Comments in relation to the ACCC's Dairy Inquiry – Interim Report
18 Jan 2018
Via email: dairyinquiry@accc.gov.au

To Whom It May Concern,

I would like to begin by congratulating the ACCC on an excellent report that correctly identifies many significant issues facing the Australian dairy industry. The report also delivers a number of powerful potential changes to the way milk is transacted between farmers and processors. If delivered, these changes would help improve competition and risk sharing within the industry: unfortunately, under the current farm gate milk price structure, farmers are forced to hold more than their fair share of risk.

However, as outlined below, I believe there is a crucial gap in the recommendations made, being the treatment of exclusive supply clauses within farmer-processor supply contracts. Given the known lack of farmer bargaining power, it is my fear that exclusive supply agreements could become an industry norm, thereby removing farmers' ability to effectively market milk and manage risk, and undoing a significant amount of the benefit that other recommendations in the report aim to deliver.

Background

1. The ACCC has correctly identified many key issues which stem from a difference in bargaining power between farmers and processors:

Processors, in turn, have significant bargaining power over farmers. This is reflected in farmgate prices, milk supply contract terms that favour processors and the way in which processors can pass on risk to farmers (page 14)

Due to the significant bargaining power processors have over farmers, there has been:

- minimal competition and innovation in relation to offering farmers milk pricing products that address specific needs, such as price risk management tools
- minimal ability for a farmer to negotiate terms of supply with a processor, including risk management tools and/or the ability to supply milk to more than one buyer
- in sum, minimal ability for a farmer to manage and diversify the myriad milk price related risks which affect their business: price exposures, credit exposures, cash flow exposures and the ability to manage a margin vs. input costs

2. In addition, the ACCC has correctly identified that milk contract clauses such as step ups and loyalty incentives act as barriers to switching processor, thereby minimising competition:

Certain contract terms and the complexity of contracts have limited the ability of farmers to switch between processors, and resulted in a lack of milk price transparency, and the uneven allocation of risk between processors and farmers (page 21)

Many milk supply agreements contain clauses which act as switching barriers. These include loyalty bonuses or other payments that are paid in respect of one dairy season but require ongoing supply into a new dairy season. (page 24)

3. As such, the ACCC has made an Interim Recommendation to remove terms which unreasonably restrict competition.

Milk supply contracts should not include terms which unreasonably restrict farmers from switching between processors. Many milk supply agreements contain clauses which act as switching barriers. These include loyalty bonuses or other payments that are paid in respect of one dairy season but require ongoing supply *into a new dairy season. This recommendation is currently reflected in the requirements of the Voluntary Code. (Page 24)*

With regard to section 6 of the Voluntary Code, removal of the incumbent processor's first right of refusal regarding a farmer's supply of milk to an alternative processor. (page 25)

4. The ACCC is of the preliminary view that exclusive supply clauses do not minimise competition, but does welcome feedback on this point.

The ACCC's preliminary view is that past or existing clauses are unlikely to have substantially lessened competition among processors.152 The ACCC welcomes industry feedback on the impact of exclusive supply clauses on small processors (page 112).

Opinion

- The ACCC has correctly identified that the current milk supply contracts have the impact of limiting farm gate competition, particularly if we define competition as the ability to sell milk to any buyer at any time throughout the year. Currently, if a farmer tried to sell some portion of their milk to a different processor during the middle of a milk year, there are significant barriers to doing so

    - Explicit exclusive supply clauses: many supply contracts include the requirement to deliver all milk to one processor, and farmers lack the bargaining power to negotiate this option
    - Implicit exclusive supply clauses: step ups and loyalty bonuses mean farmers would have to forgo significant money if they switch some or all of their milk away from the incumbent processor; in addition, processors are typically allowed to cease pick up from a supplier on very short notice, a threat that they are willing to exercise if a farmer sells milk elsewhere

- The ACCC has correctly identified that the implicit exclusive supply clauses need to be changed i.e. that supply agreements need to have defined terms, removing the risk of a processor refusing to pick up on short notice; and enshrining the farmer's right to step ups and loyalty bonuses even if they switch processor.

- However, the potential for explicit exclusive supply clauses to remain in supply agreements could mean that farmers are not made any better off by the ACCC's recommendations.

    - Most farmers lack the bargaining power to negotiate non-exclusive supply agreements with processors
    - As such, there is the potential for exclusive milk supply agreements to become standard across the industry i.e. to circumvent ACCC recommendations in relation to steps ups and loyalty bonuses, processors could simply require exclusive milk supply agreements of all farmers and refuse to deal on a non-exclusive basis.
    - This would basically leave the industry as status quo: farmers would still bear all the risk of processor decisions, would have no bargaining power to gain access to price risk management tools, and would not be able to generate competition for their milk for the majority of the year.

- As per page 112 of the Interim Report, many processors submitted that exclusivity clauses provide benefit to farmers, including certainty that milk will collected, quality assurance and efficient collection and sampling.

- We would submit that the above benefits can be delivered through other mechanisms, and that they don't need to be tied to the sale of the milk. For example, in theory a farmer could have a logistics provider that ensures pick up / sampling / testing, but with that milk being sold to a number of buyers.

Recommendation

It is our view that the ACCC should recommend that processors are required to provide a non-exclusive milk supply contract option to all suppliers, with such contracts subject to the same rights as exclusive supply agreements i.e. that any bonuses or step ups under the agreement are payable regardless of whether supply is continuous or exclusive. Further, trading terms and pricing under these non-exclusive contracts should be regularly reviewed by the ACCC to ensure they provide a true option for farmers, rather than one which is made deliberately unattractive by processors.

Whilst this at first glance may appear unfair to processors, it is intended to ensure that processors begin delivering more innovative supply agreements to farmers who would prefer a non-exclusive agreement. Such agreements could include clauses which allow farmers to sell some portion of their milk to a 3rd party, including for example via week on / week off pickups, additional milk vats, or a farmer having the ability to buy back milk from a processor for on-sale.

It should also be noted that there is clearly some value in a processor having exclusive marketing control over a farmer's milk, value which should then be reflected in the milk price paid for any milk that is exclusively supplied.

I can be contacted via email on [redacted] for any questions or comments.

Yours faithfully,

Scott Briggs.