year duration which is far too long without any adjustments for CPI increases or the ability for dairy farmers to renegotiate a contract.

The contracts as they stand now are written to favour the processor rather than supplier as noted above, although there is the ability in some contracts now to bring in an independent negotiator to manage this situation. Each party pays their own costs.

4. The availability of price and other market information

In 2015, the WA Government investigated a number of options to help resolve the issues of managing the spring flush of milk. This included the establishment of a manufacturing facility to stabilise the WA milk industry on an annual basis so that all those farmers who wanted to stay in the industry could do so. Although discussions about this have been ongoing for some time, no real progress has been made.

If we are to capitalise on opportunities and thereby retain the dairy industry in its current state in WA, the ACCC must permit engagement with members of the supply chain, industry groups and government to discuss, agree and fund an appropriate infrastructure project.

If this is not achieved in the very near future the dairy industry in WA will continue to shrink to such an extent that it will not be realistic to maintain three processors and they too will have to cease operations. This scenario could impact the prices paid by consumers for dairy products sold in WA as the cost of transporting chilled perishable products into WA from the east is considerable.

Currently, commercial forces are driving milk prices down in a way that is unsatisfactory and unprofitable for farmers. It should be noted that two processors are willing to work with dairy farmers to find solutions to the current supply problems.

There is plenty of market information available, but it is what the various parties do with this information which requires a more collaborative involvement. This is why the ACCC needs to adopt a different approach to the interpretation of the legislative requirements in WA by giving greater latitude to open collaboration that will achieve highly satisfactory results for the industry and consumers alike.

Affectively, the CBG is proposing special dispensation is granted in WA, whereby all parties can come together to achieve the best possible outcomes for the industries future and its consumers in WA. This should not be viewed as collusion, but as a positive dialogue to drive and grow the WA dairy industry for the benefit of consumers.

5. Options for supply into global markets

There has been little investment into new infrastructure projects since deregulation in 2000, by the dairy processors to tap into exporting opportunities being presented by global markets particularly for China. This coupled with the complete lack of long term planning is seeing the dairy industry in WA declining at a significant rate. There are real opportunities that could be pursued to capitalise on export market opportunities and these must be accompanied by one to two year contracts with a two priced contract scheme to dairy farmers to develop those markets. The industry must work collaboratively to put infrastructure into place so we can capitalise on export market opportunities around a tiered pricing concept.

We need clear communications back to farmers so they can supply milk to the right markets to develop and invest in their businesses long term.

6. The key factors influencing the profitability of dairy farms.

Dairy farmers need regular meetings, for example twice per year, to review a realistic summer and winter price which the market place has the ability to pay. This has benefits for both parties to quickly address any financial changes that need to be made to their business which have occurred in the market place. Waiting three years to make major changes to any business is not a realistic way to run a business or an industry. Effectively this causes prolonged major dislocation like what is being experienced at present in WA. Three year contract terms have eliminated the effectiveness of constructive business management and have heightened mistrust. Regular meetings and contract readjustments are common place in the east but not the west, and we need to reappoint the concept of two meetings per year to reinvigorate this process.

Conclusions and Recommendations

The WA CBG has not worked to the benefit of Dairy farmers in WA. The main reasons for this are.

- WA is a white milk domestic market.
- WA has very little exposure to the export market with very little infrastructure now left to participate in the export market.
- Supermarkets dominate and control the dairy processors via a tender system which they manipulate to their advantage.
- The above power and dominance of the supermarkets lessens competition in the WA dairy industry.
- The only time there is real competition in the WA dairy industry is when milk production falls below 330 million litres per annum, which causes processors to genuinely compete for milk supply.
- WA dairy industry has reasonable high on farm production costs on a year round basis for milk i.e. similar to Queensland. We are very limited to what markets and product lines we can supply or access on the export market.

Contracts with annual review provisions are required particularly in the west to readjust dairy farm businesses with milk supply and demand trends particularly to maintain reasonable farm gate prices. This in turn will permit investment in capital infrastructure needed to develop new markets and increase profitability in existing markets.

We would welcome the opportunity to discuss these options with you in more detail at the proposed industry forums to be held in the main dairy farming areas of Western Australia in early 2017 and please do not hesitate to contact me before the forums if required.