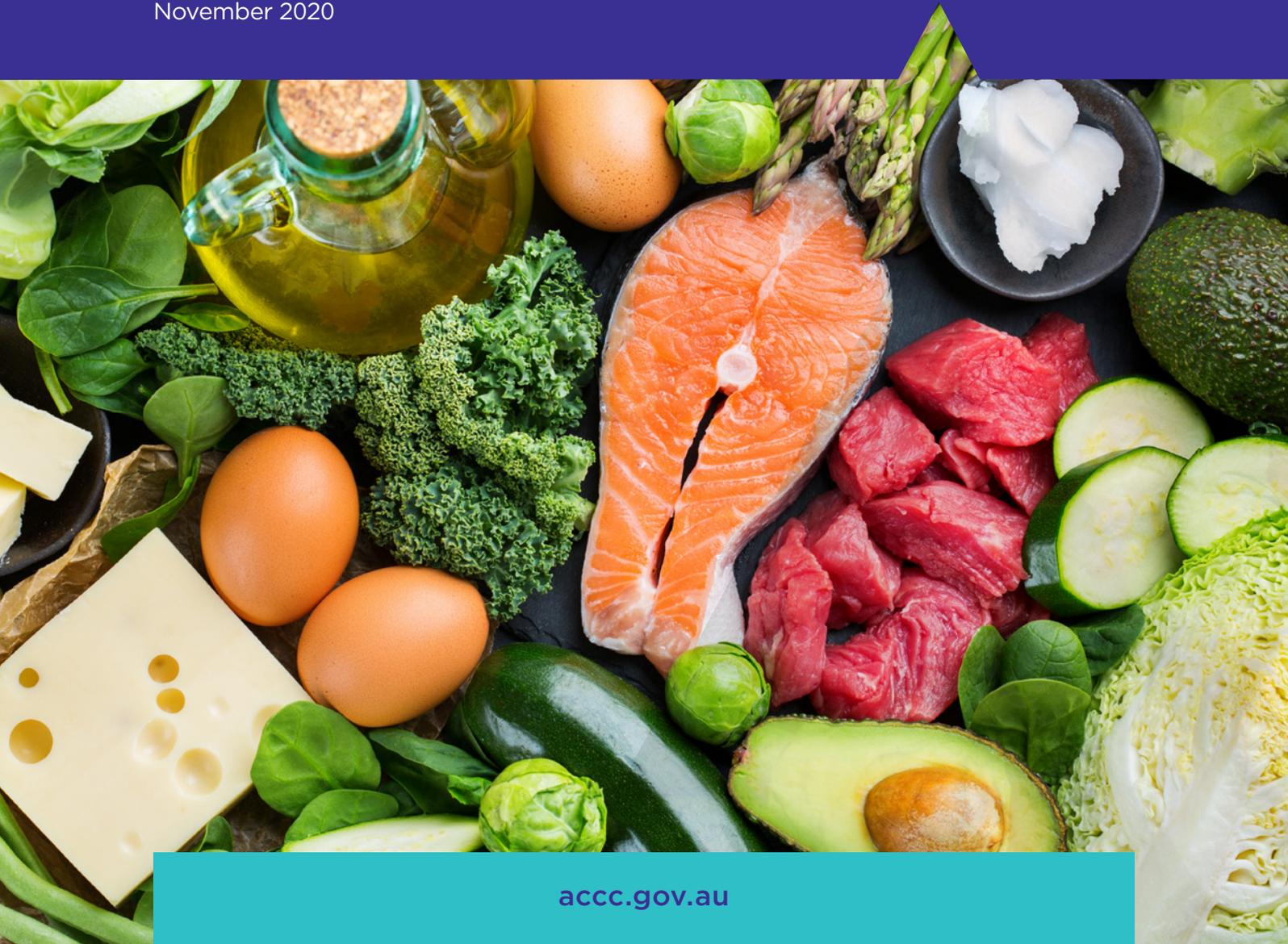




# Perishable agricultural goods inquiry

November 2020



Australian Competition and Consumer Commission  
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601  
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ACCC 11/20\_20-44

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# Glossary

ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences.
ABS	Australian Bureau of Statistics.
ACL	Australian Consumer Law, which is Schedule 2 of the <i>Competition and Consumer Act 2010</i> (Cth).
B2B	Business-to-business.
Branded products	Products that are manufactured by a processor for sale under its own proprietary brand name.
Capital expenditure	<p>Money spent by a business to buy, maintain, or improve fixed assets (e.g., processing plant equipment, or farm equipment).</p> <p>As opposed to operating expenditure, which are ongoing costs associated with running the business or operating the fixed assets (e.g., labour costs).</p>
Carcase	The body of an animal that has been slaughtered for meat (e.g., in an abattoir). As opposed to carcass, which is the body of an animal that has died of natural causes.
Cash costs	Payments made by a business for materials and services, and for permanent and casual hired labour, and excluding imputed labour (i.e., the labour performed by the farm owner and family, for which they are not paid wages).
Cattle and Beef Market Study	The ACCC's self-initiated market study into the cattle and beef industries, conducted between 2016 and 2017.
CCA	<i>Competition and Consumer Act 2010</i> (Cth).
Dairy Code	Competition and Consumer (Industry Codes—Dairy) Regulations 2019 (Cth).
Dairy Inquiry	The price inquiry into the dairy industry conducted by the ACCC pursuant to a direction from the Treasurer between 2016 and 2018.
DFMP	<p>Dairy Farm Monitor Project.</p> <p>A joint initiative between state agricultural agencies and Dairy Australia, the project gathers data from 250 dairy farms across Australia that represent a distribution of farm size, herd size, and geographic location within each region.</p>
Downstream	<p>A step in the supply chain that occurs after the business being referred to (e.g., a dairy processor may be downstream from a dairy farmer).</p> <p>See also, Upstream.</p>
Drinking milk	Milk which has been pasteurised to make it safe for human consumption. Requires refrigeration. May be full fat or modified milk.
Farmgate market	The level of a PAG supply chain where producers sell their produce, generally to a processor or wholesaler (although major supermarkets also directly acquire various products including livestock, raw milk and horticultural produce from producers).
Farmgate price	The price producers receive for their produce (e.g., raw milk).
Food and Grocery Code	Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015 (Cth).
HARPS	<p>Harmonised Australian Retailer Produce Scheme.</p> <p>A food safety certification scheme led by Australian retailers (including ALDI, Coles, and Woolworths), to harmonise their requirements. To be HARPS-compliant, a supplier will generally need HARPS certification and certification from a Global Food Safety Initiative (GFSI) accredited scheme.</p>

Horticulture Code	Competition and Consumer (Industry Codes—Horticulture) Regulations 2017 (Cth)
Conditional loyalty bonus	In the dairy industry, a payment which is either conditional on a producer completing a full season of supply with their processor, or upon a producer continuing to supply their processor in the next season.
Milk solids	The constituents of milk, other than water and milkfat. Also known as milk solids-not-fat (SNF). The main milk solids are casein, lactose, and minerals, including calcium and phosphorus.
Objective carcase measurement (OCM)	Used to describe processes and technologies that aim to measure carcase traits quantitatively in a repeatable, standardised manner. Generally used as a contrast to human estimations or measurements or carcase traits.
Pass-through	A contract mechanism where particular aspects of a supplier's cost base can be included in the price they receive. Also known as a 'rise and fall' mechanism.  This concept is most commonly discussed in private label wholesale dairy contracts, where the farmgate milk price that a processor pays to a producer may be 'passed through' to the retailer, i.e., one of the components of the price that the retailer pays to the processor may be the farmgate milk price.
PAG	Perishable agricultural goods, as set out in the terms of reference for this inquiry.
Private label	Also known as home brand, own brand, store brand, or generic brand.  Products that are manufactured or provided by a company (which may also produce its own proprietary branded products in competition with the private label) for sale under a retailer's brand.
Processor	The party that processes perishable agricultural goods into a product with a longer shelf life.
Producer	A farmer or grower of perishable agricultural goods (e.g., dairy farmers, crop farmers, beef cattle farmers, chicken meat growers, egg farmers, fishing businesses).
QDAS	Queensland Dairy Accounting Scheme.  A service of the Queensland Department of Agriculture, Fisheries, and Forestry, the scheme provides a summary of physical and financial data from various dairy production systems in Queensland.
Raw milk	Unpasteurised cow's milk.
Retail market	The level of a PAG supply chain where retailers, such as supermarkets, supply products to consumers.
Return on assets (ROA), or return on total assets (ROTA)	A measure of profitability and efficiency, calculated by dividing the net income of a farm by the value of its assets (e.g., land value, machinery, livestock).
Sales channel	A way of selling produce or processed products. A participant in a PAG industry may have multiple sales channels open to them, including supermarkets, wholesalers, restaurants and food service outlets, or exporters.
Service kill	A form of contract processing, used in this report in reference to beef cattle processing where a non-processor, generally a supermarket, directly acquires livestock from a producer, and then contracts with the processor for the slaughter process.
Step-down	A downward revision to the price being paid by a processor to a dairy farmer for raw milk during a dairy season.
Step-up	An upward revision to the price being paid by a processor to a dairy farmer for raw milk during a dairy season.
Sugar Code	Competition and Consumer (Industry Code—Sugar) Regulations 2017 (Cth).

Toll processing	<p>A form of contract processing, used in this report in reference to dairy processing where a non-processor, generally a supermarket, directly acquires raw milk from a producer, and then contracts with a processor to process the raw milk.</p> <p>As opposed to a processor acquiring the raw milk, processing it, and on-selling the processed products.</p>
Total Factor Productivity (TFP)	A measure of productivity and efficiency, usually defined as the part of output growth that cannot be explained by input growth (e.g., increased labour or capital).
UCTs	Unfair contract terms.
Upstream	<p>A step in the supply chain that occurs before the business being referred to (e.g., a dairy processor may be upstream from a supermarket).</p> <p>See also, Downstream.</p>
Wild catch	Seafood that has been caught from a natural habitat, such as a lake, ocean, or river. As opposed to farmed or farm-raised seafood.
Wine Grapes Market Study	The ACCC's self-initiated market study into the wine grapes industry, conducted between 2018 and 2019.
Wholesale market	The level of a PAG supply chain where processors or wholesalers supply their products to other wholesalers, such as exporters, or to businesses in the retail market, such as supermarkets, restaurants, and other food service outlets.

# Overview

## Conduct of the inquiry

This report provides the findings and recommendations from the ACCC's inquiry into markets for the supply of perishable agricultural goods.

The ACCC conducted this inquiry in response to a direction from the Treasurer, the Hon. Josh Frydenberg MP. Through this three month inquiry, the ACCC has considered the extent to which bargaining power imbalances exist in perishable agricultural goods (PAG) markets and whether they impact the efficient operation of these markets. Based on this analysis, the ACCC has recommended areas for reform to improve the operation of markets and identified areas where further ACCC action will be taken.

The inquiry was held in relation to perishable agricultural goods, comprising meat products (such as pork, lamb, beef and chicken), eggs, seafood, dairy products and horticulture goods. The ACCC was directed to examine:

- the relationships between suppliers at different levels of the supply chains in PAG industries and how this affects their bargaining power
- how these features of PAG markets affect the efficiency of markets and outcomes for participants
- the economic effects of bargaining power imbalances
- the scope and ability of the Competition and Consumer Act 2010 (CCA) to deal with these issues, including through the competition, fair trading and consumer protection laws
- recommendations for options for amending the regulatory framework to address any problems identified.

The analysis in this report is based on information gathered specifically for this inquiry and, given the short inquiry timeframe, also draws upon information obtained through past ACCC inquiries and market studies, and investigations.

The inquiry terms of reference were published on 1 September 2020 and the ACCC invited submissions on 3 September 2020. The ACCC received a strong response, receiving more than 80 submissions. More than half of these were subject to confidentiality claims. The public submissions are available on the ACCC website. Submissions were received from participants and representatives across many PAG industries and from different levels of the supply chain. While there was strong overall representation of PAG industries, the majority of submissions focused on the horticulture, chicken meat and dairy industries.

The ACCC undertook targeted stakeholder consultation with a range of businesses and representative groups to inform the inquiry. This included consultation with the ACCC's Agriculture Consultative Committee and Dairy Consultative Committee. The ACCC also spoke directly with a significant number of farmers and suppliers.

The ACCC used its compulsory information gathering powers and issued voluntary requests in order to obtain information, examine contracts, and consider internal business correspondence to further understand issues in PAG industries.

## Features of perishable goods markets

This inquiry has examined the existence and nature of bargaining power imbalances, and whether they cause market failure or result in harm. Market failure occurs when resources are not efficiently allocated.

All PAG markets considered in this inquiry have characteristics likely to lead to bargaining power imbalances.

First, the degree of perishability of goods in these industries influences the way that market structures evolve. The more perishable a product, the weaker the producer's position from which to negotiate favourable terms of supply with the buyers of their goods, and the more vulnerable they are to take-it-or-leave-it terms from buyers or exploitative conduct.

Second, PAG markets are often characterised by many producers, but few processors and major retailers. Economies of scale at the processing and retail levels result in market structures where there is a relatively small number of buyers acquiring the majority of produce.

Together, these features mean PAG supply chains can be particularly susceptible to market failure in the form of a lack of competition, information asymmetry, and the inappropriate (inefficient) allocation of risk. The level of susceptibility will vary across different PAG markets depending on a range of factors, including market structures, the availability of export markets, and the degree of perishability of produce. There is limited global trade of unprocessed and highly perishable PAG products, but the capacity to export processed goods provides an important outside option for participants in some PAG industries.

## Industry practices

Through this inquiry and previous work in PAG markets, the ACCC has identified a range of harmful practices associated with bargaining power imbalances and market failures. These arise in the processor-producer and supermarket-supplier relationships, as set out below.

## Reported examples of harmful PAG industry practices

Conduct	Examples of reported conduct
Contract terms that inefficiently allocate risk	<ul style="list-style-type: none"> <li>▪ Chicken meat growing contracts that allow processors to unilaterally alter producers' batch densities and rates, which greatly impacts producer income.<sup>1</sup></li> <li>▪ Contracts that result in wine grape producers not receiving full payment for up to nine months after grapes have been supplied.<sup>2</sup></li> </ul>
Harmful use of bargaining power	<ul style="list-style-type: none"> <li>▪ Changing supply volumes for perishable products at very short notice after volumes have been agreed.</li> <li>▪ In certain regions in the chicken meat industry, processors reportedly have leveraged their monopsony position to decrease growers' prices mid-contract, causing growers to forgo benefits that the contract otherwise entitled them to.<sup>3</sup></li> </ul>
Lack of transparency in relation to price and non-price factors	<ul style="list-style-type: none"> <li>▪ Some horticulture producers have no visibility over what supermarkets pay for their produce.<sup>4</sup> This occurs in situations where agents or wholesalers accept produce on consignment from producers, which they sell on the producers' behalf. As the supermarkets count for a large proportion of total purchases in the market,<sup>5</sup> this may distort price signals.<sup>6</sup></li> <li>▪ Some beef and sheep producers have little transparency over the carcass grading process, which can generate a lack of trust in the prices received.<sup>7</sup></li> </ul>
Producers making growing and investment decisions with no certainty	<ul style="list-style-type: none"> <li>▪ Some horticulture producers having no forward price or contract certainty, as contracts or supply agreements are usually negotiated after planting must commence, meaning they regularly grow crops without a guaranteed buyer or price.</li> </ul>
Commercial retribution	<ul style="list-style-type: none"> <li>▪ Some suppliers who seek a cost increase from a supermarket or refuse to decrease private label costs sometimes having other products de-listed.</li> <li>▪ A producer who raises concerns with a processor sometimes having their contract terminated or volumes reduced.<sup>8</sup></li> </ul>
Supermarkets requiring cost offsets	<ul style="list-style-type: none"> <li>▪ Supermarkets sometimes require suppliers who negotiate a cost increase to invest in an unrelated cost offset.<sup>9</sup></li> </ul>
Supermarkets requiring suppliers to disclose confidential information	<ul style="list-style-type: none"> <li>▪ Supermarkets at times requiring suppliers to disclose confidential financial information or intellectual property during cost increase negotiations.<sup>10</sup></li> </ul>

1 Australian Chicken Growers Council Limited, *Submission to the Perishable Agricultural Goods Inquiry*, 17 September 2020, p. 3; Victorian Farmers Federation, *ACCC Perishable Agricultural Goods Inquiry Submission*, p. 8.

2 ACCC, *Wine grape market study*, September 2019, p. 2.

3 Australian Chicken Growers Council Limited, p. 3.

4 National Farmers' Federation, *Submission to the ACCC Price Inquiry—Perishable Agricultural Goods*, 18 September 2020, p. 14.

5 NSW Farmers, *ACCC Perishable Agriculture Goods Inquiry Submission*, September 2020, p. 14.

6 National Farmers' Federation, p. 14.

7 ACCC, *Cattle and beef market study*, March 2017, p. 70; Sheep Producers Australia, *Perishable Goods Inquiry*, 18 September 2020, p. 2–3; NSW Farmers, *ACCC Perishable Agricultural Goods Inquiry Submission*, September 2020, p. 17.

8 Fruit Growers Victoria, *ACCC Perishable Agricultural Goods Inquiry Submission*, 17 September 2020, p. 1.

9 Professor Graeme Samuel AC, *Independent Review of the Food and Grocery Code of Conduct*, Final report, September 2018, p. 56.

10 *ibid.*

## Processor—producer relationships

The inquiry found that imbalances in bargaining power in the processor-to-producer relationship manifest in a range of ways, including:

- one-sided contracting practices reflecting imbalances in bargaining power, including potential unfair contract terms regularly being present in producer supply agreements
- practices that go beyond hard bargaining, including to inefficiently allocate risk to producers or suppliers, which often puts producers at risk of significant financial detriment
- a lack of transparency in relation to prices or quality assessment processes across a number of PAG markets
- resulting from all of the above, reduced confidence and investment by producers, potentially limiting productivity growth.

Through the ACCC's studies into the dairy and wine grape industries, and through our enforcement function, the ACCC has frequently identified contract terms that shift significant uncertainty and risk onto producers, and may be unfair contract terms within the meaning of the ACL. For example, the ACCC has identified many terms that allow a processor to unilaterally vary key elements of an agreement, such as the price or quality specifications of produce, which can greatly affect a producer's income.

In some instances, significant risk is transferred to producers that they are not best placed to manage. For example, in the wine grapes industry, full payment for the supply of grapes can be up to nine months after grape delivery. The ACCC found that producers faced significant financial risk as they often had to finance their businesses with overdrafts which incur interest between 6 to 12%. The ACCC considers that winemakers are in a better financial position to bear the cost of holding inventory than producers.

A lack of transparency is a feature of many PAG markets, including a lack of certainty in relation to prices. In the horticulture industry, growers often have no forward indication of prices, meaning they regularly grow crops without a guaranteed buyer or any sense of likely prices. There are also shortcomings in the transparency of grading or quality assessment processes in many industries, such as with carcase measurement in the cattle and sheep meat industries. These features undermine producers' ability to make sound decisions about what, when and how much they will produce, and where they can obtain the best price for their produce.

## Chicken meat industry

Throughout this inquiry, strong concerns have been raised by chicken meat growers. The industry is in transition, with large corporate farms becoming more prominent, often at the expense of smaller operations. Further, market exits by processors have left a small number of buyers in some regions. In some cases, growers who have made substantial capital investment have been left with stranded assets and their farms have been substantially devalued.

The processing level of the industry is also under pressure to reduce costs because of constraints imposed by retail pricing. Further, processors often have shorter term contracts with retailers, creating challenges in offering long-term certainty to growers.

The ACCC has received a number of reports of harmful trading practices by processors towards growers. For example, one submission stated that after a major processor exited a region, the remaining processor used the opportunity to require producers to accept a decrease in payment mid-contract despite prices having been previously agreed, or risk having their contract terminated when it is next reviewed.

The ACCC also reviewed standard form contracts between processors and growers in the chicken meat industry. Our preliminary view is that a number of terms may raise concerns under the unfair contract term laws. These contracts contain types of terms the ACCC has previously considered to be unfair in other PAG industries, such as those allowing unilateral variation to contract factors that can impact

price, and unbalanced or short termination timeframes. Whether such terms are unfair within the meaning of the law will depend on the circumstances.

The ACCC considers that further examination of issues in this industry is required, including to determine what issues can be addressed under current law.

## Dairy industry issues

The terms of reference directed the ACCC to focus on additional issues in the dairy sector, including issues affecting supply of milk, and the effectiveness of the Dairy Code.

Challenging environmental conditions in recent years have increased dairy producers' costs of production. In the 2018-19 season, average farmgate prices did not increase in line with cost of production, and therefore average profits declined. However, costs of production differ significantly between farms and over time, with some years and farms being more profitable than others.

The inquiry found that producers' costs of production are one variable among many that processors take into account when setting farmgate prices. However, farm production costs are not always a key determinant of farmgate prices. Processors set a farmgate price only as high as they need to in order to acquire the volume of milk that meets their demand in that region. The minimum price that processors need to pay will generally be higher where there is stronger competition for acquiring milk.

The ACCC has examined price pass-through mechanisms in supermarket private label dairy product contracts. The ACCC has found that most private label milk contracts and some private label contracts for other dairy products allow processors to pass-through changes in farmgate milk or commodity prices to retailers, though changes to farmgate prices and wholesale prices are not always perfectly aligned in real time. The ACCC saw evidence of processors using these clauses. Pass-through provisions typically only exist in private label contracts, and not in branded product contracts. Therefore, if processors increase farmgate prices, this would reduce their profits on branded dairy products. Farm production costs are often a factor when processors rely on these mechanisms.

The introduction of the Dairy Code has brought positive change to the industry. There is increased transparency of prices and contracting arrangements, and the Code has reduced barriers to farmers switching between processors, which encourages competition.

The substantive aspects of the Dairy Code only came into force in June 2020 and its effectiveness will only become fully known after the industry has adjusted to the new regulatory arrangements. The Dairy Code will be reviewed by the Government in 2021. The ACCC's observations about the early period of its operation indicates that this review should give particular attention to certain provisions, such as minimum price requirements, the requirements surrounding non-exclusive contracts, and cooling-off periods.

## Supermarket-processor relationships

There are also imbalances of bargaining power at the wholesale level of PAG supply chains. The major supermarkets, Woolworths, Coles and ALDI, account for over 75% of industry revenue.<sup>11</sup> Woolworths and Coles make up 65% of the market.<sup>12</sup>

Despite the high levels of concentration in the industry, supermarkets compete strongly on prices of certain products, particularly perishable goods.<sup>13</sup> In addition, some of the major supermarkets compete directly with processors and wholesalers at the farmgate and retail levels, by entering markets to acquire produce directly from producers, or selling products at retail under their own private labels, or both. These features combine to create a highly contested and tough bargaining and negotiating environment for processors and wholesalers.

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11 Department of the Treasury, *Independent Review of the Food and Grocery Code of Conduct—Final Report*, 2018, p. 10; IBISWorld, *Industry Report G4111: Supermarkets and Grocery Stores in Australia*, IBISWorld, 2020, pp. 35-39.

12 *ibid.*

13 Professor Graeme Samuel AC, p. 10.

This inquiry and previous studies have found that the profit margins of processors have decreased substantially over time in PAG and other industries. There are related concerns that, while consumers may benefit from these practices and situations, value is being removed from PAG industries to the ultimate detriment of producers. While there is some evidence that retail pricing places substantial pressure on suppliers, based on this inquiry, there is no substantial evidence to indicate the efficient supply of goods is threatened over the longer term.

While hard bargaining between retailers and suppliers is an inherent part of commercial dealings, the ACCC has concerns where behaviours move beyond this to create potential harmful impacts on markets. For example, the ACCC has received claims that retailers sometimes require some suppliers to offset any wholesale price increases with trade spends. Over the longer term, this has the potential to limit supplier investment and diminish overall supply chain efficiency.

## The current regulatory framework

The CCA seeks to protect competition and fair trading in a variety of ways, including by preventing anti-competitive acquisitions that change market structures or instances of anti-competitive behaviour, and by prohibiting key types of economically harmful and unfair behaviour.

### Box 1: Role of the ACCC

The ACCC is an independent Commonwealth statutory authority whose role is to administer the *Competition and Consumer Act 2010* (CCA), including the schedule of that law which is the Australian Consumer Law (ACL), and a range of additional legislation.

The competition laws in the CCA prohibit cartel conduct, anti-competitive agreements, misuse of market power, exclusive dealing, and acquisitions that would have the effect or be likely to have the effect of substantially lessening competition in any market.

The ACL contains laws to protect consumers, and also includes laws relating to fair trading between businesses, which prohibit a range of conduct, such as misleading or deceptive conduct and unconscionable conduct, and unfair contract terms.

The competition laws in the CCA do not, and are not intended to, prevent all of the harmful effects of bargaining power imbalances. These laws are aimed at preserving competition, and are not intended to restore or improve competition in markets where, for various reasons, competition has been substantially reduced. This means, for example, that these laws will not assist where an imbalance in bargaining power disadvantages or harms a particular supplier or group of suppliers, but does not substantially impact competition more broadly in the market.

As such, the ACL and industry codes are also of critical importance in addressing these harms. The ACL contains a range of protections for small business, including the small business unfair contract terms (B2B UCT) framework, and prohibitions on unconscionable conduct.

The B2B UCT framework seeks to protect small businesses from unfair contract terms in standard form contracts. These laws are particularly important for PAG industries, as standard form contracts are common. However, these laws have some key weaknesses, including that unfair terms are not illegal under the CCA and courts cannot impose financial penalties on companies for including UCTs in standard form contracts. This lessens the incentives for businesses to avoid using such terms. Further, the contract valuation limit and the threshold definition of a small business exclude some contracts and small businesses in PAG industries, even when the businesses face the same problems that the framework was designed to protect against. Reforms to strengthen the B2B UCT framework are underway, and are discussed below. However, even with these amendments, the B2B UCT framework will not cover non-contractual conduct stemming from bargaining power imbalances, which can also have harmful effects.

The ACL's prohibitions on unconscionable conduct also protect against some harmful practices in PAG industries, where those practices reach the threshold of being unconscionable in all the circumstances. Courts will consider the relative bargaining power of parties among a range of other factors and the

circumstances of the matter, when deciding whether conduct is unconscionable. However, the ACCC considers that harmful conduct resulting from bargaining power imbalances that does not meet the threshold of unconscionable conduct may still result in harm and reduce market efficiency.

The presence of significant market failures and imbalances in bargaining power has led to the development of industry codes in PAG industries, including the Dairy Code, Horticulture Code and the Food and Grocery Code. Industry codes can be an effective means of addressing harmful effects of bargaining power imbalances and improving transparency in specific markets. For example, the Dairy Code provides for the increased availability of price information to dairy farmers on 1 June each year. However, industry codes are not effective if they are not enforceable and breaches do not attract significant penalties, as is the case with the Food and Grocery Code.

While these ACL and industry code provisions prohibit some harmful practices, they do not prevent all the harmful effects that bargaining power imbalances can have, and are currently having, on the Australian economy. These regulatory gaps mean that some of the harmful practices identified in this inquiry are not being dealt with adequately.

## Options for reform

Competition and fair trading legislation should seek to protect against significant detriment, whether that be the result of the abuse of market power, or an imbalance in bargaining power.

However, it is not the role of these laws to equalise bargaining power amongst all market participants. Imbalances in bargaining power and market failures arise in most markets across the economy and their presence alone does not warrant regulatory intervention. Unnecessary intervention can add costs for market participants and can dampen innovation.

Further, it is also not the role of these laws to distribute value throughout a supply chain.

Through this inquiry and past work, the ACCC has identified a number of problems in agricultural markets. When assessing these issues, the ACCC considers a spectrum of options. Importantly, with a varied range of issues such as those that exist in PAG industries, a suite of regulatory tools and approaches are needed to enable the ACCC to address significantly harmful practices.

The ACCC's framework for considering the best means of addressing these challenges is:

1. Can the harms be addressed by existing laws through ACCC action?
2. If ACCC action is not possible, can existing competition and fair trading laws be improved to address these harms?
3. If existing laws cannot be improved, are more substantial reforms required and if so, should they be focused on a particular industry or have economy wide effect?
4. Are there problems that fall outside the scope of competition and fair trading laws?

## Further ACCC investigation

Firstly, as discussed above, the ACCC has reviewed standard form contracts between chicken meat processors and chicken growers, and has a preliminary view that a number of terms may raise concerns under the unfair contract term laws. The ACCC will continue to investigate potential unfair contract terms in the chicken meat industry.

Secondly, the ACCC has also received some reports that horticulture wholesalers are trading without Horticulture Producer Agreements. The ACCC will conduct further Horticulture Code audits in 2020 to examine these concerns.

## Reforms in progress

There are legislative reforms already on the horizon, including key changes to the B2B UCT framework and the ACCC's class exemption for small business collective bargaining.

Firstly, the consumer affairs ministers and agencies of the Australian federal, state, and territory governments have recently decided that they will seek to strengthen the B2B UCT framework, including through prohibiting UCTs and introducing penalties for companies that include them. The ACCC strongly supports these improvements to the B2B UCT framework.

Secondly, the ACCC has recently made a 'class exemption' that will provide immediate legal protection for small businesses who meet the criteria to engage in collective bargaining, with no fee. This class exemption will come into effect in early 2021. The ACCC considers that this class exemption provides efficiencies for producers and suppliers that are seeking to collectively bargain. The ACCC will engage directly with agricultural industry associations in 2021 to explain how the class exemption may be beneficial and how businesses can access the regime.

## Some harmful practices remain unregulated

Despite the above proposed improvements to the existing laws, a number of harmful behaviours identified in this inquiry will still be under- or un-regulated.

### Options for addressing regulatory gaps

The ACCC has considered two ways in which these ACL regulatory gaps may be reduced: sector-specific changes, such as a PAG-wide industry code, or performance-based, economy-wide prohibitions, such as an ACL prohibition on unfair trading practices.

A number of industry bodies and market participants have submitted that a mandatory code governing all areas of the PAG supply chains should be introduced. Industry codes are a key piece of Australia's competition and fair trading regime. They can be effective in resolving specific problems within individual sectors, where they are mandatory and contain penalties sufficient to deter non-compliance.

However, the ACCC considers that the diversity of harmful practices across PAG supply chains means it would be challenging to develop a code to address harmful conduct spanning a vast variety of different scenarios. It is also the case that even in sectors where the market is working well, compliance with a code can impose additional costs on market participants.

In addition, this kind of process-based regulation in industry codes is less successful at responding to evolutions in behaviour over time compared to a performance-based ACL prohibition. The code would require significant resources to ensure it remains up-to-date.

Finally, a PAG-wide industry code would be limited in the penalties available for non-compliance. The maximum penalty currently available for a contravention of an industry code is 300 penalty units (currently, \$66,600), although this may be doubled soon. Nevertheless, this is significantly lower than the maximum penalties available for a contravention of the ACL by a corporation.

An alternative to prescriptive, sector-by-sector regulation is performance-based regulation in the form of an economy-wide prohibition on unfair trading practices. Discussions are currently underway between the consumer affairs ministers and agencies of the Australian federal, state, and territory governments about what form an ACL prohibition on unfair trading practices could take. Key international jurisdictions, including the United States and the European Union, already prohibit unfair trading practices in various forms.

The ACCC considers that an unfair trading practices prohibition has a number of advantages over a PAG-wide industry code, including:

- It would establish a norm of behaviour that would be better able to apply across different sets of circumstances, and for all participants in markets. This would allow it to focus its prohibition on behaviour that was causing significant harm, instead of prohibiting particular practices that may or may not cause harm, depending on the circumstances.

- This norm of behaviour would be able to keep up with evolving commercial practices in a way that more rigid regulation, like a PAG-wide industry code, would not.
- The current regulatory gaps in the ACL are a problem that extends beyond PAG supply chains. While PAG industries are the focus of this inquiry, the ACCC considers that regulatory responses should be considered from a broader perspective as well.
- An ACL-based prohibition would potentially be subject to the greater penalties available under the ACL in comparison to industry code penalties. These penalties are critical for encouraging compliance with the law, and would help to ensure that a new prohibition would function effectively to secure meaningful behavioural change.

Of the options outlined here, the ACCC considers that introducing a prohibition on unfair trading practices to the ACL has the greater capacity to address significant harms and to evolve over time to address new harms.

## **The Food and Grocery Code**

The Food and Grocery Code is intended to cover certain conduct by grocery retailers and wholesalers in their dealings with suppliers. However, the code has serious weaknesses that undermine its ability to effectively regulate misconduct.

The ACCC considers that many of the recent changes to the Food and Grocery Code do not address these key weaknesses, and that further changes are necessary to address the harmful effects of bargaining power imbalances.

Firstly, the Food and Grocery Code should be made into a mandatory code, applying to all relevant retailers and wholesalers in the sector. Without being mandatory, the risk of signatories withdrawing from its coverage undermines the force of the code and the extent to which businesses can rely on its protections.

Secondly, the ability to contract out of important protections in the Food and Grocery Code should be removed. The Code is intended to address the fact that retailers and wholesalers hold the bargaining power in negotiations with suppliers. Allowing them to contract out of Code obligations fatally undermines this purpose.

Thirdly, the Food and Grocery Code should be updated to make significant civil pecuniary penalties and infringement notices available for contraventions. As it currently stands, the Code does not provide the ACCC with the necessary enforcement tools to protect suppliers against signatories that fail to comply with its requirements.

Finally, the Food and Grocery Code needs to provide a genuinely independent dispute resolution process, so that suppliers are not deterred from using it because of concerns over confidentiality, bias, or commercial retaliation by retailers or wholesalers.

# Recommendations and ACCC actions

This inquiry has found that there is potential for economic harm arising from conduct by participants in PAG industries. The following recommendations and ACCC actions are targeted at addressing these harms.

## Recommendations

► **Recommendation 1: The business-to-business unfair contract terms framework should be strengthened in the ways agreed to by the Legislative and Governance Forum on Consumer Affairs**

This framework should be strengthened as currently proposed by the consumer affairs ministers and agencies of the Australian federal, state, and territory governments. This includes:

- making the inclusion of UCTs in standard form contracts illegal and subject to penalties
- removing the contract valuation threshold
- reforming the small business definition threshold
- providing greater clarity on what constitutes an effective opportunity to negotiate between parties to a contract.

► **Recommendation 2: An economy-wide prohibition on unfair trading practices should be introduced into the ACL**

The findings of this report provide further evidence that an economy-wide unfair trading practices provision is needed. Introducing a prohibition on unfair trading practices to the ACL is necessary to reduce the significant harms that are not currently captured by the provisions of the ACL, and which will not be covered by the proposed reforms to unfair contract terms laws.

An unfair trading practices provision is likely to provide greater flexibility and is less likely to constrain innovation when compared to a code across PAG industries.

► **Recommendation 3: The Food and Grocery Code should be strengthened, including by making it mandatory for retailers and wholesalers, and by introducing significant penalties for contraventions**

Despite recent amendments, the Food and Grocery Code still has significant shortcomings that lead to potentially harmful behaviours being under-regulated.

The Food and Grocery Code should be made into a mandatory code, applying to all relevant retailers and wholesalers in the sector, and should be updated to make civil pecuniary penalties and infringement notices available for contraventions. Signatories should not be able to contract out of protections under the Code, given it is intended to address the fact that retailers and wholesalers hold the bargaining power in negotiations with suppliers. The Code also needs to provide a genuinely independent dispute resolution process.

► **Recommendation 4: Governments and industries should explore measures to increase price transparency in PAG industries, in order to increase competition in those industries**

The ACCC has identified that information failures and information asymmetries occur across PAG industries. Improving market transparency can be an important tool for increasing competition and the confidence that industry participants have in markets.

The ACCC has previously made recommendations for improving transparency through the cattle and beef, and wine grapes market studies, and the Dairy Inquiry. However, the ACCC has not made specific transparency recommendations in this inquiry. This is because any price or market transparency mechanisms need to be carefully considered to avoid unintended consequences, and must be tailored to a particular industry.

## ACCC actions

In addition to the above recommendations, the ACCC considers that a number of issues require further consideration following this inquiry. The ACCC has a dedicated Agriculture Unit and will have an ongoing focus on issues in PAG industries. This Unit will prioritise the use of its resources to focus on key issues in agriculture markets. Arising from this inquiry, the ACCC will:

1. Investigate the potential UCTs identified in the chicken meat industry.
2. Investigate reports that horticulture wholesalers are trading without Horticulture Produce Agreements. The ACCC will conduct further Horticulture Code audits in 2021 to examine these concerns.
3. Engage directly with agricultural industry associations in 2021 to explain how the ACCC's new small business collective bargaining class exemption may be beneficial and how businesses can access the regime.

# 1. Bargaining power in markets for perishable agricultural goods

## Key Points

- Bargaining power imbalances are a common feature of markets for perishable agricultural goods. Economies of scale at the processing and retail levels result in market structures where there are a relatively small number of buyers acquiring the majority of produce.
- The more perishable a product, the more vulnerable the producer is to being subject to take-it-or-leave-it terms from buyers. In contrast to agricultural goods which can be stored, there is limited or no ability to delay or withhold supply to negotiate better supply terms.
- Market failure from insufficient competition and information failures can undermine the efficiency of perishable agricultural goods markets. This exacerbates bargaining power imbalances along the supply chain, particularly between producers and processors.
- Bargaining power imbalances and market failures are also features at the wholesale level of supply chains for perishable agriculture goods.
- Hard bargaining and low profits are features of a competitive market and do not necessarily indicate market failure. Strong and effective competition between market participants, including producers, also rewards the most efficient businesses through greater profits and growth, at the expense of the decline and exit of the higher cost businesses.
- Markets that operate efficiently often do not result in an equitable distribution of profits along the supply chain. However, when traders can use their bargaining power to engage in behaviour or impose supply terms which place undue risk and uncertainty on suppliers, it undermines confidence in the supply chain and deters investment and efficient levels of supply.

## 1.1 Introduction

Perishable agricultural goods (PAG) markets are generally mature and well-established in Australia. However, the way they operate has changed significantly over time owing to changes such as:

- improvements in productivity (such as technology changes)
- consolidation among producers, processors and buyers
- changes to environmental and water conditions
- changes to transport methods and distribution channels
- increased vertical integration
- changes to processor business models including a move away from cooperatives toward corporations and multinationals
- changes to regulatory settings (including deregulation).

Producers have shown great resilience to these changes. However, at least in some sectors, the farm level has come under strain. This is particularly the case where, combined with existing market structures, change has created or exacerbated uncertainty (particularly production signals) and barriers to competition at the farmgate.

PAG markets are often characterised by many producers, but few processors and major retailers. This structural characteristic can lead to market failure in the form of market power (see box 1.3). This, combined with market features such as the perishable nature of goods, means that these markets can be particularly susceptible to information failure and significant imbalances in bargaining power.

Market failure occurs when resources are not efficiently allocated. When market failure exists, and that market is left to operate without intervention or regulation of some form, it will lead to a market not operating as well as it could. This can harm not only supply chain participants including consumers, but also the broader economy. The harm that arises from market failure ultimately takes the form of suppliers and/or consumers being excluded from the market, or supplying/buying less than they otherwise would. Relative to a more efficient market, exclusion or reduced participation may be caused by:

- market power and the associated retention of profits leading to prices offered to producers being lower than they could be (or prices to consumers being higher)
- producers and consumers not having sufficient and timely information to make informed production or consumption decisions, meaning resources are not allocated as efficiently as they could be
- producers reducing output or investment because they face uncertainty in the terms of supply that are offered to them.

Consequently it is important to evaluate these markets and identify how they are functioning, and when conditions might warrant intervention to help them function better.

In determining whether regulatory intervention is warranted in a market, it must be established that:

- market failures or other harms exist
- these can be remedied through intervention
- the benefits of the intervention would outweigh the costs.

This chapter considers the characteristics of PAG markets and the types of market failures and imbalances in bargaining power that can arise, and the impacts these can have on outcomes experienced by market participants. This framework is then used throughout the report to assess whether market failures exist in specific PAG markets and whether regulatory intervention is warranted.

## 1.2 Varying degrees of perishability

The degree of perishability of a good influences the way that market structures evolve. Agricultural food products can be divided into three broad categories, being perishable, semi-perishable and non-perishable goods (see box 1.1). For this inquiry, PAG markets are assumed to include a range of staple and discretionary goods, encompassing meat products (pork, beef, and lamb, chicken), fish and shellfish, eggs, dairy products, and horticultural and viticultural produce.<sup>14</sup>

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14 Competition and Consumer (Price Inquiry—Perishable Agricultural Goods) Direction 2020; 28 August 2020.

## Box 1.1: Perishability of agricultural goods exists on a spectrum

The perishability of agricultural foodstuffs can be divided into three broad categories:

1. Perishable goods: foodstuffs which deteriorate quickly and have a short storage life. Storage must retain moisture in the produce and substantially lower the temperature.
2. Semi-perishable goods: foodstuffs that do not require refrigeration, but still have a limited shelf life, or which can last for several months if well stored. Examples include potatoes, onions, pumpkins and cured meats.
3. Non-perishable goods: foodstuffs that deteriorate slowly. These generally only need to be stored in a dry, cool environment. Examples include grain, flour, sugar, spices, and nuts.

Perishability exists on a spectrum, both at the farm level, and through the supply chain. For example, milk requires refrigeration on farm, and collection and processing within a couple of days. After this it can be converted to perishable products which require consumption within weeks, such as milk or cream, through to shelf stable products such as long life milk or milk powder. In contrast, under certain conditions eggs can be kept for several weeks, and apples may be stored for many months. It is possible to prolong the life of some perishable goods, such as fish, meat, fruit and vegetables through freezing.

Perishability may result in:

- Products which the farmgate producer cannot store and must be delivered (or harvested and then delivered) within a relatively short period.
- For some perishable agricultural goods, there is limited or no ability to export or import. It can be difficult and expensive to transport perishable agricultural goods owing to Australia's vast and remote geography; and because fresh or unprocessed goods may also raise biosecurity risks.

This limits the bargaining power of producers, because perishability affects their ability to hold out for better terms and conditions of sale, and their best alternative if they were to cease bargaining with a particular buyer (this is known as an 'outside option').

In some cases, processing can convert a perishable agricultural good into a product with a longer shelf life, which mitigates the challenges associated with perishability. It can also overcome some biosecurity concerns. These factors allow products like cheese, butter, cured meats, frozen fruits and vegetables to sometimes be imported to compete with Australian produced products, or exported from Australia to global markets.

Some products remain perishable throughout the supply chain, meaning that neither the processor nor the retailer can stockpile or store the goods for any length of time.

### 1.2.1 Limited flexibility in supply of agricultural goods

Perishability is also a factor in producers having limited control over the amount of product supplied to market within the short term. The supply of agricultural goods cannot be easily changed in response to a change in market prices, as suppliers' growing decisions are made well in advance of when the goods are supplied to the market, and cannot be easily scaled up or down. For example:

- Harvest for plants depends on the amount planted at the start of the growing period. The lag may be a matter of weeks, months, or even years, depending on the product.
- Many perishable agricultural goods (such as fruit and vegetables) have a very limited window of time for their optimal harvest, and producers have no ability to delay harvest or delivery to seek a more competitive option.
- The supply of animal products has a significant lag and depends on the breeding and nurturing of animals over several years.

- The production of some products is highly volatile and seasonal, affecting volumes coming to market, and resulting in large fluctuations in wholesale and retail prices. Volumes and prices may be impossible to accurately forecast, preventing players from taking measures to limit their risk.

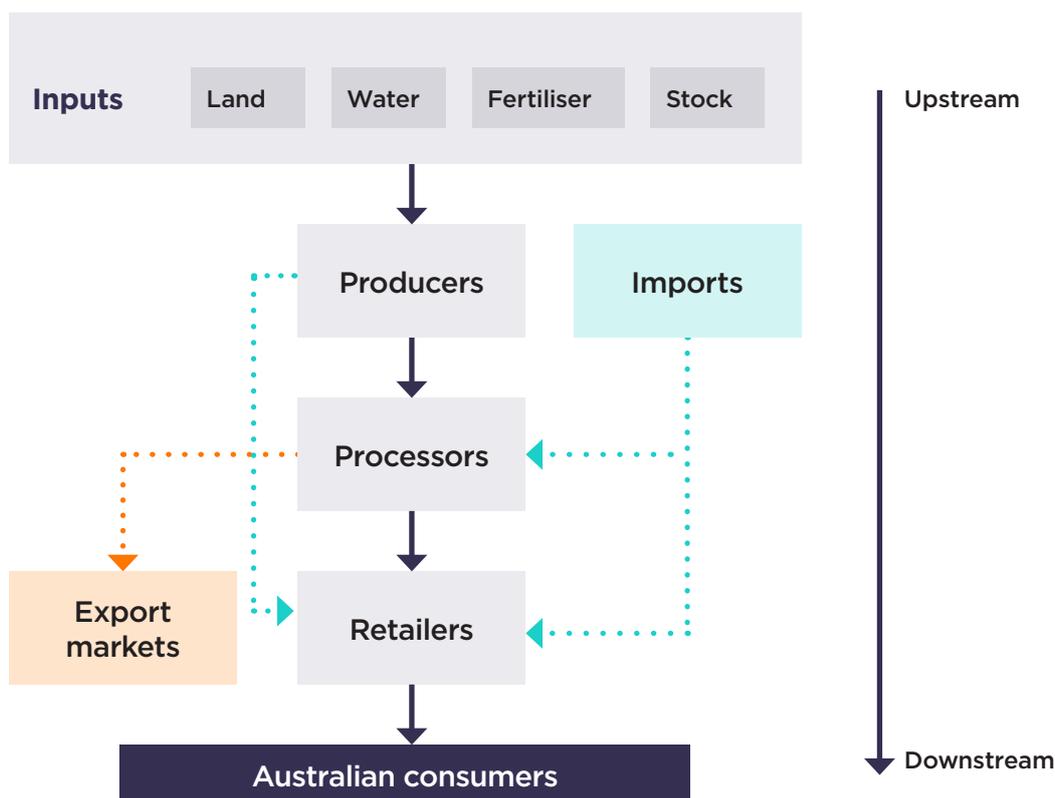
Perishable agricultural goods deteriorate quickly when not stored properly. While more durable goods can be stockpiled in anticipation of changes in demand, perishable agricultural goods must be disposed of before spoilage occurs, decreasing the producer’s ability to withhold product from market. This can be in contrast to non-perishable agricultural goods (such as grain) where the product can be stored for a long period of time and even exported, thereby providing growers with more options for sale.

### 1.3 Characteristics of perishable agricultural goods supply chains

The characteristics and structures of PAG markets heavily influence the way markets operate and the types of market failures that can emerge.

PAG supply chains exist to transform farm produce into a product that consumers want to buy, at the place and time they want it, for a price that they are prepared to pay. These supply chains share a general structure as outlined in figure 1.1. That is, input markets feed into farm production; farm produce is sold into processing and wholesale markets; and these in turn feed into export or domestic retail markets, where they may compete with imports.

Figure 1.1: Simple model of agricultural goods supply chain



The structure of an agricultural goods supply chain has three main levels:

- **Farmgate:** markets where producers (dairy farmers, growers of various horticultural crops, farmers of beef, pork, sheep and chickens, eggs, fishing and aquaculture) sell their produce to a processor.
- **Wholesale:** markets where processors or wholesalers (for example horticulture packing sheds, dairy processors, abattoirs) compete to supply their products to retailers, food service providers or export
- **Retail:** markets where retailers (supermarkets, speciality retailers such as butchers and green grocers, food service) compete to supply products to consumers.

### 1.3.1 Market structure and competition

Agricultural goods markets often have common structural characteristics that strongly influence the way competition occurs and the outcomes for producers, processors, retailers and ultimately, consumers. A common market structure is:

- A large number of farmgate producers in a given region for a given product.
- A small number of processors, wholesalers or intermediaries in a given region for a given product (sometimes as few as one).
- For access to domestic markets, three major supermarket retailers generally account for a majority of supply to consumers. Other important channels can include smaller or specialty retailers, and food service channels such as cafes, restaurants and quick service ('fast food') restaurant chains.
- Where imports and exports are possible, international demand and supply conditions affect the prices Australian farmers receive. Prices on global markets can fluctuate considerably with relatively small shifts in world production which can increase volatility of domestic prices throughout the supply chain.

Market structure is a key influence on whether market power exists, which can effect whether that market operates efficiently and fairly.

## 1.4 Insufficient competition and information failure

Insufficient competition and information asymmetries are market failures which the ACCC has previously identified in agriculture supply chains,<sup>15</sup> and can be a feature of PAG supply chains more broadly. Externalities, behavioural bias and regulatory failure are additional categories of market failure which may feature in some industries. The presence and extent of these market failures can be considered in PAG markets to determine how markets are operating and whether regulatory intervention may be appropriate.

### 1.4.1 Insufficient competition resulting from market structure

Where there are too few firms in a market, on either the buyer or seller side, this can lead to insufficient competition. Insufficient competition is a form of market failure and results in a loss of allocative, productive and dynamic efficiencies (see box 1.2).

When sellers hold market power, the most obvious manifestation is higher prices charged to consumers. A less obvious outcome is buyers with market power driving down prices paid to producers. The first example, sellers holding market power, can result in the exclusion of some buyers from the market. The second can result in the exclusion of some producers. In either case, there may be an undersupply of product relative to the market's efficient supply level. Box 1.3 describes a model of market structure and how the number of buyers and sellers on each side of the market can influence competition and efficiency.

#### Box 1.2: Market efficiency

Efficiency in markets can be considered in three ways:

- **Allocative efficiency:** the allocation of resources to their most valuable use.
- **Productive efficiency:** the production of goods and services using the most cost-effective means.
- **Dynamic efficiency:** the economically efficient use of resources over time, incorporating process and product innovation in response to changes in the market.

15 Australian Competition and Consumer Commission, *Cattle and beef market study—final report*, ACCC, 2017; Australian Competition and Consumer Commission, *Dairy Inquiry final report*, ACCC, 2018; Australian Competition and Consumer Commission, *Wine Grapes market study—final report*, ACCC, 2019.

Insufficient competition can be a result of:

- there being too few firms in the market, or
- firms in the market not competing effectively because there are barriers to competition (such as contract terms or durations which hinder switching), or
- conditions exist which facilitate coordination (for example, a small number of firms which can observe each other, settle on a consensus and punish deviation).

Barriers to competition can be created where a firm can use its bargaining power in a vertical relationship to limit the competition it faces in a downstream market. An example of this could be where a processor uses its bargaining power with a producer to offer a take-it-or-leave-it contract which prevents the producer from switching to sell to another processor in the future. This has the potential to harm both the producer, and the processor's competitors, because it limits the options of each party to sell and buy goods. In some cases conduct of this kind can be illegal where it substantially lessens competition in a relevant market.

Coordination can be a problem in PAG markets in circumstances where processors or retailers can repeatedly signal their intended prices and reach a tacit arrangement, such as one firm setting the price and others following.

In practice, market power can result in:

- At the farmgate, downstream firms reducing prices paid to producers to below their marginal cost of production. This will exclude producers or volumes of product that would otherwise be supplied.
- At the wholesale or retail level, firms increasing prices above marginal cost. This excludes some buyers from the market who would otherwise participate.
- Firms not being constrained in their pricing or other behaviour by the threat of competition from new entrants, or expansion by other firms. This can diminish their incentive to innovate or invest in more cost effective production methods.

### Box 1.3: Models of market structure and impacts on efficiency

Different levels of a supply chain interact with one another through trade. The number of competitors at each level of the supply chain is relevant in determining how that interaction occurs. This is shown in figure 1.2.

Figure 1.2: Market structure and competition

		Number of sellers (growers/producers)		
		One	Few	Many
Number of Buyers (processors/retailers)	One	Bi-lateral monopoly	Oligopoly-monopsony	Monopsony
	Few	Monopoly-Oligopsony	Bi-lateral oligopoly	Oligopsony
	Many	Monopoly	Oligopoly	Competitive



Figure 1.2 shows how the intensity of competition and efficiency of outcomes generally change in accordance with the number of buyers and sellers on each side of the market (the market structure). A market structure which has many buyers and many sellers (shown as green) is optimal for competition and efficiency, but is less common in PAG markets. The more balanced market structures (shown as yellow) tend to be preferable over those where there is an imbalance in the number of buyers or suppliers (shown as orange or red). A greater degree of regulatory intervention can be warranted in markets with the least efficient outcomes, as the cost of intervention is more likely to be offset by the greater efficiency gains to be made.

In monopsony markets, a single buyer has market power and can influence the amount of produce that is purchased and the price at which it is bought. Under certain conditions, a monopsonist has incentives to restrict the amount of product it buys, which can drive the market price below the competitive level. In the case of farmgate markets, a monopsonist processor will set farmgate prices at the minimum level required to generate the volume of produce it wants to buy. If competition is introduced, processors competing against one another to acquire produce will bid prices up above the monopsony level. This will result in profits to existing producers, and will also incentivise some of those producers to increase production, and new producers to enter the market.

Where there are a small number of buyers (oligopsony), the competitive dynamics and welfare consequences are variable and depend on other characteristics of the specific market. Processors in oligopsony markets may have incentives to reduce transparency (the amount of information available to sellers) and introduce or exacerbate barriers to switching (such as contract terms that 'lock in' sellers) in order to diminish competition.

PAG markets at the wholesale and retail level naturally tend towards an oligopolistic market structure because of economies of scale (producing large volumes) and scope (producing a variety of products). For example, a dairy processor producing a large volume and variety of products is likely to be able to operate at lower costs, and therefore offer lower prices to a major retailer, than a relatively smaller processor.

## 1.4.2 Information failure at different levels of a supply chain

There are many unknowns in PAG supply chains. Volumes, quality and prices in domestic and global markets may be impossible for anyone to accurately forecast, and can be highly volatile. However, the level and quality of information available for decision making also frequently varies through supply chains.

Allocative and productive efficiency can be lost if producers, processors or consumers do not have enough information to make informed decisions. This is because they may not make production or consumption decisions which are in their best interests.

A particular challenge for some PAG markets is producers having to make production and sale decisions well in advance of information about price and market conditions. Processors are in a better position from which to understand and manage this risk, and are able to gather and aggregate more information about likely market conditions, sooner, than is an individual farmer.

In some supply chains, farmers may also have limited access to information about the broader market for their product. They cannot optimise their production or match with the processor that best suits their operation if they cannot observe, understand and compare prices and terms offered by rival processors.

Depending on the nature of the PAG market, information asymmetry and failure can lead to:

- Ex-post hold-up: a processor or retailer uses its bargaining power to extract the value created from relationship-specific investments made by the producer or processor.
  - This could occur where a producer has committed to supply a processor, but there is insufficient contractual certainty (about price, quantity delivered, quality parameters, or delivery time) to protect investments made by the producer.
  - Processors supplying highly perishable agricultural goods, or that have made significant investment in private label production facilities, may be at risk in their negotiations with major retailers. Given the size and resources of processors in Australia they are better placed (relative to producers) to negotiate contract terms which limit this risk.
- A principal agent problem: a seller or processor is acting on a producer's behalf but is not incentivised to act in the producers' best interests. For example, there are perceived or real conflicts of interest arising for brokers in water markets, including brokers providing services to both parties in a trade or taking a personal position in a trade.
- Moral hazard: a processor engages in excessive risk taking because they have the ability to shift that risk to producers. In PAG markets this could involve a processor taking risks in export markets because they have supply agreements with producers allowing them to change prices after producers have committed supply. Similarly, this could be an issue at the retail level if a major retailer is able to return and bill back stock of perishable products to the processor.

## Box 1.4. Investment timeframes

A capital investment will generally need to be owned and operated for a length of time before it will be profitable for the investor. For this reason, where a processor would need to make a significant capital investment to be able to manufacture a product, they may require a long-term contract with a retailer, to facilitate a return on the investment. The same may apply in some processor-producer relationships where the producer needs to make significant capital investments.

Long-term supply agreements may facilitate entry by new competitors, by providing a higher degree of certainty on the firm's return on investment. Securing long-term agreements reduces the risk associated with the capital investment required to establish a business.

For example, the Dairy Inquiry found<sup>16</sup> that contracts for private label milk frequently involved longer term agreements<sup>17</sup>, providing processors with greater certainty. Despite, supermarkets' demand for lower wholesale prices from processors in exchange for longer term contracts<sup>18</sup>, the length of contracts offered provide an incentive for processors to undertake substantial capital investment for efficiency improvement to obtain and/or retain these arrangements. For example, in 2013 Murray Goulburn invested over \$150 million to secure a major long-term private label milk contract with Coles.<sup>19</sup>

However, producers or processors may be exposed and have a weakened bargaining position at the time of contract renewal if the profitability of their investments is dependent on being awarded a further contract.

Information asymmetry also contributes to bargaining power imbalances, as it puts one party at an advantage. Compared to producers, processors are likely to have better information regarding processing costs and the value of the produce at the wholesale level (both domestically and internationally) and the terms on which it is supplied.

Similarly at the wholesale level, major retailers may have an information advantage over processors as they have greater visibility over profit margins at the retail level and wholesale prices that other processors are offering. Increased use of toll processing arrangements means that retailers also have significant information about processing costs.

A retailer with market power may leverage its bargaining power to compel processors to provide information (such as the cost of production or the cost of inputs) to remove any information advantage that a processor may have in a negotiation. Following the 2018 review of the Food and Grocery Code, the Government recognised that price rise negotiations had become a key source of friction in the food and grocery industry. From 2 January 2021 amendments to the Code will prohibit a retailer or wholesaler from requiring suppliers to disclose commercially sensitive information at any stage during the negotiation process for price increases.<sup>20</sup>

Incomplete information will likely lead to a degree of underinvestment and inefficient production. Incomplete information can involve imposing terms of supply that allocate wholesale market risks to producers who are not best placed to identify, manage or price the risk that they bear. Similarly, producers may be provided with information which is not reliable, such as supply terms which are subject to change at the processors' discretion, or pricing guidance which processors do not commit to. The uncertainty surrounding the information provided can have a similar effect to no information being

16 ACCC, *Dairy Inquiry final report*, p. 30–31.

17 Australian Food News, *Woolworths announces 10-year milk deals, but Lion is the loser in Victoria and WA*, 7 April 2014, [www.ausfoodnews.com.au/2014/04/07/woolworths-announces-10-year-milk-deals-but-lion-is-the-loser-in-victoria-and-wa.html](http://www.ausfoodnews.com.au/2014/04/07/woolworths-announces-10-year-milk-deals-but-lion-is-the-loser-in-victoria-and-wa.html), viewed 14 September 2017.

18 Retail World Editor, *Private labels the dairy industry's new cash cow*, 11 March 2016, [www.retailworldmagazine.com.au/private-labels-the-dairy-industrys-new-cash-cow/](http://www.retailworldmagazine.com.au/private-labels-the-dairy-industrys-new-cash-cow/), viewed 1 November 2017.

19 Joe Anderson, *The skinny on Murray Goulburn, Coles milk deal*, *The Financial Review*, 23 May 2016, [www.afr.com/brand/rear-window/the-skinny-on-murray-goulburn-coles-milk-deal-20160523-gp1d98](http://www.afr.com/brand/rear-window/the-skinny-on-murray-goulburn-coles-milk-deal-20160523-gp1d98), viewed 10 October 2017.

20 Australian Government, *Strengthening commercial dealings in the foods and grocery industry—Government response to the review of the Food and Grocery Code of Conduct*, Commonwealth of Australia, 2019, p. 9; Australian Competition and Consumer Commission, Canberra, [www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct/changes-to-the-food-and-grocery-code#changes-to-negotiating-price-rises](http://www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct/changes-to-the-food-and-grocery-code#changes-to-negotiating-price-rises), viewed 13 October 2020.

provided at all: producers will be hesitant to invest owing to the risks they face or will not make the optimal production decisions because the information is subject to change.

### 1.4.3 Additional sources of market failure in PAG markets

As discussed in table 1.1, other forms of market failures can include behavioural biases, externalities and regulatory failure.

**Table 1.1: Behavioural biases, externalities and regulatory failure**

<b>Behavioural biases of producers</b>	Behavioural biases may be a cause of market failure where producers would be better off changing part of their business strategy, but choose not to. For example, producers may demonstrate undue 'loyalty' to supplying a given processor, farming particular breeds or varieties, or maintaining a particular production system.  Behavioural biases may be more common in sectors which have a history of cooperatives or have undergone significant reform, such as deregulation.
<b>Externalities</b>	Externalities are a form of market failure where the prices in a market fail to fully account for the costs imposed on parties not involved in that market.  Common examples of negative externalities relate to pollution. For example, a factory that operates and releases pollution into the atmosphere imposes a cost on society (such as health issues caused by diminished air quality) but the operator of the factory does not directly bear those costs.  In the case of PAG markets an example of a negative externality can be where a producer's actions degrade the environment, for example through farming practices that cause damage to land, water or animal species.
<b>Regulatory failure</b>	Regulatory intervention can distort markets and lead to an inefficient allocation of resources. Regulations can have unintended consequences and become ineffective over time, or be too complex. The potential benefits of regulatory interventions require careful weighing against potential inefficiencies, so that regulatory responses to market failures are proportionate to the harm identified.

## 1.5 Bargaining power imbalances resulting from market structure

The degree of competition, or the possibility of other firms competing, is a very good indicator of efficiency, inefficiency, or the potential for exploitation in a supply chain. This is because bargaining power is determined by each parties' outside option, or the value they can achieve in the event an agreement is not reached. The party with a better outside option has a stronger bargaining position, which allows it to extract a greater proportion of the value that an agreement generates.

In terms of a bargain between a single producer and single processor, the processor will typically have a much more valuable outside option. This is because there are many other producers they can secure supply from, whereas the producer may have few other processors to potentially supply, and may also face barriers to switching. In the extreme, if one party has valuable outside options and the other party effectively has none, then one party can extract all of the value created by the transaction between them.

### 1.5.1 Varying market dynamics across the supply chain

#### Farmgate PAG markets

In Australia, PAG farmgate markets are often characterised by:

- Many producers, resulting in a significant degree of horizontal competition in geographically localised markets.
- Few processors, potentially resulting in limited horizontal competition at the processor level for the acquisition of the produce.

- Limited scope for producers to access alternative outside options for sale (such as exports). This can be because of geography, transport costs and perishability.
- In some markets, significant vertical integration of production and processing (such as in some horticulture sectors, pork production, and wine grapes), in box 1.5.
- Information asymmetries between producers and processors with processors having greater knowledge of the wholesale value of produce, and prevailing domestic and export market conditions.
- Production which generally cannot be easily or quickly changed in response to a change in market prices (this is known as inelastic supply).

### **Box 1.5: Vertical integration in the supply chain**

Some PAG markets (for example, wine grapes and horticulture) have been subject to increased vertical integration at the producer-processor level, with some processors owning an increasingly large proportion of the produce they source. This weakens the bargaining position of the non-integrated producers and may also disadvantage them in other ways.

Vertically integrated processors have incentives to discriminate in favour of their own produce. This potentially comes at the expense of more efficient or better quality, non-vertically integrated producers. These concerns are more likely to arise where there is limited capacity at the processing level and non-vertically integrated producers have limited options for selling their goods.

Loss of efficiency owing to a lack of competition may also be exacerbated where there is vertical integration. Other types of market failures such as information failures, moral-hazard and ex-post hold-up are not an issue for vertically integrated businesses, as the interests and information of the producer and processor become aligned under common ownership.

Several of these characteristics result in downstream purchasers having a significant degree of bargaining power compared to the producer. The processor will generally have many more outside options than the farmer, and more options to change the amount of product they purchase, than the producer will have to change the amount they supply. This effects negotiations because a failed transaction at the farmgate may be of little consequence to a processor, but have significant ramifications to the producer.

An outcome can be that producers face 'take-it-or-leave-it' terms for supply of their products, and have limited ability to seek alternative channels of supply and better terms. Producers may also have limited or no opportunity to temporarily withhold supply while terms are negotiated or disputed with a processor. Perishability may also limit the potential for producers to dispute buyers' quality assessments or whether the evaluation was objective, and creates greater risk of ex-post hold-up.

The relative bargaining position of producers may not be uniform, even within a local market. Provided there is some competition between processors, relatively large producers, or those selling higher quality product, may be able to negotiate more favourable terms, particularly if they provide some efficiency gains relative to smaller producers. While some producers may consider this form of price discrimination to be 'unfair', it is not inefficient. Converting farm produce into something the consumer wants to buy involves costs, and the share of the retail price that a producer receives at the farmgate can be an indication of their relative bargaining power.

However, all else being equal, the more perishable a product, the weaker the bargaining position of the producer and the more vulnerable they are to being exploited by a processor.

## Wholesale PAG markets in Australia

PAG wholesale markets in Australia are often characterised by:

- A number of processors competing on an interstate or national basis for domestic wholesale supply.
- Significant market concentration on the demand side with few major retailers accounting for the majority of domestic wholesale purchases and many, varied retailers and food service providers making up the remainder.
- For some products, a significant increase in demand over time for private label products at the expense of branded products, which diminishes the value of brands.
- In some sectors, the ability of processors to export into a global market.
- In some sectors, import competition from international competitors.

The size of processing businesses, and greater concentration in these markets, means that processors are less vulnerable to ‘take-it-or-leave-it’ terms for supply than producers are. However, they are typically highly reliant on major retailers as the largest supply channel to end consumers. This puts retailers in the superior bargaining position, allowing them to extract lower wholesale prices.

The growth of private label products, toll processing, and retailers bypassing the traditional wholesale level to purchase directly from farmers, erodes the brand value of processors and limits the retail shelf-space available to them, further weakening the processor’s bargaining position. As processors need to ensure that their smaller retailer customers can compete with the major supermarkets, lower wholesale prices negotiated by the major retailers can constrain the prices that processors can charge their other customers. In the case of a processor’s smaller customers, the wholesale price they are offered must be lower than the supermarket shelf price, as otherwise the smaller customer’s alternative is simply to purchase directly from the supermarket. This can be a significant constraint for some key consumer items.

Processors that are able to supply both export and domestic markets have a significant outside option. The ability to adjust the focus of their businesses mitigates their exposure to major retailers’ bargaining power to some extent. Some negotiating power can also be derived from supplying differentiated and premium products.

Processors supplying products which are unsuitable for export because of being highly perishable, or that have limited or no brand recognition, are more vulnerable to the bargaining power of major retailers. This is because the value of their outside options is likely to be low, especially given that domestic demand for food is relatively fixed and unresponsive to changes in price.

## Retail PAG markets in Australia

Retail markets are relatively highly concentrated. While there is a large number of retailers with specialist or varied offerings, such as butchers, green-grocers and delis, the major supermarket chains account for the vast majority of sales to end consumers. For example:

- 81% of domestically retailed fresh meat is sold by supermarkets, with butchers making up the other 19%<sup>21</sup>
- 59% of drinking milk produced is sold by supermarkets, with 51% of this being private label<sup>22</sup>
- 45% of eggs produced are sold by the major supermarkets<sup>23</sup>
- around half of domestically retailed fresh fruit and vegetables are sold through Coles and Woolworths.<sup>24</sup>

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21 Meat & Livestock Australia, *Market snapshot – beef & sheepmeat*, MLA, Sydney, 2020, p. 3.

22 ACCC analysis of data from Dairy Australia 2019, *The Australian Dairy Industry In Focus 2019*.

23 ACCC analysis of 2018–19 production and sales data from Australian Eggs Limited 2020, Australian Eggs, Sydney, [www.australianeggs.org.au/egg-industry/](http://www.australianeggs.org.au/egg-industry/), viewed 9 November 2020.

24 Roy Morgan 2018, *Coles and Woolworths continue to gain share in fresh fruit and vegetable market*, Roy Morgan, Melbourne [www.roymorgan.com/findings/7597-coles-and-woolworths-continue-to-gain-share-in-fresh-fruit-and-vegetable-market-201805220618](http://www.roymorgan.com/findings/7597-coles-and-woolworths-continue-to-gain-share-in-fresh-fruit-and-vegetable-market-201805220618), viewed 9 November 2020.

The major supermarkets compete with one another locally, and in a broader chain-on-chain basis. Perishable agricultural goods are a vital part of their offering and play a key role in driving store traffic and store loyalty. For example, fresh meat is the largest category of supermarket sales (excluding liquor and tobacco).<sup>25</sup> Consumers can compare prices for PAG related products and switch between retailers with relative ease. Consequently, despite the high levels of market concentration, the major retailers are often close competitors for the sale of these products, which are often considered key value items.

Retail pricing of perishable agricultural goods is not always closely linked to the cost of production. For example, major retailers maintain consistent pricing nationally and across the year for private label milk, despite the cost of production in Queensland being significantly higher than in Victoria<sup>26</sup>, and varying through the year. Retail prices for perishable agricultural goods are often less volatile compared to wholesale and farmgate prices, as retailers engage in price smoothing to provide a more consistent price offering to consumers.

There can be information asymmetries between consumers and the retailer, and/or processors, hindering consumers' ability to value products accurately. For example, there appears to be a commonly held perception that farmers receive a higher farmgate price from the sale of branded milk products relative to private label milk. However, this is not the case. The Dairy Inquiry found that farmers are not paid according to the type or value of the end product that their milk is used in, and that there is no direct relationship between retail private label milk prices and farmgate prices. Indeed, processors and major retailers appear to offset lower margins on private label products with the higher margins earned on branded products.<sup>27</sup>

## 1.6 Competitive market outcomes and equity

Economic harm arising from market failure results in a loss of value in the supply chain (including for consumers) rather than modifying the distribution of value among market participants. Hard bargaining and low profits are features of a competitive market, and are not necessarily signs of market failure. Competitive markets that operate efficiently are associated with low profits as margins are competed away by suppliers to the benefit of buyers. The competitive process between market participants also rewards the most efficient businesses through greater profits and growth, at the expense of higher cost businesses, which will decline and may exit the market.

Low average profits among producers of perishable agriculture goods are to be expected given the prevailing market structures outlined in section 1.3. Producers compete with each other, and therefore some degree of loss-making and exit is likely to occur even in the absence of market failure.

Supply chains which are profitable and are characterised by imbalances in bargaining power will have an inequitable distribution of profits. PAG supply chains, even when functioning well, will likely result in some producers making greater profits than others, and processors retaining a greater share of the wholesale profits rather than passing them on to producers.

However, when traders can use their bargaining power to engage in behaviour or impose supply terms which place undue risk and uncertainty on producers, it undermines confidence in the supply chain and deters investment and efficient levels of production. Their superior bargaining position may enable them to act in a way that goes beyond hard bargaining and causes economic harm.

For example they may offer a contract on a 'take it or leave it' basis which contains terms which result in a significant imbalance in the parties' rights and obligations, and/or would cause detriment to the weaker party if they were relied on. Specific examples of the kinds of conduct that arise in PAG markets where bargaining power imbalances exist are discussed in detail in chapter 3.

The presence of such supply terms and other unreasonable conduct creates significant uncertainty for producers and this undermines their incentives to make investments and maximise their production, for example by purchasing new plant or equipment that would increase their efficiency. Optimal levels

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<sup>25</sup> Meat & Livestock Australia, *Market snapshot—beef & sheepmeat*, MLA, Sydney, 2020, p. 3.

<sup>26</sup> See chapter 4 for discussion of cost of production for dairy.

<sup>27</sup> Australian Competition and Consumer Commission, *Dairy Inquiry final report*, ACCC, Canberra, 2018, p.xxi.

of output from PAG producers can only be achieved if producers have confidence in their supply terms and their exposure to risks of the supply side are minimised.

The above examples can be distinguished from outcomes of efficient markets which might be perceived by producers or consumers to be inequitable. Economically efficient outcomes require allocation of scarce resources to maximise production, but not necessarily in an equitable way. Examples of this may include the outcomes of greater efficiency through increased mechanisation at the farm production level, or liberalisation of agricultural markets through deregulation or greater trade mobility.

In the first example, increased mechanisation at the farm level results in less labour being required. In the second, farmers with a lower cost of production will increasingly gain market share from less efficient producers. If the cost savings of increased efficiency are passed along the supply chain to the retail price, all consumers receive a small benefit. However, the workers who became redundant or farms that go out of business suffer a significant detriment. The gains to society as a whole may exceed the losses, but it may seem undesirable that jobs and businesses are lost so that consumers can make a small saving.

Australia's agricultural markets have become increasingly liberalised over time, allowing interstate and international trade, and removing sources of regulation such as price floors and quotas. One result has been an increased flow of trade from countries or states with lower average production costs to those where production costs are higher. This is also a feature of other products such as manufactured goods. Increased trade mobility is desirable for an economy because it means that more or the same amount of produce can be processed or consumed at a lower price: an improvement in efficiency. However that may come at the cost of producers in higher cost regions decreasing volumes or exiting the market: an outcome some may consider undesirable.

Similarly, removal of various sources of supply certainty for buyers through deregulation would likely lead to exit by higher cost producers and expansion of lower cost producers. Some may consider it undesirable that some producers are squeezed out of the market, however, this shift can be the nature of markets operating efficiently and is not necessarily a sign of failure.

### **Box 1.6: Producers' share of the retail dollar over time**

Primary producers' share of the retail dollar tends to decline over time. This is because as income levels rise within the general population, consumers typically do not demand more food, but instead look for added services, such as processed or pre-cooked products, and consequently costs incurred along the supply chain increase. In wealthy countries, the labour component of processing costs tends to rise over time in particular.<sup>28</sup>

## **1.7 Proportionate responses to market failures**

Regulatory responses to market failure need to be proportionate to the corresponding efficiency loss that is identified. While regulatory intervention has the potential to improve competition, reduce information failures, and mitigate bargaining power imbalances, it also has a cost. This cost is not just administrative, but also stems from the way in which regulation can distort market outcomes and create other inefficiencies. For this reason, it is not always desirable to attempt to address every market failure that is identified. The relative benefits and costs in each instance should be assessed.

The current regulatory framework for PAG markets is discussed in chapter 5 and options to improve the regulation of PAG markets are discussed in chapter 6.

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28 B Malcolm, P Sale and A Egan, *Agriculture in Australia—an introduction*, Oxford university press, South Melbourne, 2003, p. 288.

## 2. Structures in markets for perishable agricultural goods

### Key Points

- Markets for perishable agricultural goods vary in terms of their features and characteristics, but contain a range of common structures. All PAG markets considered in this inquiry have characteristics likely to lead to bargaining power imbalances, as they have a relatively small number of buyers acquiring the majority of produce, compared with the number of producers.
- Some industries, like pork and eggs, are highly vertically integrated. This weakens the bargaining position of the non-integrated producers.
- Retailers have strong bargaining power in their relationships with processors and wholesalers. The major retailers are also increasingly bypassing wholesalers to deal directly with producers and processors.
- Perishability limits the ability of producers to withhold supply of their produce as a bargaining tool in potential negotiations with buyers. This makes producers of perishable agricultural goods vulnerable to take-it-or-leave-it terms from buyers, or practices that allow buyers to extract further value by exploiting the producers' weaker bargaining position.
- There is limited global trade of unprocessed and highly perishable agricultural goods. Trade in less perishable, processed (including frozen), and high value perishable agricultural goods occurs to a greater extent. Imports constrain domestic prices and reduce bargaining power for producers and processors, while the capacity to export provides an important outside option for market participants.

### 2.1 Introduction

As outlined in chapter one, is it not possible to generalise how competition in markets occurs, how bargaining takes place, or the consequences of this for welfare and efficiency. However, the particular features of markets will influence how bargaining takes place and the outcomes that occur. This chapter examines the specific structures and characteristics of PAG markets. The dairy industry is discussed separately in chapter four, while chapter three considers the types of practices that can occur as a result of the structure of PAG markets.

### 2.2 The structures of PAG markets

While PAG markets have common characteristics, features that are specific to each perishable agricultural good can influence the degree of any bargaining imbalances and market failures in markets. The characteristics of perishable agricultural goods considered in this inquiry are discussed below.

All PAG markets considered in this inquiry are characterised by a relatively small number of buyers acquiring the majority of produce, compared to a relatively large number of producers. This is likely to lead to bargaining power imbalances.

There are also bargaining power imbalances at the wholesale level of PAG supply chains. Supermarkets are the primary domestic sales channel for wholesale businesses and processors. Other domestic customers include smaller and specialty retailers, as well as food service operators, and these are sectors which are usually highly fragmented and where individual players do not have significant market share. This gives supermarkets the greater bargaining power at the wholesale level. Major retailers are also increasingly bypassing wholesalers to deal directly with producers and processors. Imports at the wholesale and retail level also limit the bargaining power of processors and wholesalers, and constrain domestic prices in several industries.

Processors that supply both export and domestic markets, or differentiated products, are less exposed to supermarkets' bargaining power. However, exports are not a meaningful option for several PAG industries, or for produce grown in certain regions.

The ACCC has had regard to the market shares of key players, and other information from IBISWorld, for the purpose of analysing bargaining power along the supply chain at a general level for this inquiry. However, IBISWorld's market definitions and market shares are likely to differ significantly from those that the ACCC would develop. A key reason for this is that IBISWorld market definitions are industry-wide, whereas previous ACCC reviews of PAG markets have found that competition often takes place within narrower geographic regions, or within specific product categories. If the ACCC were to consider a proposed acquisition or merger of a party in PAG supply chains in the future, or to examine the market power of any given firm, the ACCC would have regard to the particular circumstances in which competition takes place. This would result in the definition of market boundaries, market concentration and other factors that were specific to the matter being reviewed.

### 2.2.1 Chicken meat

The key characteristics of the chicken meat industry that are likely to impact on bargaining power are outlined in figure 2.1. The industry is characterised by a large number of small producers and a concentrated processing sector, and is domestically focused, with the Australian industry a small producer, exporter and importer on a global scale.

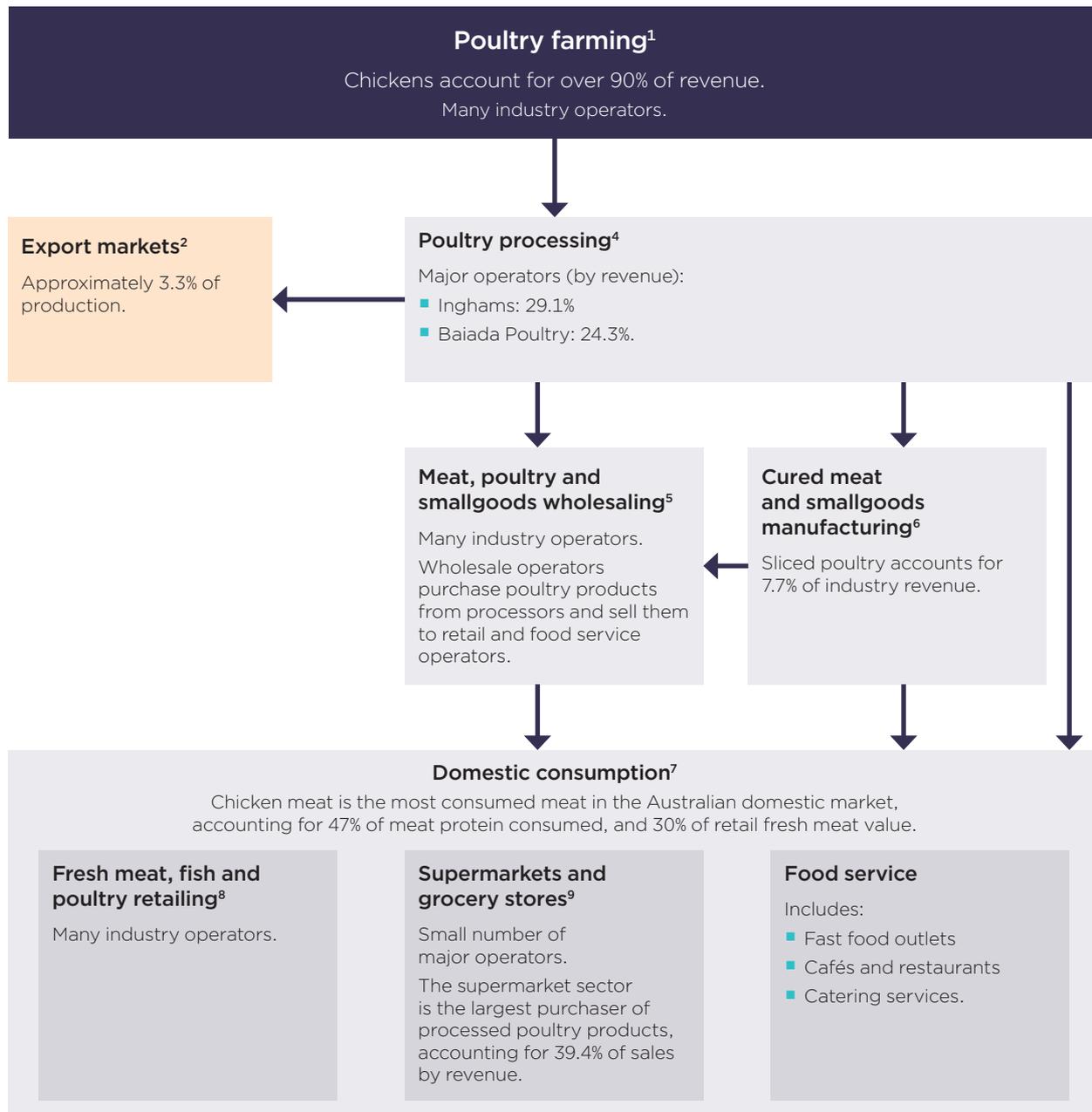
There are strict biosecurity controls for chicken meat imports, both raw and cooked.<sup>29</sup> Birds mature in a matter of weeks, and fresh chicken meat products have a very limited shelf life once slaughtered. Hence, timely sales are important and there is little scope for processors to withhold production as a bargaining tool in negotiations with downstream buyers like the major retailers. The industry is capital intensive, and growers rely on establishing long-term commercial relationships to meet the financial obligations associated with setting up the necessary infrastructure.<sup>30</sup> This significant specialised capital investment and the accompanying need to secure a contract reduces the bargaining power of producers.

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29 Australian Chicken Meat Federation (ACMF), [www.chicken.org.au/local-international-trade/#Export](http://www.chicken.org.au/local-international-trade/#Export), viewed 2 October 2020; ACMF, [www.chicken.org.au/facts-and-figures/](http://www.chicken.org.au/facts-and-figures/), viewed 2 October 2020.

30 IBISWorld, *Industry Report A0171: Poultry Meat Farming in Australia*, IBISWorld, 2020, p. 34; NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, IBISWorld, 2020, p. 13.

Figure 2.1: Chicken meat supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

1 IBISWorld, Poultry Meat Farming in Australia, 2020

2 ACMF, <https://www.chicken.org.au/facts-and-figures/>

3 IBISWorld, Poultry Processing in Australia, 2020, p. 25

4 IBISWorld, Poultry Processing in Australia, 2020

5 IBISWorld, Meat Poultry and Smallgoods Wholesaling in Australia, 2020

6 IBISWorld, Cured Meat and Smallgoods Manufacturing in Australia, 2019

7 MLA, Market Snapshot: Beef and Sheepmeat, 2020

8 IBISWorld, Fresh Meat Fish and Poultry Retailing in Australia, 2020

9 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; IBISWorld, Poultry Meat Farming in Australia, 2020

## Farmgate

Conventional farms are intensive, highly mechanised, and require significant infrastructure investment. They typically comprise from two to more than 12 barns, with associated shedding and silos.<sup>31</sup> Growers are contracted to rear birds on a fee-per-bird basis, by major companies operating highly integrated supply chains.<sup>32</sup> Submissions to this inquiry stated that farmers in some regions may have little choice but to deal with a single processor, which limits their bargaining power significantly.<sup>33</sup>

Processors operate the breeder farms and processing facilities and retain ownership of birds at all times. Chicks are delivered to contracted farms to rear, and harvested for processing between 30 and 65 days.<sup>34</sup> Contracts between growers and processors specify the inputs that the grower must provide, such as land, sheds, equipment, labour, water, utilities and insurance, and the methods that the grower must use to care for birds. Processors typically supply and pay for feed, medications and pick up crews to the growers.<sup>35</sup> The ACCC has authorised collective bargaining agreements among growers with processors in New South Wales, Queensland, Victoria, South Australia, Tasmania and Western Australia.<sup>36</sup>

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31 ACMF, [www.chicken.org.au/chicken-meat-production/](http://www.chicken.org.au/chicken-meat-production/), viewed 24 November 2020.

32 IBISWorld, *Industry Report A0171: Poultry Meat Farming in Australia*, IBISWorld, 2020, p. 13.

33 NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 13; Australian Chicken Growers' Council, *Submission to Perishable Agricultural Goods Inquiry*, 2020, pp. 2-3.

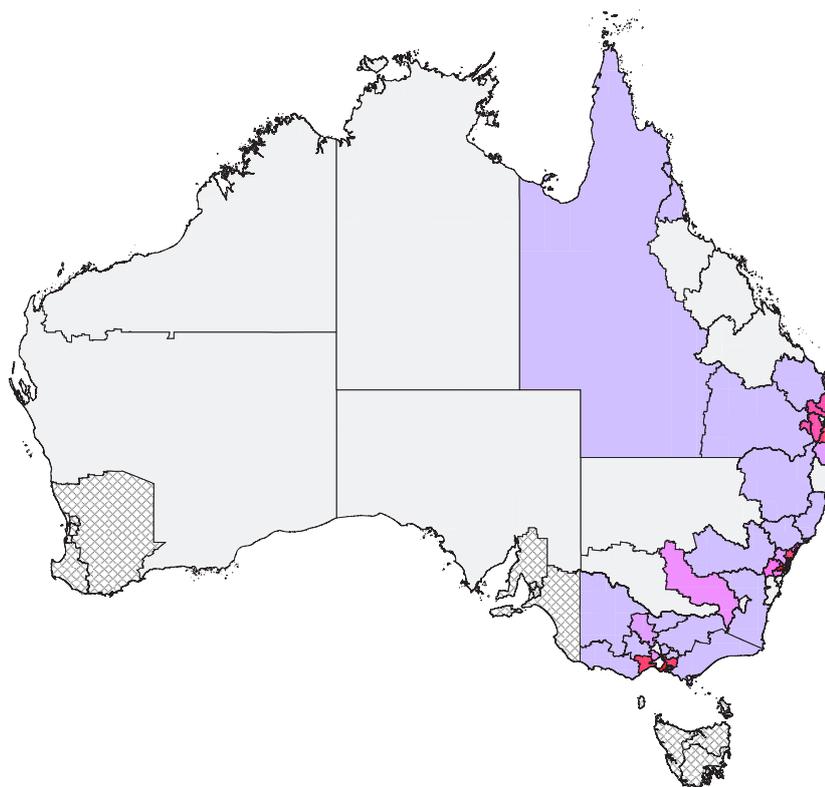
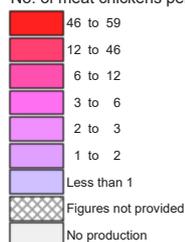
34 ACMF, [www.chicken.org.au/chicken-meat-production/](http://www.chicken.org.au/chicken-meat-production/), viewed 2 October 2020.

35 National Farmers' Federation (NFF), *Submission to Australian Competition and Consumer Commission Price Inquiry—Perishable Agricultural Goods*, 2020, p. 8; NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 13; IBISWorld, *Industry Report A0171: Poultry Meat Farming in Australia*, IBISWorld, 2020, p. 25.

36 See NSW Farmers' Association—Authorisation—A91417, granted 25 June 2014; Queensland Chicken Growers Association Incorporated—Authorisation—A91347, granted 24 January 2013; Victorian Farmers Federation—Authorisation—A91534, granted 16 June 2016; South Australian Baiada Growers Group—Authorisation—AA1000403-1, granted 20 December 2017; Tasmanian Chicken Growers Association—Collective Bargaining Notification—CB00323; Western Australian Broiler Grower Association Incorporated—Revocation and Substitution—A91527, granted 31 May 2016.

**Figure 2.2: Production of meat chickens by region**

**Livestock - Poultry - meat chickens**  
No. of meat chickens per hectare



State	Number of agricultural businesses: meat chickens
New South Wales	150
Victoria	137
Queensland	98
Western Australia	68
South Australia	51
Tasmania	15

Source: Based on Australian Bureau of Statistics data.

### Access to buyers and consumers

Processing is dominated by two major companies, Baiada and Inghams, operating highly integrated supply chains that encompass breeding, feeding, slaughtering, and further processing.<sup>37</sup>

One submission stated that six processors control 90% of the national poultry meat market.<sup>38</sup> Processing is concentrated in South Australia, New South Wales and Victoria, and most farms are located within 100 kilometres of processing plants.<sup>39</sup>

As with most agricultural industries, chicken growers' options for supplying processors are likely to have regional boundaries. While this inquiry has not analysed competition at the regional level, one submission described the industry as a 'regional monopsony environment' where processors can contract multiple farmers to raise their chickens, but farmers may have only one processor to whom

<sup>37</sup> S Spencer, *From Farm to Retail—How Food Prices Are Determined in Australia*, Rural Industries Research and Development Corporation, 2016, p. 60 ('From Farm to Retail').

<sup>38</sup> NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, September 2020, p. 12.

<sup>39</sup> IBISWorld, *Industry Report C1112: Poultry Processing in Australia*, IBISWorld, 2020, 28; IBISWorld, *Industry Report A0171: Poultry Meat Farming in Australia*, IBISWorld, 2020, p. 23.

they can sell. The same submission stated that there are just two chicken meat processors who operate four regional plants in NSW.<sup>40</sup>

Chickens are transported directly from rearing farms to the processing plant. Here they are slaughtered and dressed, processed further, packaged and frozen or chilled. They are sold to distributors or direct to retailers and restaurants. Processing plants are very large, and increasingly automated. Grain storage and feed are a significant source of cost and risk for processors. Feed is made up of 85–90% grains, legumes and oilseeds, and consequently climate conditions like drought can affect processors' production costs significantly.<sup>41</sup> In recent years, rising feed prices, combined with low retail prices, have reduced processors' profits.<sup>42</sup>

Access to domestic market consumers is via major supermarkets, smaller and specialty retailers, and food services, particularly quick service restaurants. Supermarkets typically purchase chicken meat directly from processors.<sup>43</sup> Non-processor wholesalers also purchase and sell processed chicken meat products, generally to smaller or specialty retailers.

## 2.2.2 Beef

The ACCC analysed the industry through the cattle and beef market study. Our analysis and findings are contained in the 2017 and 2018 final and update reports.<sup>44</sup>

The key characteristics of the beef industry that are likely to impact on bargaining power are outlined in figure 2.3. The industry is characterised by large numbers of producers in any given region, selling to a relatively small number of processors, or direct to major supermarkets.

Major players operate at multiple supply chain stages. The export market is the dominant sales channel for processed cattle, and the major retailers purchase significant volumes of beef for domestic markets. Cattle must be slaughtered at a certain point in their life cycle to optimise quality and producer returns,<sup>45</sup> and fresh meat has a limited shelf life, making timely access to markets important.<sup>46</sup> These factors limit producers' and processors' options to withhold supply.

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40 NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, September 2020, pp. 12, 13.

41 Australian Chicken Meat Federation, [www.chicken.org.au/chicken-meat-production/](http://www.chicken.org.au/chicken-meat-production/), accessed 2 Oct 2020; [www.chicken.org.au/facts-and-figures/](http://www.chicken.org.au/facts-and-figures/), viewed 2 October 2020.

42 IBISWorld, *Industry Report C1112: Poultry Processing in Australia*, IBISWorld, 2020, p. 10; see also NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 13.

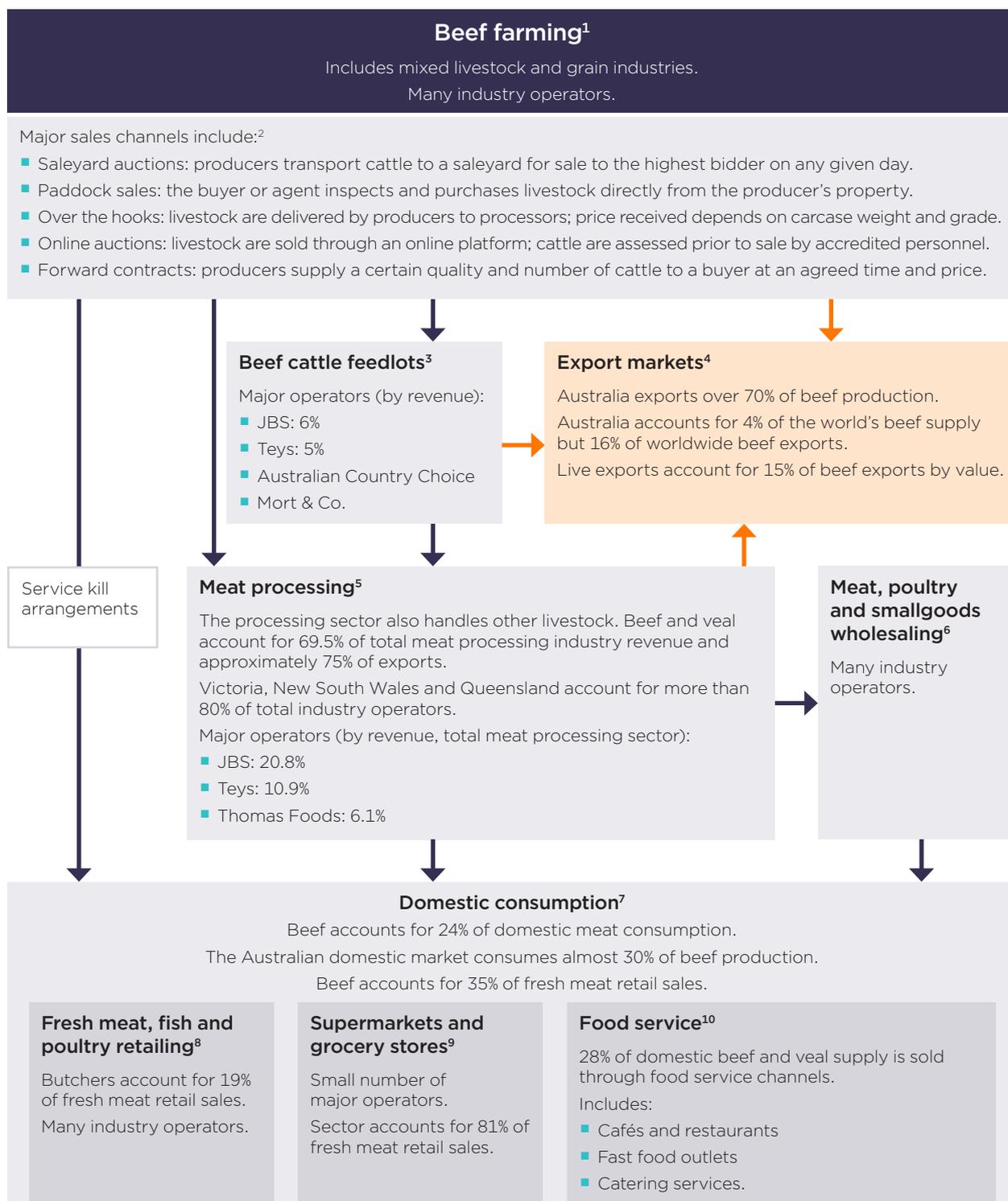
43 IBISWorld, *Industry Report A0171: Poultry Meat Farming in Australia*, IBISWorld, 2020, p. 22.

44 Australian Competition and Consumer Commission (ACCC), *Cattle and Beef Market Study—Final Report*, 2017; ACCC, *Cattle and Beef Market Study—Update Report*, 2018.

45 ACCC, *Cattle and Beef Market Study—Final Report*, 2017, p. 47.

46 S Spencer, *Price Determination in the Australian Food Industry—A Report*, Australian Government Department of Agriculture, Fisheries and Forestry, Canberra, 2004, p. 40 ('*Price Determination in the Australian Food Industry*').

**Figure 2.3: Beef cattle supply chain**



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

1 IBISWorld, Beef Cattle Farming in Australia, 2020; IBISWorld, Sheep-Beef Cattle Farming in Australia, 2020; IBISWorld, Grain-Sheep or Grain-Beef Cattle Farming in Australia, 2020

2 ACCC, Cattle and Beef Market Study - Final Report, 2017, pp. 26-27

3 IBISWorld, Beef Cattle Feedlots in Australia, 2020

4 MLA, Global Snapshot: Beef, 2020, p. 1, 7; ABARES, Agricultural commodity statistics 2019 (exc. live exports of breeding cattle)

5 IBISWorld, Meat Processing in Australia, 2020

6 IBISWorld, Meat Poultry and Smallgoods Wholesaling in Australia, 2020

7 MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 1

8 MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 3; IBISWorld, Fresh Meat Fish and Poultry Retailing in Australia, 2020

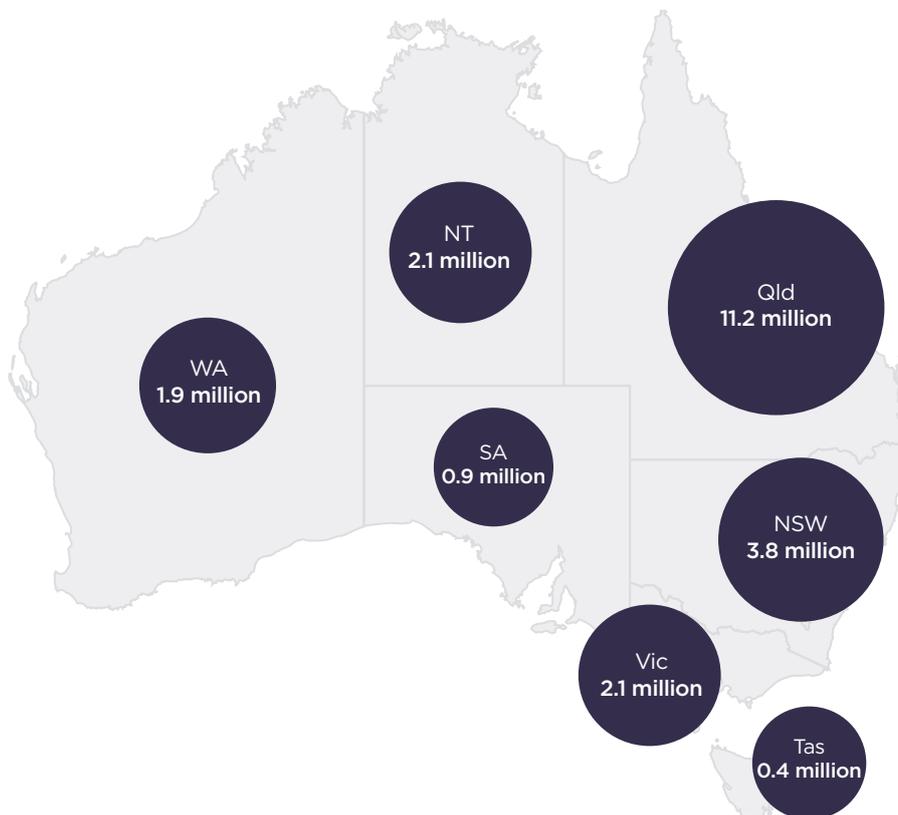
9 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 3

10 MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 2

## Farmgate

Cattle enterprises are typically non-employing family businesses.<sup>47</sup> Farm location has a significant bearing on the production system, size and end market. The industry can be broadly separated into two regions, northern (Queensland, the Northern Territory and the northern half of Western Australia) and southern, reflecting differences in climate, pasture, infrastructure and proximity to markets.<sup>48</sup> Most cattle and beef produced in the north is exported, whereas domestic consumers prefer the eating quality of southern beef breeds.<sup>49</sup>

**Figure 2.4: Australian cattle numbers by state**



Source: Based on Australian Bureau of Statistics data.

The majority of farms produce calves, which may be grown to slaughter weight (prime cattle), or sold to other farms or feedlots for fattening (store cattle). Cattle are predominantly raised on pasture, and seasonal variations in rainfall and temperature can cause significant volatility in the supply of cattle. Feedlots 'finish' cattle on grain until they reach slaughter weight, producing consistent quality and cut size. Feedlotting has increased significantly over the last two decades. Domestic demand is largely driven by the major supermarkets, which in 2015 sourced around 80% of their cattle from feedlots.<sup>50</sup> Feedlots are typically located in areas that have good access to cattle, grain, water and processing facilities, and are more common in northern Australia.<sup>51</sup>

47 IBISWorld, *Industry Report A0142: Beef Cattle Farming in Australia*, IBISWorld, 2020, p. 27; IBISWorld, *Industry Report A0144: Sheep-Beef Cattle Farming in Australia*, IBISWorld, 2020, p. 26; IBISWorld, *Industry Report A0145: Grain-Sheep or Grain-Beef Cattle Farming in Australia*, IBISWorld, 2020, p. 27.

48 T Gleeson, P Martin & C Mifsud, *Northern Australian beef industry, Assessment of risks and opportunities*, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra, 2012.

49 ACCC, *Cattle and Beef Market Study—Final Report*, 2017, p. 22.

50 *ibid.*, pp. 17, 21, 39.

51 IBISWorld, *Industry Report A0143: Beef Cattle Feedlots in Australia*, IBISWorld, 2020, p. 25; IBISWorld, *Industry Report A0142: Beef Cattle Farming in Australia*, IBISWorld, 2020, p. 22.

Many producers have the option of selling prime cattle to a range of buyers. There are several medium scale operators, and a range of smaller processors.<sup>52</sup>

Vertical integration is not a significant feature of the beef cattle industry, although some larger firms operate at multiple supply chain stages. JBS and Teys are partially integrated, with feedlot and processing facilities. Both rely on supply from cattle producers for a substantial volume of their throughput. Mid-tier processors and large cattle producers often have some degree of vertical integration.<sup>53</sup> Some processing businesses have their own vertically integrated wholesale arm, while other businesses act exclusively as wholesalers.<sup>54</sup>

### Access to buyers and consumers

Supermarkets are the primary sales channel for the supply of beef to Australian consumers at the retail level (81% of combined fresh meat retail sales).<sup>55</sup> Supermarkets purchase cattle from producers through contract arrangements, paddock sales and saleyards. The majority of cattle are acquired under contract with long-term suppliers. Cattle are slaughtered through service kill arrangements with beef processors, and the resulting carcasses and primal cuts are sent to boning rooms or direct to in-store butchers for further processing into shelf-ready cuts, ready meals and other value added products.<sup>56</sup>

Supermarket price promotions for popular cuts are a major influence on domestic prices.<sup>57</sup> However, domestic retail prices are not significantly influenced by export prices.<sup>58</sup> Quick service restaurants typically obtain supply under direct contracts with processors,<sup>59</sup> while speciality retailers are often more reliant on wholesalers.<sup>60</sup>

### 2.2.3 Sheep meat (lamb and mutton)

The key characteristics of the sheep meat industry that are likely to impact on bargaining power are outlined in figure 2.5. The industry is characterised by a large number of producers, selling into a processing industry comprising a small number of key players. Export markets are the primary destination for sheep meat, and the major supermarkets form the primary sales channel to domestic consumers.

Lamb is regarded as having superior eating quality compared to older sheep. Delays in selling may result in lambs being reclassified as mutton, leading to lower prices for the producer, rejection of stock or inability to find a buyer. Fresh sheep meat has a very limited shelf life once slaughtered at the processing level of the supply chain. These characteristics of the product influence bargaining power of producers and processors by limiting their ability to withhold supply.

Australia has some of the best market access globally, and export markets provide an important alternative to the domestic market, where growth is limited. Despite accounting for only 5% of global sheep meat production, Australia is the largest supplier to the global market.<sup>61</sup> Imports are negligible.

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52 ACCC, *Cattle and Beef Market Study—Final Report*, 2017, pp. 6-7.

53 *ibid.*, p. 19.

54 IBISWorld, *Industry Report F3602: Meat, Poultry and Smallgoods Wholesaling in Australia*, IBISWorld, 2020, p. 24.

55 Meat and Livestock Australia (MLA), *Market Snapshot: Beef and Sheepmeat*, 2020, p. 3.

56 ACCC, *Cattle and Beef Market Study—Final Report*, 2017, p. 36.

57 Spencer, *From Farm to Retail*, p. 47.

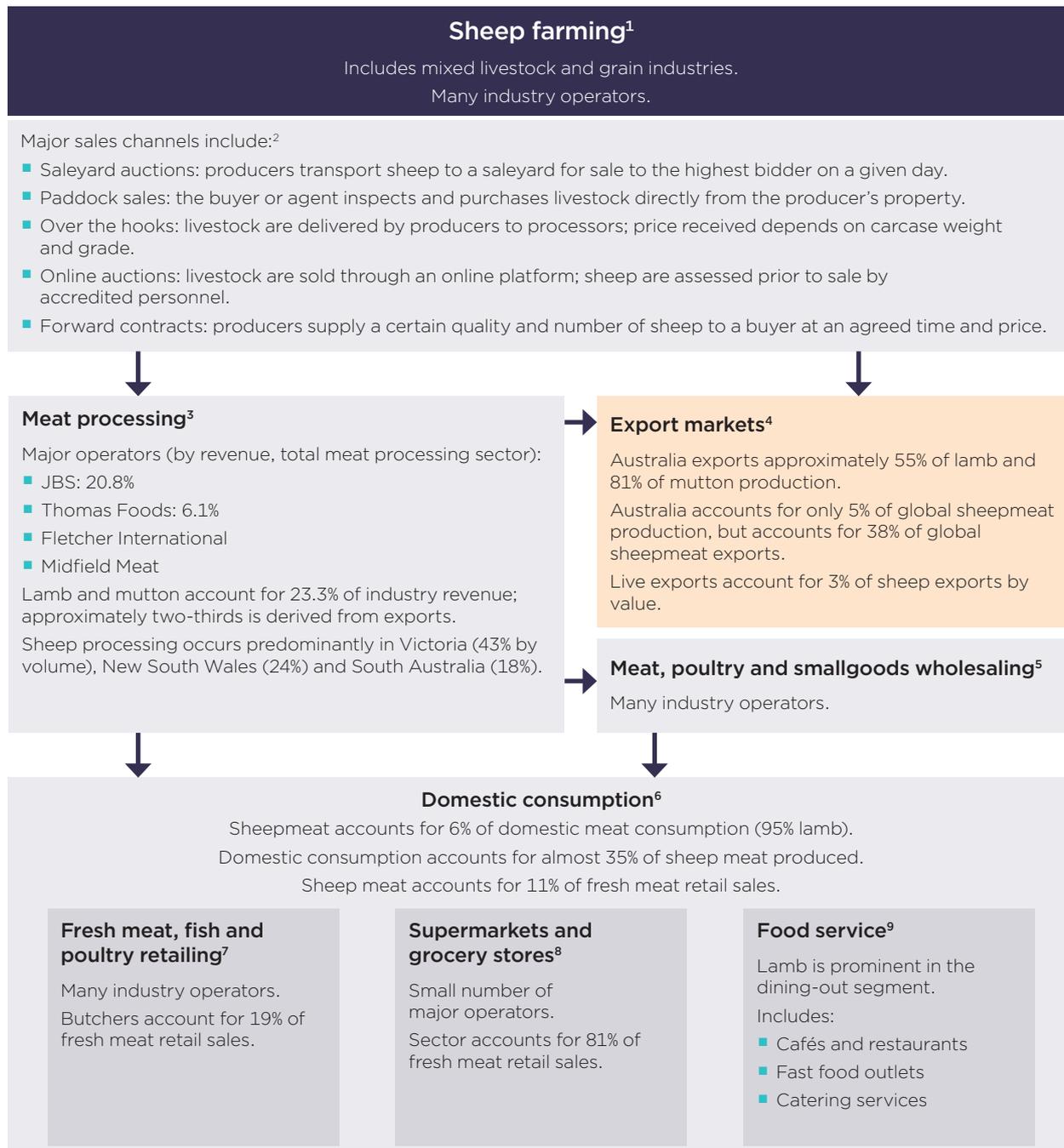
58 See e.g. Spencer, *From Farm to Retail*, pp. 47, 55.

59 *ibid.*, p. 45.

60 IBISWorld, *Industry Report F3602: Meat, Poultry and Smallgoods Wholesaling in Australia*, IBISWorld, 2020, p. 23.

61 MLA, *Global Snapshot: Sheepmeat*, 2020, pp. 1, 7.

**Figure 2.5: Sheep meat supply chain**



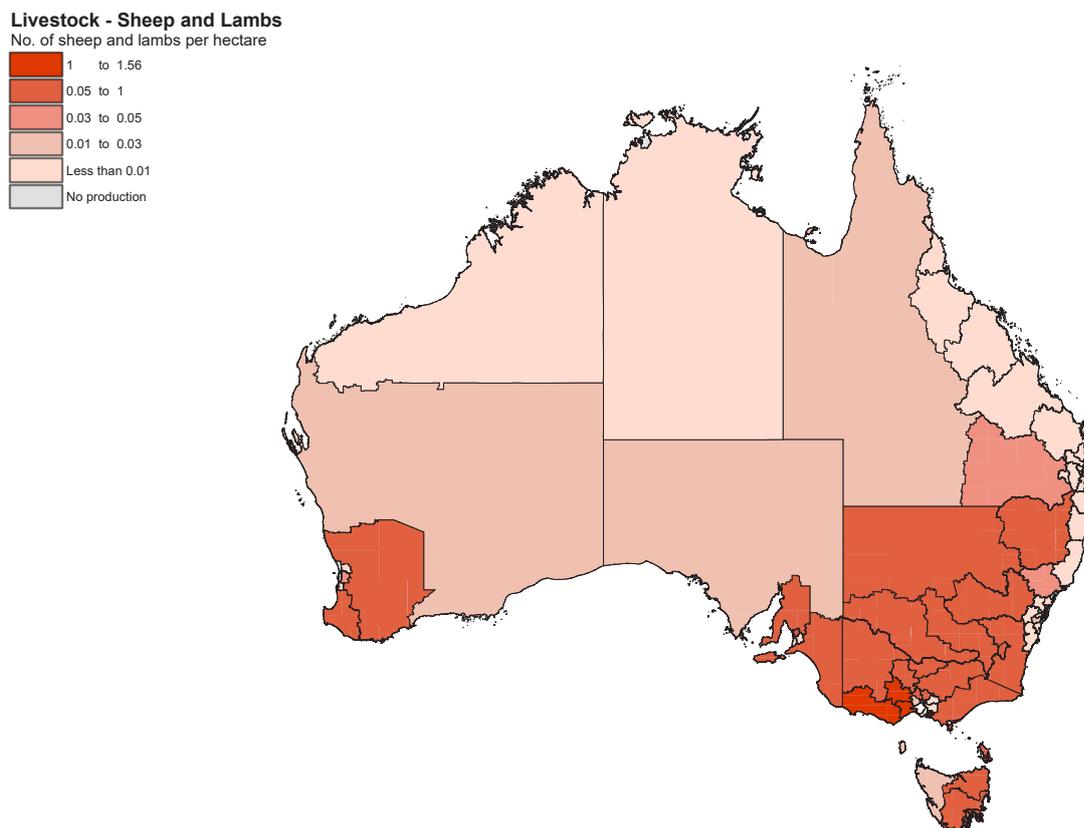
Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 IBISWorld, Sheep Farming in Australia, 2020; IBISWorld, Sheep-Beef Cattle Farming in Australia, 2020; IBISWorld, Grain-Sheep or Grain-Beef Cattle Farming in Australia, 2020
- 2 MLA, Sheepmeat Market Structures and Systems Investigation, 2017, pp. 32-38; DPIRD, Forward Supply Contracts for the WA Sheep Sector, 2018, p. 6-8
- 3 IBISWorld, Meat Processing in Australia, 2020; DEDJTR (VIC), Beef and Sheep: Invest in Victorian Agriculture and Food, August 2018, p. 2
- 4 ACCC calculation using production and export data from MLA statistics database, 2019-20; MLA, Global Snapshot: Sheepmeat, January 2020, pp. 1-2; ABARES, Agricultural commodity statistics 2019
- 5 IBISWorld, Meat Poultry and Smallgoods Wholesaling in Australia, 2020
- 6 MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 1
- 7 IBISWorld, Fresh Meat Fish and Poultry Retailing in Australia, 2020; MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 3
- 8 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 3
- 9 MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 4

## Farmgate

Australian sheep farming has shifted over time to an increased emphasis on meat, rather than wool, production. In 2018-19 the majority of sheep were raised to produce meat.<sup>62</sup> The industry includes specialist producers, and mixed farming enterprises producing sheep as well as grain and cattle. Proximity to markets, access to water, and the ability to grow quality pasture are important determinants of sheep farm location. Commercial production is heavily concentrated in Victoria, New South Wales and Western Australia (see figure 2.6).

**Figure 2.6: Sheep and lamb production by region**



State	Number of agricultural businesses: Sheep and Lambs
New South Wales	11,881
Victoria	8,217
South Australia	5,242
Western Australia	4,423
Queensland	1,345
Tasmania	991

Source: Based on Australian Bureau of Statistics data.

The primary production sector is highly fragmented. There are numerous large operators, however no single producer accounts for a significant portion of industry revenue. Most industry operators are small and medium-sized owner-operator/family businesses.<sup>63</sup> Profit margins are volatile from season to season, and prolonged harsh conditions or drought pose particular risks.<sup>64</sup> Producers in some regions may have a limited number of processors to which they can sell.<sup>65</sup>

<sup>62</sup> Based on Australian Bureau of Statistics data.

<sup>63</sup> IBISWorld, *Industry Report A0141: Sheep Farming in Australia*, IBISWorld, 2020, p. 27.

<sup>64</sup> *ibid*, p. 29.

<sup>65</sup> Sheep Producers Australia (SPA), *Submission: Perishable Agricultural Goods Inquiry*, 2020, p. 2.

## Access to buyers and consumers

Processors are typically located relatively close to production zones, to reduce time and costs of transporting live animals. Several major meat industry processors have multi-species sites that include sheep; while some operators have specialist sheep-processing facilities. Larger processors are generally vertically integrated to some extent, and some are also involved in farming and wholesaling operations.<sup>66</sup>

Most sheep destined for processing are sold directly to a processor or through the saleyard (or virtual auction) system where processors can compete for livestock in an open market.<sup>67</sup> Major retailers in the eastern states offer forward contracts direct to selected producers to ensure continuous supply of lambs to the required specifications. By contrast, major retailers in Western Australia tend to obtain supply directly from processors.<sup>68</sup> Processors may also use forward contracts to guarantee supply for specific domestic retail and food service markets.<sup>69</sup>

The majority of lamb sold through the food service channel goes to the 'dining out' segment (rather than, for example, quick service restaurants).<sup>70</sup> In contrast to beef, domestic retail prices are much more strongly linked to export prices.

### 2.2.4 Pork

The key characteristics of the pork industry that are likely to impact on bargaining power are outlined in figure 2.7. The industry is characterised by a small number of large players, many of which are vertically integrated, and together account for the majority of production. The remainder of the industry is made up of small scale farms.

Access to domestic customers is primarily through retail channels,<sup>71</sup> and only a small amount of pork is exported. There are stringent quarantine regulations in several potential markets.<sup>72</sup> Unlike other meats, domestic markets are strongly influenced by competition from imported processed pork (ham, bacon and manufactured meats).<sup>73</sup> All fresh pork consumed in Australia is domestically sourced.<sup>74</sup> Australia has strict biosecurity legislation relating to the import of pork.<sup>75</sup>

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66 IBISWorld, *Industry Report C1111: Meat Processing in Australia*, IBISWorld, 2020, pp. 26–27, 34–38.

67 Sheep Producers Australia (SPA), *Submission: Perishable Agricultural Goods Inquiry*, 2020, p. 1.

68 Department of Primary Industries and Regional Development (DPIRD), *Forward Supply Contracts for the WA Sheep Sector*, 2018, p. 6.

69 *ibid*, p. iii.

70 Meat and Livestock Australia (MLA), *Market Snapshot: Beef and Sheepmeat*, 2020, p. 4.

71 Australian Pork Limited (APL), *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 4.

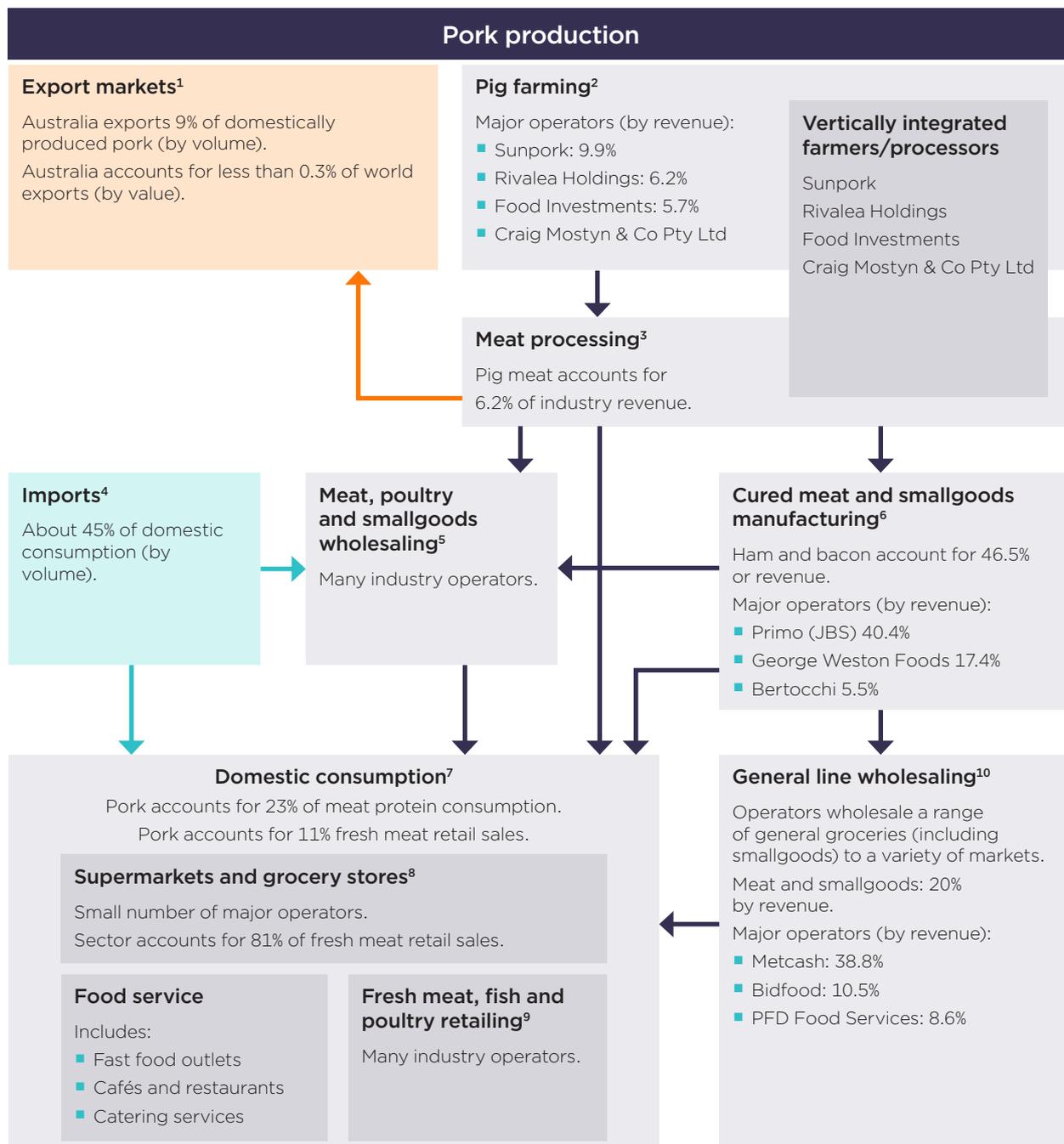
72 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 30.

73 Spencer, *From Farm to Retail*, p. 56.

74 Australian Pork Limited (APL), *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 3; IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 14.

75 Australian Pork Limited (APL), *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 3; IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 14.

Figure 2.7: Pork supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 APL, Import, Export and Domestic Production Report, June 2020, p. 1; Australian Intercollegiate Meat Judging Association, Increasing the Value of Australian Pork within the Global Market, 2016, <https://icmj.com.au/2017/05/09/increasing-the-value-of-australian-pork-within-the-global-market/>
- 2 IBISWorld, Pig Farming in Australia, 2020
- 3 IBISWorld, Meat Processing in Australia, 2020
- 4 APL, Import, Export and Domestic Production Report, June 2020, p. 1
- 5 IBISWorld, Meat Poultry and Smallgoods Wholesaling in Australia, 2020
- 6 IBISWorld, Cured Meat and Smallgoods Manufacturing in Australia, 2019
- 7 Market Snapshot: Beef and Sheepmeat, September 2020, p. 1
- 8 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; MLA, Market Snapshot: Beef and Sheepmeat, September 2020, p. 3
- 9 IBISWorld, Fresh Meat Fish and Poultry Retailing in Australia, 2020
- 10 IBISWorld, General Line Grocery Wholesaling in Australia, 2020

Pigs breed throughout the year, grow quickly, and are typically sold for slaughter five to six months after weaning.<sup>76</sup> This gives farmers some flexibility in responding to changing market conditions, although once production decisions have been made, supply becomes relatively inelastic. Fresh pork is highly perishable, making timely access to markets important.

## Farmgate

A small number of large companies account for the majority of pig production.<sup>77</sup> The largest of these businesses are vertically integrated through production and processing, and in some cases extended further upstream. For example, Rivalea Holdings' interests include stockfeed, operating three feedmills for both their own use, and commercial sales.<sup>78</sup> The remainder of the industry is made up of small scale farms. One submission stated that around 4,000 smaller producers service niche or local markets, and may have only one or two customers.<sup>79</sup>

The large, vertically integrated businesses are relatively commercially sophisticated and appear to be able to negotiate contracts with major downstream operators<sup>80</sup>, often on a long term basis and containing mechanisms for price fluctuations based on known input cost fluctuations.<sup>81</sup> By contrast, some submissions raised concerns about the ability of smaller producers to negotiate contracts with buyers.<sup>82</sup>

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76 APL, [aussiepigfarmers.com.au/pigs/our-animals/reproduction/](https://aussiepigfarmers.com.au/pigs/our-animals/reproduction/), viewed 24 November 2020.

77 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 26; NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 16.

78 B Carter, 'QAF out to bring home the bacon', *The Australian*, 20 September 2020.

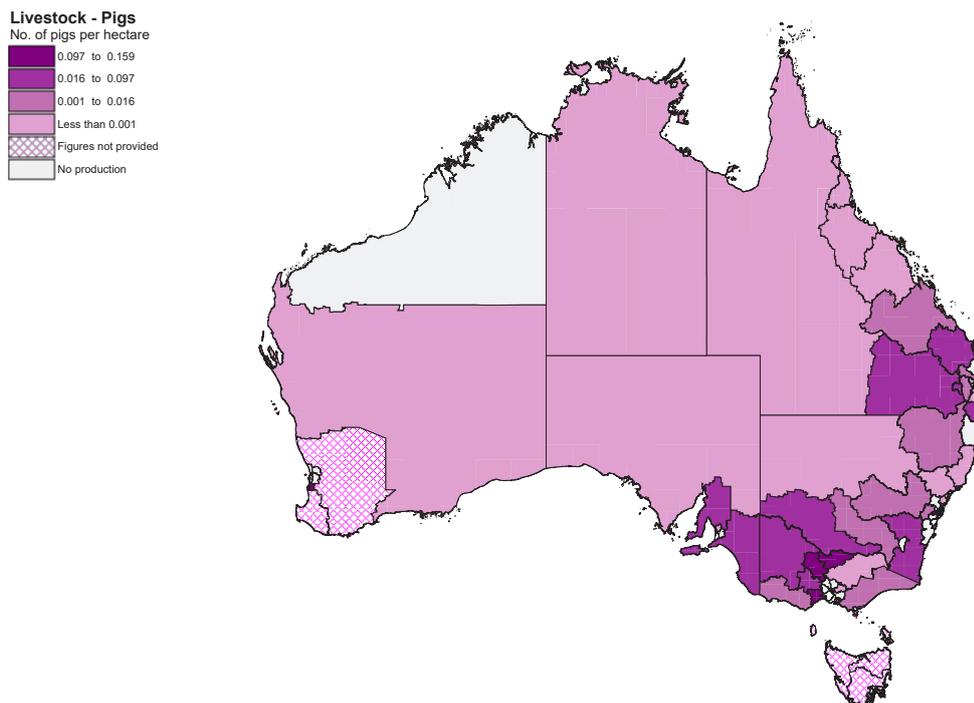
79 APL, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 5.

80 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 18.

81 APL, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 4.

82 APL, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 3; NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 16.

**Figure 2.8: Pig production by region**



State	Number of agricultural businesses: pigs
New South Wales	286
Queensland	178
Victoria	168
South Australia	134
Western Australia	65
Tasmania	25

Source: Based on Australian Bureau of Statistics data.

Modern pig production is highly technical and specialised. Oversupply of pigs, and high feed costs (estimated to account for 60% of the cost of production<sup>83</sup>) as a result of drought have caused revenue volatility and fluctuating domestic pig meat prices in recent years.<sup>84</sup>

### Access to buyers and consumers

While a small number of large businesses account for the majority of pork processing at the national level<sup>85</sup>, processing at the regional level is the more important determinant of the competition an individual, non-vertically integrated producer can expect for their product.

Key purchasers for pigs include fresh meat processors, and bacon, ham and smallgoods manufacturers (see figure 2.7). Most purchases are direct transactions between producers and buyers, without an auction system, and approximately 2% of pigs are sold through physical saleyards or online (typically by smaller producers).<sup>86</sup>

While the majority of pig production goes to the production of pork, around a third is processed into bacon, ham and smallgoods.<sup>87</sup> The majority of production occurs within a vertically integrated supply

83 Spencer, *From Farm to Retail*, p. 56.

84 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 10

85 *ibid.*, p. 26.

86 APL, *AuctionsPlus: Online Saleyard Pilot Report*, 2019, pp. 3, 6.

87 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, p. 20; Australian Pork Limited, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 4.

chain. Large vertically integrated production and processing businesses sometimes offer processing services for external parties.<sup>88</sup>

Around half of retail volumes, approximately 25 to 30% of pork production, are purchased by large retailers directly from producers or from processors.<sup>89</sup> Australian Pork Ltd (APL) stated that contracts with the larger supermarkets have more stringent requirements to ensure consistency for consumers, and smooth out price volatility. APL also submitted that commercially sophisticated operators have successfully negotiated contracts which share risk between parties and promote price stability and transparency.<sup>90</sup>

Large and small supermarkets may also contract processors or wholesalers for specific cuts and volumes at certain prices, accounting for another 25 to 30% of pork production.<sup>91</sup> These agreements are typically for an agreed specification, cut and time period (weekly, monthly or quarterly). Smaller retailers, who tend to service local or niche markets, and foodservice channels generally buy from a wholesaler, who in turn may source from smaller producers. This accounts for around 10 to 15% of pork produced.<sup>92</sup> This sector is characterised by fewer long-term agreements and increased vulnerability to changes in the market.<sup>93</sup>

### 2.2.5 Fish and shellfish

The key characteristics of the fish and shellfish industry that are likely to impact on bargaining power are outlined in figure 2.9. Fish and seafood are highly perishable, although they can be held in cold storage for extended periods or frozen. Handling methods and temperature must be tightly controlled at each point along the supply chain to avoid spoilage.<sup>94</sup> At any point along the supply chain, the party holding fresh fish and seafood is under pressure to find a buyer before the product deteriorates. Fish and seafood are products of the aquaculture and wild-catch industries.

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88 IBISWorld, *Industry Report A0192: Pig Farming in Australia*, IBISWorld, 2020, pp. 32–35.

89 APL, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 4.

90 *ibid.*

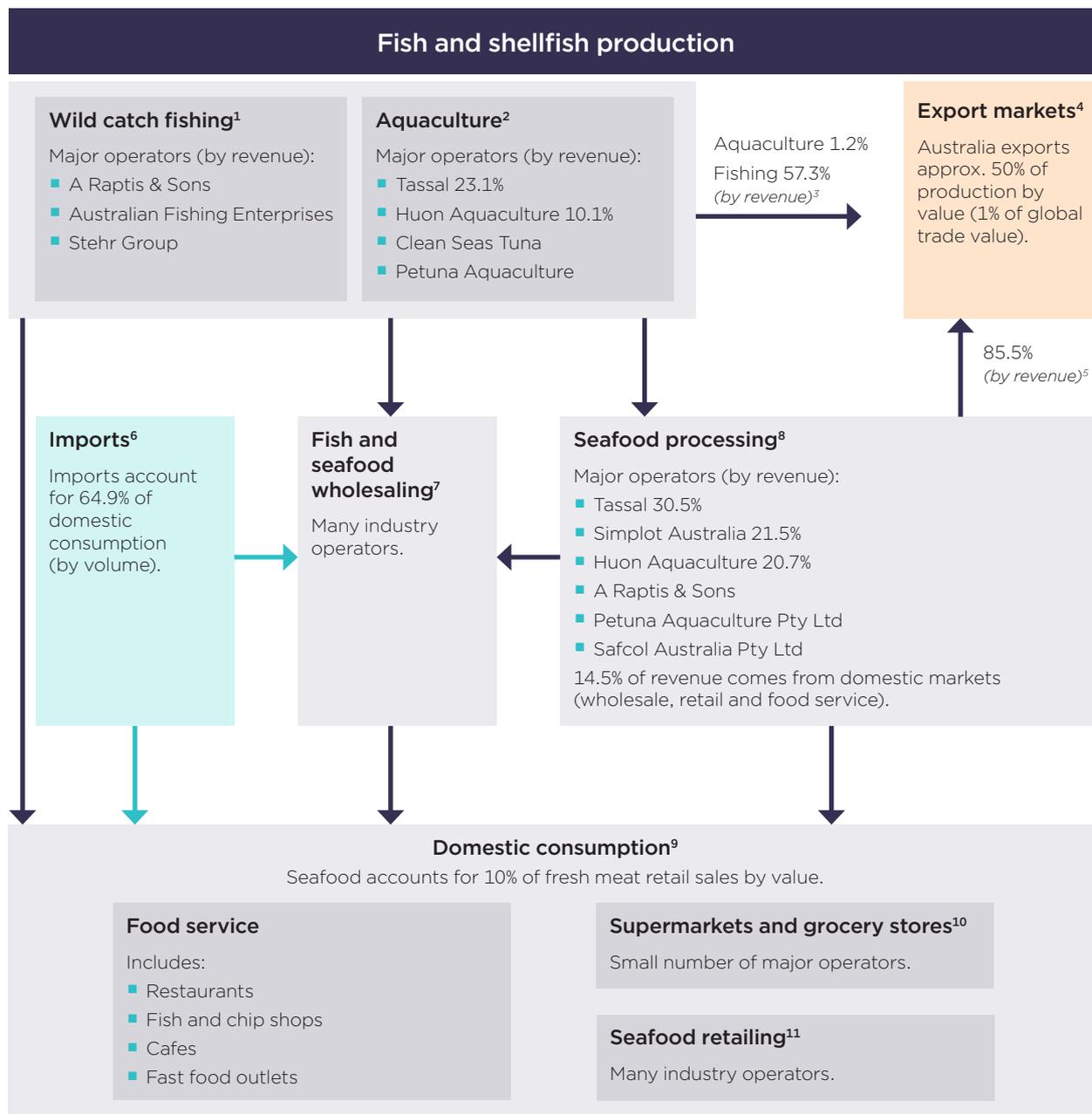
91 *ibid.*, p. 5.

92 *ibid.*

93 APL, *Submission: ACCC Inquiry into Perishable Agricultural Goods*, 2020, p. 5; S Spencer & M Kneebone, *FOODmap: An Analysis of the Australian Food supply Chain*, Department of Agriculture, Fisheries and Forestry, Canberra, 2012, p. 49.

94 A A Gonçalves and F Blaha, 'Cold Chain in Seafood Industry' in *Refrigeration: Theory, Technology and Applications* (1st Edition), Nova Science Publishers, 2011, pp. 287–88.

Figure 2.9: Fish and shellfish supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 IBISWorld, Fishing in Australia, 2019
- 2 IBISWorld, Aquaculture in Australia, 2019
- 3 IBISWorld, Aquaculture in Australia, 2019; IBISWorld, Fishing in Australia, 2019
- 4 ABARES, Fisheries and aquaculture statistics 2018
- 5 IBISWorld, Seafood Processing in Australia, 2020
- 6 ABARES, Australia's Consumption of Seafood, 2017-18
- 7 IBISWorld, Industry Report F3604: Fish and Seafood Wholesaling in Australia, 2020
- 8 ABARES, Australia's Consumption of Seafood, 2017-18
- 9 MLA, Market Snapshot: Beef and Sheepmeat, 2020
- 10 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020
- 11 IBISWorld, Seafood Retailing in Australia, 2019

## Aquaculture

Aquaculture is the cultivation of seafood under controlled conditions. At the production level, the Australian industry consists of two large, publicly listed companies with significant market share, vertically integrated through hatchery, aquaculture, and processing. Outside of this, it is highly fragmented.<sup>95</sup>

Production is often land-based (using ponds and tank systems) with a fish growth schedule of 12–24 months. Harvest and volume planning are possible under these systems, and the industry has relatively more capacity than wild-catch to manage supply to meet changing demand.<sup>96</sup> Production is dominated by salmon and trout (Tasmania), tuna and oysters (SA), and prawns (Queensland and NSW).<sup>97</sup>

While exports are increasing, they account for a small share of industry revenue, as overseas buyers view wild-caught product as being of superior quality, and therefore prefer it. While imports are low, the availability of product from countries with lower production costs puts pressure on domestic firms.<sup>98</sup>

Downstream buyers include processors and retailers. A significant proportion of product requires processing to some extent before being ready for consumers, and for non-vertically integrated producers, processors are aquaculture's primary customers. Unprocessed fish and seafood is also purchased and on sold by wholesalers to downstream markets like retail and food-service.<sup>99</sup> One submission observed that the NSW oyster industry had benefitted significantly from many growers joining seafood 'marketing' companies, which have greater collective bargaining power and have been able to secure higher prices from processor and wholesalers, to the benefit of growers.<sup>100</sup>

While independent specialist fishmongers have tended to dominate the retail category, increasing volumes appear to be sold through major supermarket chains, supported by shifting their business model to purchase directly from processors or producers.<sup>101</sup> According to Seafood Industry Australia, some producers will accept a lower margin to secure high-volume supermarket contracts, and offset this by pursuing higher margins through food service, independent retailers and the export market.<sup>102</sup>

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95 IBISWorld, *Industry Report A0200: Aquaculture in Australia*, IBISWorld, 2019, pp. 33, 35–37.

96 Seafood Industry Australia (SIA), *Australian Competition and Consumer Commission Perishable Agricultural Goods Inquiry Submission*, 2020, pp. 4, 6.

97 IBISWorld, *Industry Report A0200: Aquaculture in Australia*, IBISWorld, 2019, pp. 19–20.

98 *ibid.*, pp. 9, 23, 24.

99 *ibid.*, pp. 10, 22.

100 NSW Farmers' Association, *ACCC Perishable Agricultural Goods Inquiry Submission*, 2020, p. 18.

101 IBISWorld, *Industry Report A0200: Aquaculture in Australia*, IBISWorld, 2019, 22; Spencer, *From Farm to Retail*, p. 75; IBISWorld, *Industry Report OD5490: Seafood Retailing in Australia*, IBISWorld, 2019, p. 28.

102 SIA, *Australian Competition and Consumer Commission Perishable Agricultural Goods Inquiry Submission*, 2020, p. 3.

## Wild-catch

The wild-catch industry is fragmented at the producer level although there are several large operators that focus on fishing particular types of fish or areas. Larger businesses may, in addition to fishing, be involved in processing, wholesaling, importing, or aquaculture.<sup>103</sup>

Australia exports 'high-value' product and imports low-cost chilled and frozen product.<sup>104</sup> Most export revenue comes from relatively few products grown in particular locations, such as Tasmanian abalone, WA rock lobsters, and Queensland prawns.<sup>105</sup>

Producers may sell their catch to processors, wholesalers, retailers or for export. Most products require processing (including filleting, freezing, packing, canning, smoking, cooking, battering, crumbing) before being sold to consumers, and processing companies are producer's largest, though declining, domestic market. Export demand for unprocessed wild-caught product, and competition from imports has reduced the proportion of domestic raw product purchased by processors.<sup>106</sup>

Wholesalers often purchase directly from fishers or cooperatives, and sell a variety of fish and seafood in various fresh or processed forms to domestic and international retail markets, including the food service industry. Fishing operators increasingly sell directly into export markets or to retailers.<sup>107</sup>

As with aquaculture, it appears that increasing volumes of wild-catch fish are sold through major supermarket chains.<sup>108</sup>

### 2.2.6 Eggs

The key characteristics of the egg industry that are likely to impact on bargaining power are outlined in figure 2.10. The industry includes free range, barn and cage eggs. A distinction between the 'farmgate' and processing is less applicable for eggs than for some other industries, as complex processing is not necessary. The industry instead consists of production, wholesaling, and retailing.

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103 IBISWorld, *Industry Report A0410: Fishing in Australia*, IBISWorld 2019, p. 35.

104 Spencer, *From Farm to Retail*, p. 75.

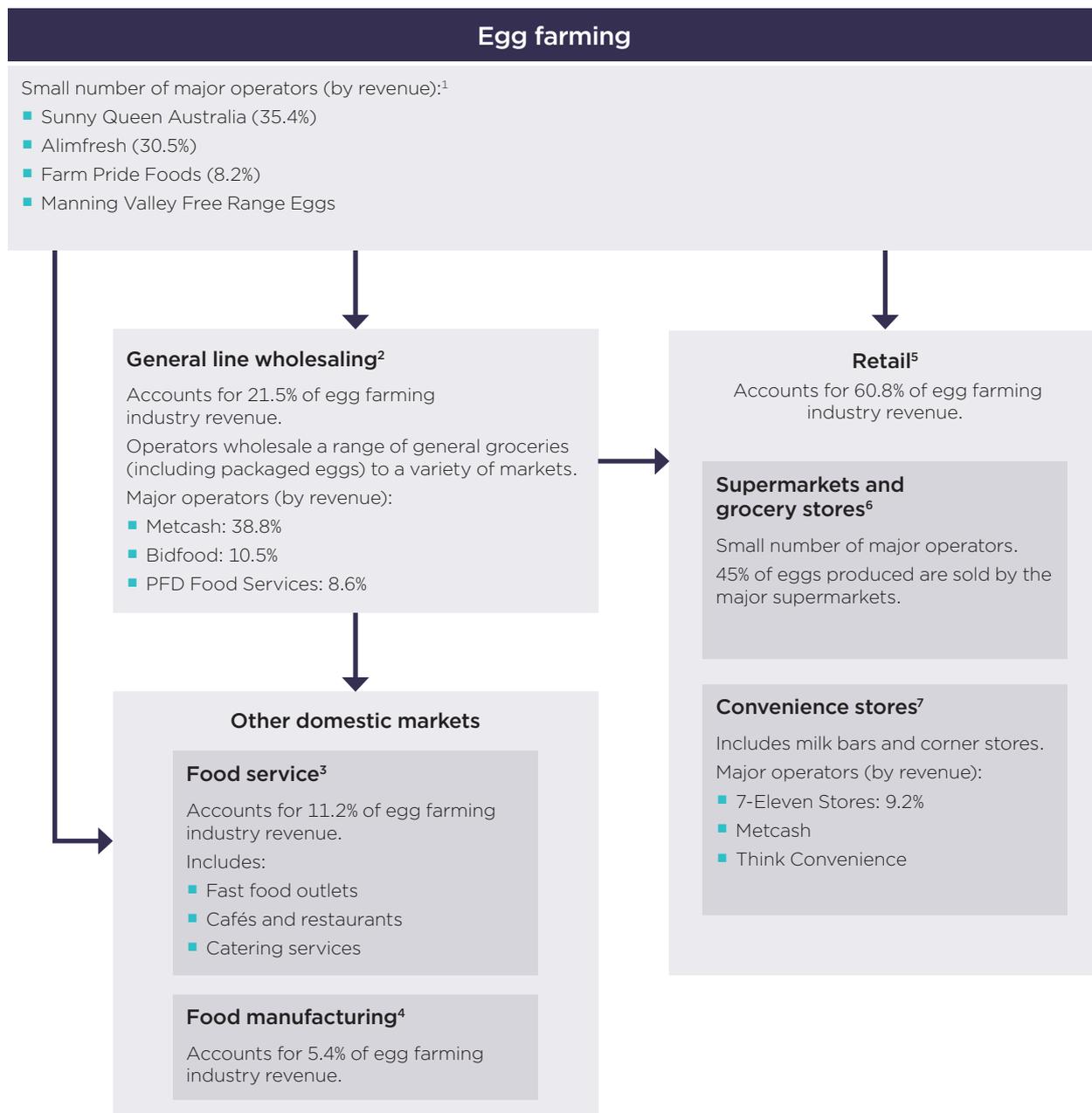
105 IBISWorld, *Industry Report A0410: Fishing in Australia*, IBISWorld, 2019, pp. 19, 21.

106 *ibid*, pp. 11-12, 22-23.

107 IBISWorld, *Industry Report A0410: Fishing in Australia*, IBISWorld, 2019, p.23; IBISWorld, *Industry Report C1120: Fish and Seafood Wholesaling in Australia*, IBISWorld, 2020, p. 18.

108 IBISWorld, *Industry Report A0410: Fishing in Australia*, IBISWorld, 2019, p. 22.

Figures 2.10: Egg supply chain



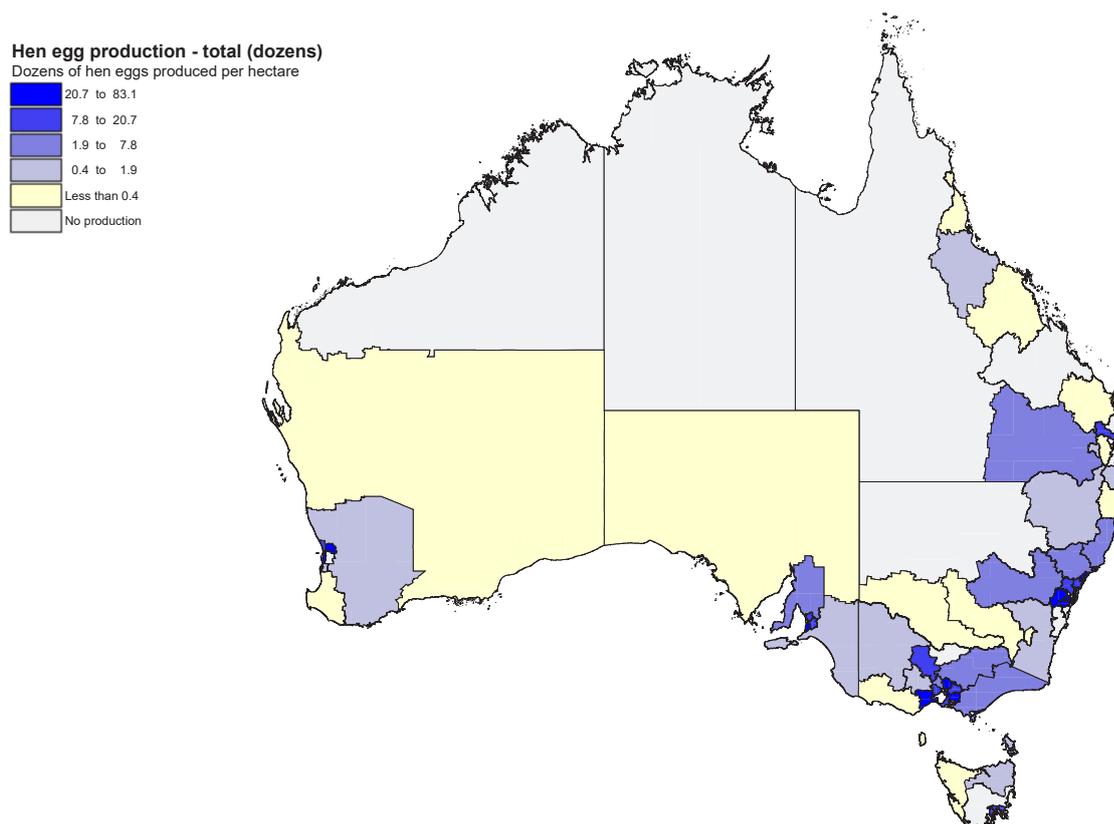
Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 IBISWorld, Egg Farming in Australia, 2020
- 2 IBISWorld, Egg Farming in Australia, 2020; IBISWorld, General Line Grocery Wholesaling in Australia, 2020
- 3 IBISWorld, Egg Farming in Australia, 2020
- 4 IBISWorld, Egg Farming in Australia, 2020
- 5 IBISWorld, Egg Farming in Australia, 2020
- 6 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; Australian Eggs, Australian Egg Industry Overview, 2020, <https://www.australianeggs.org.au/egg-industry/>
- 7 IBISWorld, Convenience Stores in Australia, 2020

## Production

Three large, vertically integrated firms operate across the entire east coast of Australia, producing, grading, and packing eggs for direct sale to the major supermarkets, quick service restaurants, and smaller retailers. These large players often source eggs from smaller producers to on-sell at a wholesale level, and in some cases have a financial interest in smaller producers.<sup>109</sup> Rising consumer demand for organic, free-range and locally grown eggs has allowed some scope for smaller, independently owned companies to gain market share in recent years.<sup>110</sup> International trade in this industry is negligible, given the perishable nature of eggs, freight costs and disease risks.<sup>111</sup>

**Figure 2.11: Egg production by region**



State	Number of agricultural businesses: Hen egg production
New South Wales	155
Queensland	96
Victoria	68
South Australia	65
Western Australia	56
Tasmania	31

Source: Based on Australian Bureau of Statistics data.

<sup>109</sup> IBISWorld, *Industry Report A0172: Egg Farming in Australia*, IBISWorld, 2020, p. 27.

<sup>110</sup> *ibid.*

<sup>111</sup> *ibid.*, p. 22.

Eggs are highly perishable and require careful handling to avoid spoiling and breakage. Operators need to be located close to key markets to minimise the amount of time eggs spend in transport and storage. Only around 5% of industry revenue comes from food manufacturing, where eggs are processed into less perishable products including egg powder, pasteurised egg white mix, mayonnaise and aioli.<sup>112</sup>

Production has become more capital intensive over time, reducing participants' ability to respond quickly to market signals.<sup>113</sup> Traditionally, producers have needed to be located close to population centres, although advances in transport and packaging have made this less important.<sup>114</sup>

### **Access to buyers and consumers**

Fresh eggs are a staple product which do not have any close substitutes, unlike meat proteins, which often compete with one another for market share. Retailers are the most significant channel for reaching domestic consumers, and the largest purchaser of eggs from producers.<sup>115</sup> Nearly half of all eggs produced are supplied to supermarkets,<sup>116</sup> and the large producers have supply contracts with the major retailers.<sup>117</sup> Sales to the major supermarkets are usually made through 12-month contracts on a tender basis. Contracts for private-label products are awarded on a regional basis.<sup>118</sup>

While many retailers and convenience stores bypass wholesalers<sup>119</sup>, they are the industry's second largest market, linking producers with downstream markets like specialty and independent grocers, and foodservice.

## **2.2.7 Horticultural produce**

The key characteristics of the horticulture industry that are likely to impact on bargaining power are outlined in figure 2.12. The industry is diverse across product groups, the scale of farm enterprises, and the extent of integration through the supply chain. While there may be some exceptions, in general the industry is characterised by a large number of farmgate producers in a given region for a given product. By contrast, there are typically fewer processors, wholesalers or other intermediaries in that region. The major supermarkets generally account for a majority of supply to consumers, as well as some smaller retailers. Where imports and exports are possible, international demand and supply conditions affect the prices Australian farmers receive.

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112 *ibid*, p. 23.

113 *ibid*, p. 40.

114 *ibid*, p. 26

115 *ibid*, p. 22.

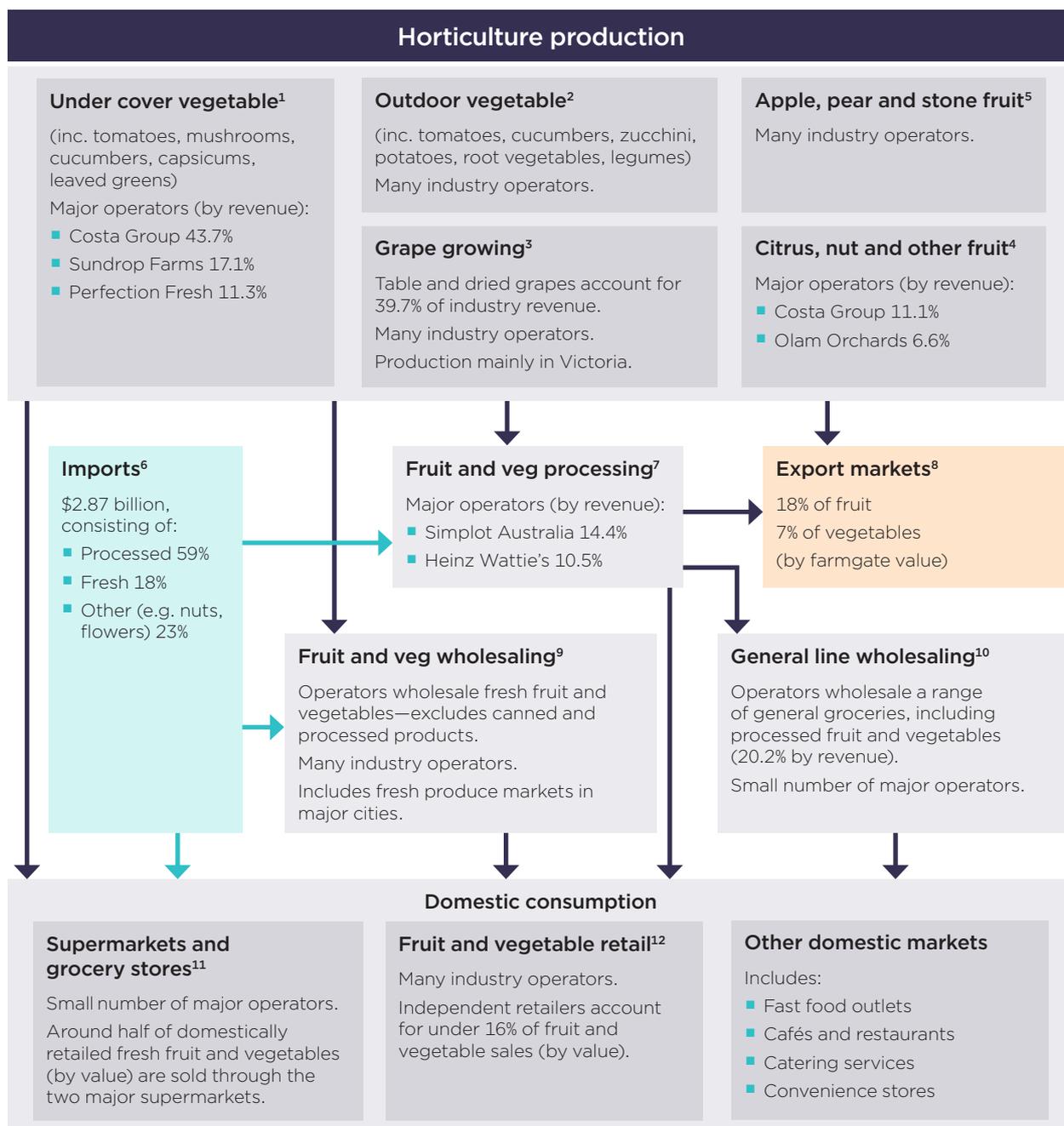
116 Australian Eggs, *Australian Egg Industry Overview*, 2020, [www.australianeggs.org.au/egg-industry/](http://www.australianeggs.org.au/egg-industry/), viewed 16 November 2020.

117 IBISWorld, *Industry Report A0172: Egg Farming in Australia*, IBISWorld, 2020, p. 31.

118 *ibid*, p. 22.

119 *ibid*.

Figure 2.12: Horticultural produce supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 IBISWorld, Under Cover Vegetable Growing in Australia, 2020
- 2 IBISWorld, Outdoor Vegetable Growing in Australia, 2020
- 3 IBISWorld, Grape Growing in Australia, 2020
- 4 IBISWorld, Citrus Fruit, Nut and Other Fruit Growing in Australia, 2020
- 5 IBISWorld, Apple, Pear and Stone Fruit Growing in Australia, 2020
- 6 Hort Innovation, Australian Horticulture Statistics Handbook 2018-19: Fruit, 2020, p. 24
- 7 IBISWorld, Fruit and Vegetable Processing in Australia, 2020
- 8 Spencer, From Farm to Retail, 2016, p. 23
- 9 IBISWorld, Fruit and Vegetable Wholesaling in Australia, 2020
- 10 IBISWorld, General Line Grocery Wholesaling in Australia, 2020
- 11 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; Roy Morgan, 'Coles and Woolworths continue to gain share in fresh fruit and vegetable market', 2018, <http://www.roymorgan.com/findings/7597-coles-and-woolworths-continue-to-gain-share-in-fresh-fruit-and-vegetable-market-201805220618>
- 12 IBISWorld, Fruit and Vegetable Retailing in Australia, 2020; Roy Morgan, 'Coles and Woolworths continue to gain share in fresh fruit and vegetable market', 2018

Production of fruit and vegetables is volatile and seasonal, resulting in large fluctuations in volumes coming to market, and wholesale and retail prices.<sup>120</sup> Perishability varies between product groups, and the industry includes semi-perishable goods, such as potatoes, apples and oranges, through to products such as berries and leafed vegetables, which must be stored under specific conditions shortly after harvesting. Perishability necessitates timely access to market, and for optimal shelf life produce may require storage and transport under controlled temperature, humidity, or atmosphere.<sup>121</sup> Where produce is rejected by the purchaser, producers may struggle to find another buyer before their produce deteriorates. By contrast, processed fruit and vegetables are less perishable, providing the possibility of carrying inventory.

Producers and processors face competition from fresh and processed imports. However, fresh fruit and vegetables are more typically imported to accommodate counter-seasonal demand, and quarantine regulations limit producers' exposure to import competition from fresh produce.<sup>122</sup> The majority of revenue in the processed produce sector is derived from exports, and exports of fresh produce are dominated by less perishable fruits, like citrus. There is a smaller export market for stone fruit, and grape exports have increased dramatically in recent years.<sup>123</sup>

## Farmgate

Horticulture production includes several industries as outlined in figure 2.12. Producer location is dictated by a combination of climatic suitability, proximity to population centres and other markets, and the number of established orchards or plantings. Improved transport and storage technology have enabled production of some produce to move to more remote areas. The long distances that horticultural products are often transported are reflected in transport costs amounting to approximately 21% of the gross value of farm production.<sup>124</sup>

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120 Spencer, *Price Determination in the Australian Food Industry*, p. 55.

121 A McKerrow, *Supply Chain Analysis St George to Inglewood: Horticultural infrastructure and product flows*, University of Southern Queensland, 2016, [www.publications.qld.gov.au/dataset/high-value-horticulture-value-chains-for-the-queensland-murray-darling-basin-activity-4/resource/dc37a055-2130-4b7b-9461-9ed088252c8e](http://www.publications.qld.gov.au/dataset/high-value-horticulture-value-chains-for-the-queensland-murray-darling-basin-activity-4/resource/dc37a055-2130-4b7b-9461-9ed088252c8e), pp. 7-8; see also Department of Primary Industries and Regional Development, *Storage of Fresh Fruit and Vegetables*, Government of Western Australia, [www.agric.wa.gov.au/fruit/storage-fresh-fruit-and-vegetables?nopaging=1](http://www.agric.wa.gov.au/fruit/storage-fresh-fruit-and-vegetables?nopaging=1), viewed 12 November 2020.

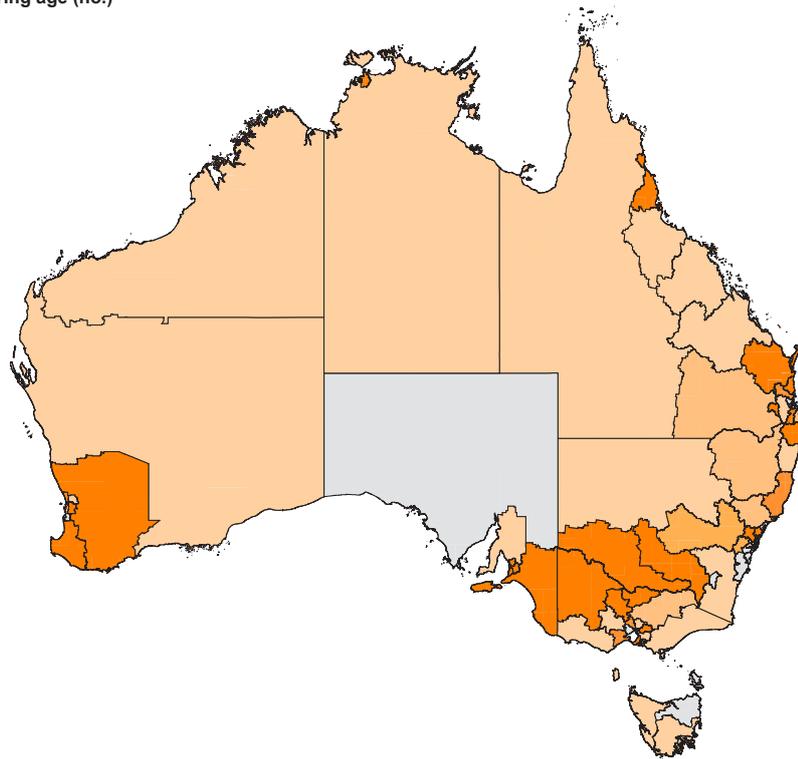
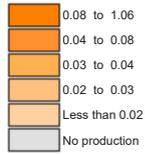
122 See e.g. IBISWorld, *Industry Report A0139: Citrus Fruit, Nut and Other Fruit Growing in Australia*, IBISWorld, 2020, pp. 14-15; IBISWorld, *Industry Report A0130: Apple, Pear and Stone Fruit Growing in Australia*, IBISWorld, 2020, pp. 25-26.

123 See e.g. IBISWorld, *Industry Report C1140: Fruit and Vegetable Processing in Australia*, IBISWorld, 2020, pp. 25-26; IBISWorld, *Industry Report A0139: Citrus Fruit, Nut and Other Fruit Growing in Australia*, IBISWorld, 2020, pp. 26-27; IBISWorld, *Industry Report A0130: Apple, Pear and Stone Fruit Growing in Australia*, IBISWorld, 2020, p. 24.; IBISWorld, *Industry Report A0131: Grape Growing in Australia*, IBISWorld, 2020, p. 13.

124 IBISWorld, *Industry Report A0139: Citrus Fruit, Nut and Other Fruit Growing in Australia*, IBISWorld, 2020, p. 28; IBISWorld, *Industry Report A0123: Outdoor Vegetable Growing in Australia*, IBISWorld, 2020, p. 28. IBISWorld, *Industry Report A0130: Apple, Pear and Stone Fruit Growing in Australia*, IBISWorld, 2020, p. 27; IBISWorld, *Industry Report A0122: Under Cover Vegetable Growing in Australia*, IBISWorld, 2020, p. 25; IBISWorld, *Industry Report A0131: Grape Growing in Australia*, IBISWorld, 2020, p. 26; Deloitte Access Economics, *The Impact of Freight Costs on Australian Farms*, AgriFutures Australia, 2019, pp. 17, 33.

**Figure 2.13: Citrus and orchard fruit trees by region**

**Fruit - Citrus and orchard fruit trees of bearing age (no.)**  
 Fruit trees as proportion of region



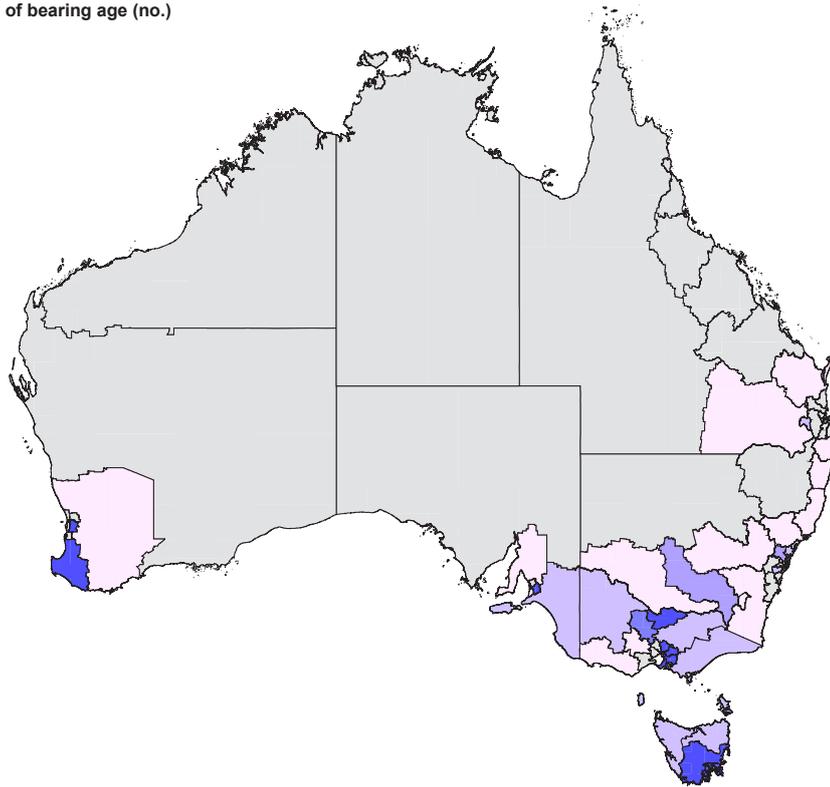
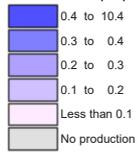
State	Number of agricultural businesses: citrus & other orchard fruit
Queensland	1013
New South Wales	913
South Australia	613
Western Australia	606
Victoria	346
Northern Territory	114
Tasmania	14

Note: Map shows the number of citrus and orchard fruit trees of bearing age per hectare.

Source: Based on Australian Bureau of Statistics data.

**Figure 2.14: Stone fruit & pome fruit trees by region**

**Fruit - Stone fruit & pome fruit - trees of bearing age (no.)**  
 Fruit trees as proportion of region



State	Number of agricultural businesses: stonefruit & pome fruit
Victoria	968
Western Australia	577
New South Wales	377
South Australia	371
Tasmania	148
Queensland	143

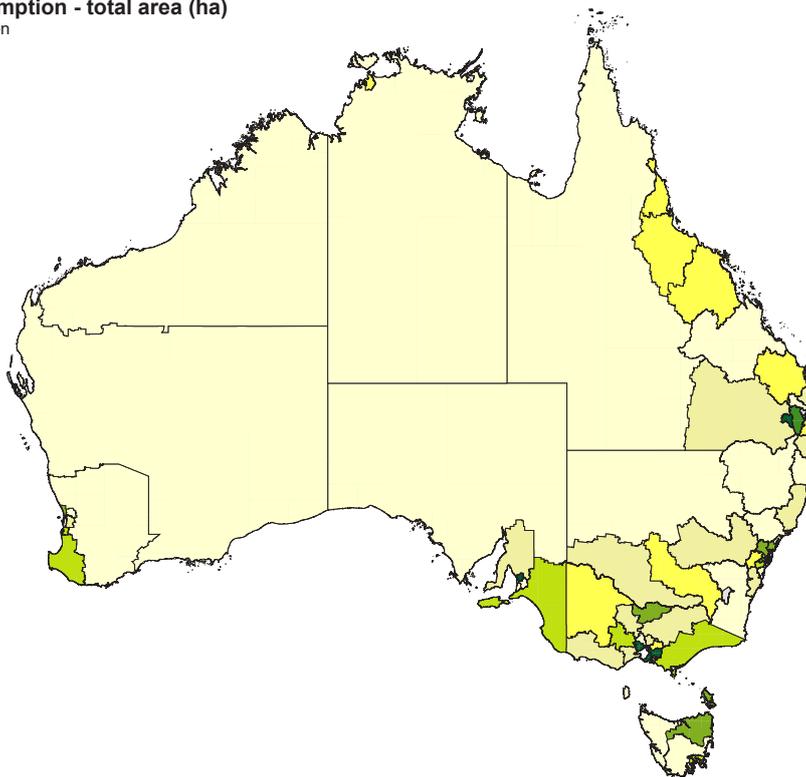
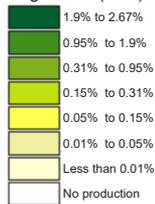
Note: Map shows the number of stone fruit and pome fruit trees of bearing age per hectare.

Source: Based on Australian Bureau of Statistics data.

**Figure 2.15: Area devoted to vegetable production by region**

**Vegetables for human consumption - total area (ha)**

Vegetables (area) as proportion of region



State	Number of agricultural businesses: Vegetables
Queensland	906
New South Wales	897
Victoria	663
South Australia	417
Western Australia	410
Tasmania	410
Northern Territory	60

Source: Based on Australian Bureau of Statistics data.

Submissions suggested there is a lack of complete and current information about supply and demand at any point in time, reducing producers' ability to accurately value their produce.<sup>125</sup>

### Access to buyers and consumers

Typically small, single-state wholesalers buy produce from growers (and from processors to a lesser extent), or receive less perishable produce from growers to sell on consignment over time, and on-sell produce to retail and food service customers. They are generally located close to markets, population centres, or locations where produce is grown or processed.<sup>126</sup> These wholesalers also face competition from several vertically-integrated processors who also operate at the processing and farming levels in multiple states.<sup>127</sup>

The processing sector cans, bottles, preserves, quick-freezes and dries fruit and vegetables, and consequently tends to be located in major horticultural growing areas. Close proximity to growers minimises transport costs while ensuring access to fresh inputs. Although there are a number of larger

125 QFF, *Submission to the ACCC perishable agricultural goods inquiry*, 2020, pp. 2-3; NFF, *Submission to Australian Competition and Consumer Commission Price Inquiry—Perishable Agricultural Goods*, 2020, p. 13.

126 IBISWorld, *Industry Report F3605: Fruit and Vegetable Wholesaling in Australia*, IBISWorld, 2020, p. 26.

127 For example, Costa and Perfection Fresh Australia: *ibid*, p. 34.

operators in the processing industry (typically subsidiaries of multinational food manufacturers), the industry also includes small-scale processors specialising in niche product markets.<sup>128</sup>

The majority of domestic market sales go through the two major retailers, Coles and Woolworths, along with many smaller retailers. The major supermarkets' distribution networks enable them to minimise costs by purchasing directly from growers.<sup>129</sup> Smaller retailers source produce from wholesalers, as do major supermarkets to obtain niche products, or to make up product shortfalls.<sup>130</sup>

## 2.2.8 Wine grapes

The ACCC examined the wine grapes industry in detail in the Wine grapes market study. Detailed analysis, findings and recommendations are set out in the 2019 final report.<sup>131</sup>

The key characteristics of the wine grapes industry that are likely to impact on bargaining power are outlined in figure 2.16. These characteristics apply mainly to bulk grape growers, who typically do not engage in wine production. The industry comprises a wide variety of businesses, ranging from small family-owned farms, large corporate winemakers and major retailers. The production sector is fragmented, with grape growing businesses mostly small and family-owned. By contrast, the winemaking market is heavily concentrated, and there are low levels of competition between winemakers acquiring grapes in warm climate regions. The market study found that there is a significant imbalance in bargaining power between winemakers and growers.<sup>132</sup>

Producers have little control over the amount of product they supply to the market in the short term, and will not be able to find an alternative buyer if problems arise when delivering grapes. Newly established vines take at least three years to fruit, which limits producers' ability to scale production up or down in response to changing market conditions.<sup>133</sup> Only certain grape varieties are suitable for wine production, and these are not suitable to sell as table grapes,<sup>134</sup> further limiting producers' sales channels. Additionally, producers have little scope to withhold supply, as the quality of grapes may be reduced if harvest is delayed, and grapes are highly perishable after picking.<sup>135</sup> By contrast, wine can be stored for a considerable period of time.<sup>136</sup>

International supply and demand largely determines the prices for Australian wine exports, and therefore have a strong impact on grape prices. In contrast, despite a steady increase in imports, domestic demand is relatively stable. The markets for Australian wine can be broadly divided into export and domestic, each having distinct characteristics and demand factors. Larger-scale winemakers have a greater reliance on export markets.<sup>137</sup>

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128 IBISWorld, *Industry Report C1140: Fruit and Vegetable Processing in Australia*, IBISWorld, 2020, pp. 27, 29, 33.

129 IBISWorld, *Industry Report F3605: Fruit and Vegetable Wholesaling in Australia*, IBISWorld, 2020, pp. 24, 32.

130 IBISWorld, *Industry Report F3605: Fruit and Vegetable Wholesaling in Australia*, IBISWorld, 2020, pp. 24; IBISWorld, *Industry Report A0123: Outdoor Vegetable Growing in Australia*, IBISWorld, 2020, p. 15.

131 See ACCC, *Wine Grape Market Study*, [www.accc.gov.au/focus-areas/market-studies/wine-grape-market-study](http://www.accc.gov.au/focus-areas/market-studies/wine-grape-market-study).

132 ACCC, *Wine Grape Market Study—Final Report*, 2019, pp. 2, 4, 26, 28, 96.

133 *ibid.*, pp. 22, 109.

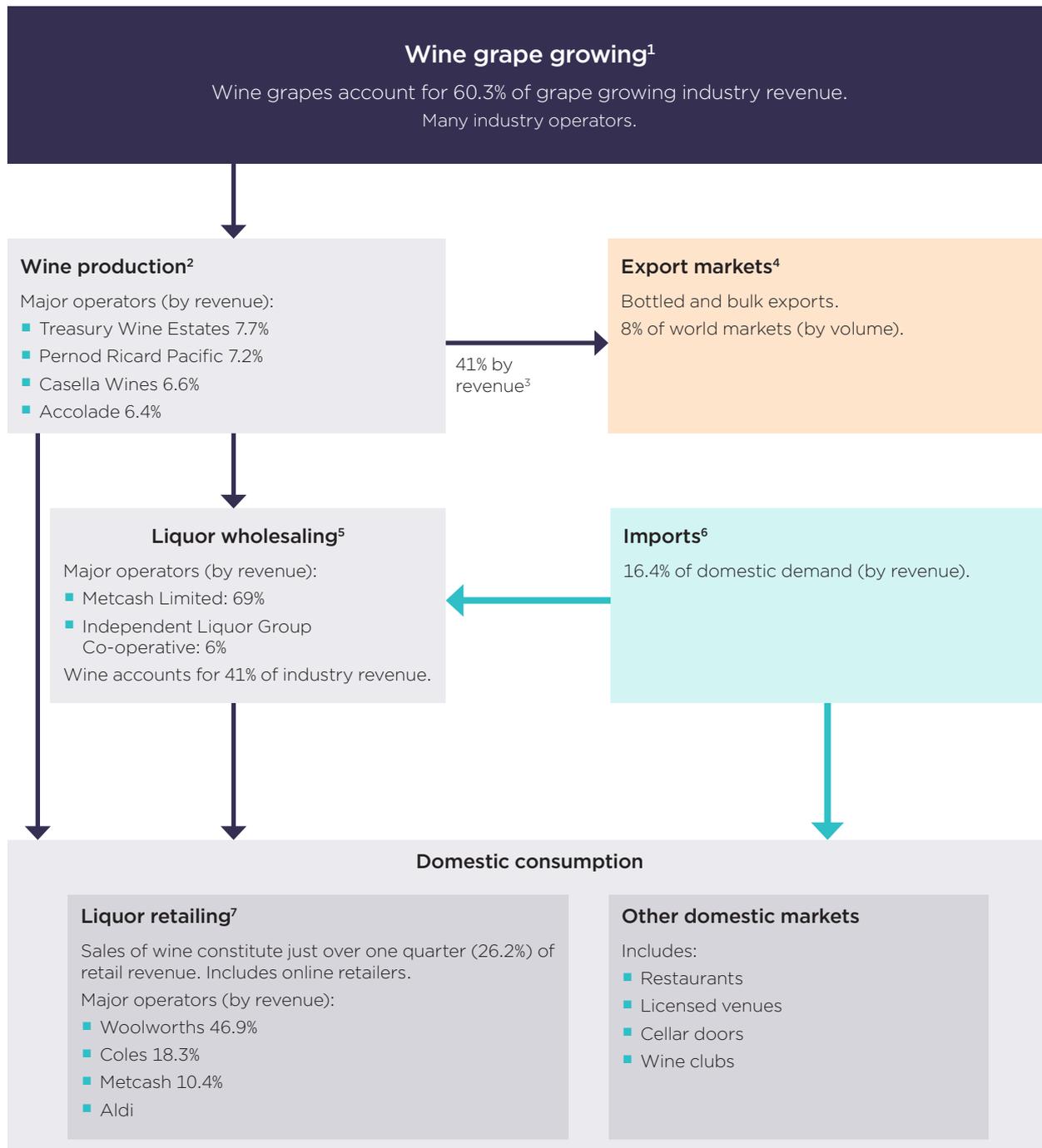
134 IBISWorld, *Industry Report A0131: Grape Growing in Australia*, IBISWorld, 2020, p. 13.

135 ACCC, *Wine Grape Market Study—Final Report*, 2019, pp. 8, 110.

136 *ibid.*, p. 97.

137 *ibid.*, pp. 30, 31, 74.

Figure 2.16: Wine grapes supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

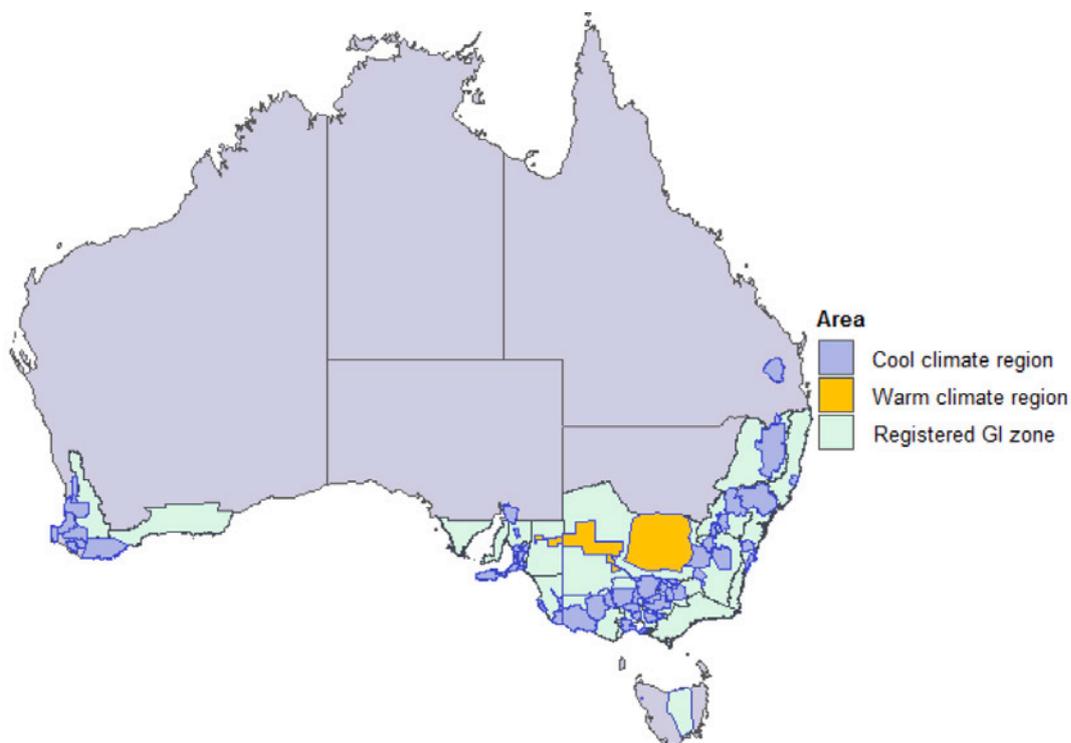
- 1 IBISWorld, Grape Growing in Australia, 2020
- 2 IBISWorld, Wine Production in Australia, 2020
- 3 IBISWorld, Wine Production in Australia, 2020
- 4 Organisation of Vine and Wine, 2019 Statistical Report on World Viticulture, April 2019, p. 21
- 5 IBISWorld, Liquor Wholesaling in Australia, 2020
- 6 IBISWorld, Liquor Retailing in Australia, 2020
- 7 IBISWorld, Liquor Retailing in Australia, 2020

## Farmgate

The majority of grape production occurs in south eastern Australia, and production regions are referred to as warm or cold climate.<sup>138</sup> The vast majority of warm climate grapes are used for commercial, low value wine destined for export markets. Most growers in warm climate regions are not involved in wine production, in contrast to many (but not all) cool climate growers. Warm climate growers generally supply grapes to winemakers under supply agreements and are paid based on volume and quality. Growers are generally exposed to various risks relating to grape production, harvest, grape price and finance.<sup>139</sup>

Competition among buyers of warm climate grapes primarily occurs within or close to a given grape growing region because of transportation costs, perishability, and bio-security regulations. Between one and three large winemakers buy half or more of the grapes in each warm climate region.<sup>140</sup>

**Figure 2.17: Australian wine grape growing regions**



Source: Wine Australia, *Geographical indications*, 2019.

**Table 2.1: Number of wine grapes business by state**

State	Number of agricultural businesses: wine grapes
South Australia	1,854
Victoria	905
New South Wales	742
Western Australia	362
Tasmania	73
Queensland	22

Source: Based on Australian Bureau of Statistics data.

<sup>138</sup> The warm climate regions are the Riverina (NSW), Riverland (South Australia) and Murray Valley (NSW/Victoria).

<sup>139</sup> ACCC, *Wine Grape Market Study—Final Report*, 2019, pp. 5, 26.

<sup>140</sup> *ibid.*, pp. 28,110.

## Access to buyers and consumers

Winemaking comprises a diverse range of business sizes and models, from family-owned boutique businesses to publicly listed companies. There are many small winemakers and a small number of very large winemakers. Collectively, they produce wines of different varieties, regions and styles for a wide spectrum of sales channels, market segments and prices. Most major winemakers have some degree of vertical integration into production. Small winemakers are generally more vertically integrated. Most winemakers retain their wineries for their exclusive use. Small winemakers are more likely to use contract processing owing to the high capital cost of winemaking equipment.<sup>141</sup>

Domestic winemakers compete in the wholesale market with one another, with large retailers' private label wines and with imports. Wholesalers acquire wine from processors to sell to downstream sectors, major markets being retailers, supermarkets and licensed venues.<sup>142</sup> Less than half of the wine produced in Australia is sold in the domestic retail market.<sup>143</sup> Wine is retailed at various price points. Retail pricing is a primary factor in consumer decision making, and consumers generally choose their wine with a particular price point in mind.<sup>144</sup>

The domestic retail market has become increasingly concentrated, largely as a result of Woolworths and Coles having grown their presence in the liquor retailing market. Together, the four largest retailers, which also include Metcash Limited and Aldi, have around an 80% share of national liquor retail sales.<sup>145</sup>

Additionally, the four largest retailers each source wine which they market using numerous 'private label' brands. Private label sales have increased from an estimated 5% in 2005 to an estimated 16 to 25% in 2016. Retailers source private label wines under a number of different arrangements, including purchasing finished wines, and purchasing unfinished bulk wines to be blended with other wines and bottled. At least one major retailer also owns a winemaking company that sources grapes and produces its own wines.<sup>146</sup>

Direct channel sales, such as cellar doors, and wine and loyalty clubs, represent an estimated 10% of domestic wine sales. Sales of wine via exclusively online businesses have also increased over the past five years. Small-scale winemakers generally have a greater reliance on direct channels than large-scale winemakers.<sup>147</sup>

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141 *ibid*, pp. 27–30.

142 ACCC, *Wine Grape Market Study—Final Report*, 2019, p. 5; IBISWorld, *Industry Report F3606a: Liquor Wholesaling in Australia*, IBISWorld, 2020, p. 22.

143 Wine Australia, Export report December 2018, [www.wineaustralia.com/news/media-releases/export-report-december-2018](http://www.wineaustralia.com/news/media-releases/export-report-december-2018), viewed 16 November 2020.

144 ACCC, *Wine Grape Market Study—Final Report*, 2019, p. 31.

145 IBISWorld, *Industry report G4123: Liquor retailing in Australia*, IBISWorld, 2020, p. 24.

146 The Real Review, *Who makes my wine?*, The Real Review, 2019, [www.therealreview.com/who-makes-my-wine](http://www.therealreview.com/who-makes-my-wine); Rural and Regional Affairs and Transport Reference Committee, *Australian grape and wine industry*, Parliament House, Canberra, 2016, [www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Rural\\_and\\_Regional\\_Affairs\\_and\\_Transport/Australian\\_wine\\_industry/Report](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry/Report), p. 36.; Gillespie Economics, *Economic Contribution of the Australian Wine Sector*, Gillespie Economics, 2015, [www.wineaustralia.com/market-insights/australian-wines-economic-contribution](http://www.wineaustralia.com/market-insights/australian-wines-economic-contribution), p. 12.

147 IBISWorld, *Industry report G4123: Liquor retailing in Australia*, IBISWorld, 2020, pp. 17–18.; Wine Australia, *Results of the Wine Direct-to-Consumer survey 2020*, Wine Australia, Adelaide, 2020, [www.wineaustralia.com/market-insights/wine-direct-to-consumer-survey-report](http://www.wineaustralia.com/market-insights/wine-direct-to-consumer-survey-report), p. 7.

# 3. Practices in markets for perishable agricultural goods

## Key Points

- The ACCC's analysis of PAG industries throughout this inquiry and other recent work has highlighted a number of harmful outcomes emerging from imbalances in bargaining power and market failures, including:
  - One sided contracting practices, including potential unfair contract terms regularly being present in producer supply agreements
  - Practices that go beyond hard bargaining, because of inappropriate and inefficient allocation of risk to producers or suppliers, which can reduce confidence and investment in markets.
  - A lack of price and market transparency across a number of PAG industries.
- Reported conduct in the chicken meat industry is particularly concerning and the ACCC will be investigating issues in this industry further.

## 3.1 Introduction

This chapter considers how market structures for perishable agricultural goods are likely to shape behaviours and practices in these supply chains, with a focus on the relationships between supermarkets, processors and producers. In particular, the ACCC identifies concerns relating to contracting practices, harmful trading practices and transparency that can cause markets to operate less efficiently.

The chapter begins by examining the distinction between practices which are a normal feature of competitive markets (so-called 'hard bargaining') and practices which go beyond this which are harmful to market efficiency. The chapter then assesses in detail the relationship between processors and producers, followed by supermarkets and suppliers.

The practices identified in this chapter are a combination of issues raised with the ACCC in recent years and those raised as part of this inquiry. A number of claims were raised as part of this inquiry that the ACCC has not been able to substantiate in the timeframe, and this is reflected in this chapter where relevant.

## 3.2 Harmful conduct

Hard bargaining is a feature of a competitive market and can help to improve overall market outcomes. This is because it promotes efficient allocation of resources and helps to ensure prices do not increase above competitive levels, which would be harmful to end customers and the broader economy. In supply chains where one party has a stronger bargaining position, this party will usually extract more favourable terms. Such an imbalance in bargaining power will not always be harmful to the functioning of the market.

Imbalances in bargaining power can lead to behaviour that goes beyond hard bargaining, to constitute significantly harmful practices. Harmful practices can be an outcome of imbalances in bargaining power and are damaging to markets where they inefficiently allocate risk, reduce market confidence and lead to a misallocation of resources and underinvestment. What constitutes harmful conduct may differ depending on the nature of the products and parties involved.

Table 3.1 outlines the ACCC's distinction between practices which represent hard bargaining and those which are harmful, as a guide for assessing the practices in PAG industries throughout this chapter. The ACCC notes that these thresholds are likely to vary depending on the situation.

**Table 3.1: Practices which are hard bargaining vs harmful to market efficiency**

Type of practice	Hard bargaining	Harmful practices
<p><b>Contracting practices</b></p> <p>At times, a stronger party will offer the weaker party standard form contracts which they are unable to negotiate.</p>	<p>The contract terms are reasonably necessary to protect the stronger party's legitimate interests.</p> <p>The contract clearly outlines the requirements the weaker party will have to comply with.</p>	<p>The contract terms are not reasonably necessary to protect the stronger party's legitimate interests.</p> <p>The contract would cause significant detriment to the weaker party that they cannot manage.</p>
<p><b>Risk allocation</b></p> <p>It is a normal part of business to face risk. However, stronger parties can re-allocate the risks they face to weaker parties through commercial agreements.</p>	<p>The weaker party is able to manage the risk when they have:</p> <ul style="list-style-type: none"> <li>▪ multiple channels to diversify their supply through</li> <li>▪ transparent access to industry information, or</li> <li>▪ are fully aware of the risks before entering the arrangement.</li> </ul>	<p>The risk has been allocated on a take it or leave it basis and the weaker party is not able to manage their risk owing to:</p> <ul style="list-style-type: none"> <li>▪ having few outside options</li> <li>▪ a lack of visibility over the potential risks assumed by the stronger party which the weaker party is not able to mitigate, or</li> <li>▪ the product no longer being in their control.</li> </ul>
<p><b>Transparency of price and non-price factors</b></p> <p>Supply chain participants have differing access to information based on their position in the chain; those at the top typically have access to better information.</p>	<p>The stronger party has access to price offers through a competitive bid process.</p> <p>The stronger party imposes rigorous but transparent quality specifications and processes.</p>	<p>Weaker parties have no visibility over price because there is a lack of transparency or prices are released after planting decisions must be made.</p> <p>Weaker parties have no transparency over quality testing.</p>

In relation to price allocation throughout the supply chain, all participants would prefer to achieve their desired price. However, it is a usual outcome in competitive markets that the party with the stronger bargaining power will try to pay as little as possible in order to minimise their costs and maximise their profits. Low prices or a price below the cost of production do not necessarily equate to market failure, particularly where:

- the low margin is associated with a large volume, higher value income stream
- a sizeable private label contract may provide economies of scale at a facility which helps achieve better profitability on other products<sup>148</sup>
- supply and demand conditions are highly variable year to year or season to season, potentially as a result of supplying into volatile export markets, or where production volumes depend on climate conditions, or
- the party may be operating their business less efficiently than their competitors.

Pricing below the cost of production can be a sign of market failure where the result is under-production and there is not enough product to meet demand.

Throughout this inquiry and previous work, the ACCC has identified harmful conduct in PAG industries resulting from insufficient competition and information failures. Some of this conduct is likely already addressed by existing laws and industry codes, while other conduct is not.

The ACCC has had examples reported to it of harmful conduct to market efficiency throughout this inquiry, as shown in table 3.2. These examples, including other issues raised throughout the inquiry, are examined in greater depth throughout the chapter.

<sup>148</sup> ACCC, *Dairy inquiry final report*, April 2018, p. xxi.

**Table 3.2: Reported examples of harmful PAG industry practices**

Conduct	Examples of reported conduct
Contract terms that inefficiently allocate risk	<ul style="list-style-type: none"> <li>Chicken meat growing contracts that allow processors to unilaterally alter producers' batch densities and rates, which greatly impacts producer income.<sup>149</sup></li> <li>Contracts that result in wine grape producers not receiving full payment for up to nine months after grapes have been supplied.<sup>150</sup></li> </ul>
Harmful use of bargaining power	<ul style="list-style-type: none"> <li>Changing supply volumes for perishable products at very short notice after volumes have been agreed.</li> <li>In certain regions in the chicken meat industry, processors reportedly have leveraged their monopsony position to decrease growers' prices mid-contract, causing growers to forgo benefits that the contract otherwise entitled them to.<sup>151</sup></li> </ul>
Lack of transparency in relation to price and non-price factors	<ul style="list-style-type: none"> <li>Some horticulture producers have no visibility over what supermarkets pay for their produce.<sup>152</sup> This occurs in situations where agents or wholesalers accept produce on consignment from producers, which they sell on the producers' behalf. As the supermarkets count for a large proportion of total purchases in the market,<sup>153</sup> this may distort price signals.<sup>154</sup></li> <li>Some beef and sheep producers have little transparency over the carcass grading process, which can generate a lack of trust in the prices received.<sup>155</sup></li> </ul>
Producers making growing and investment decisions with no certainty	<ul style="list-style-type: none"> <li>Some horticulture producers having no forward price or contract certainty, as contracts or supply agreements are usually negotiated after planting must commence, meaning they regularly grow crops without a guaranteed buyer or price.</li> </ul>
Commercial retribution	<ul style="list-style-type: none"> <li>Some suppliers who seek a cost increase from a supermarket or refuse to decrease private label costs sometimes having other products de-listed.</li> <li>A producer who raises concerns with a processor sometimes having their contract terminated or volumes reduced.<sup>156</sup></li> </ul>
Supermarkets requiring cost offsets	<ul style="list-style-type: none"> <li>Supermarkets sometimes require suppliers who negotiate a cost increase to invest in an unrelated cost offset.<sup>157</sup></li> </ul>
Supermarkets requiring suppliers to disclose confidential information	<ul style="list-style-type: none"> <li>Supermarkets at times requiring suppliers to disclose confidential financial information or intellectual property during cost increase negotiations.<sup>158</sup></li> </ul>

The effects of these reported industry features and practices may include:

- suppliers having less capacity to innovate, conduct research and development and take on risk.<sup>159</sup> This can also result in underinvestment by suppliers or inefficient production, if suppliers invest heavily in producing a new product that is quickly discontinued (the risk of which may also deter investment)<sup>160</sup>

149 Australian Chicken Growers Council Limited, *Submission to the Perishable Agricultural Goods Inquiry*, 17 September 2020, p. 3; Victorian Farmers Federation, *ACCC Perishable Agricultural Goods Inquiry Submission*, p. 8.

150 ACCC, *Wine grape market study*, September 2019, p. 2.

151 Australian Chicken Growers Council Limited, p. 3.

152 National Farmers' Federation, *Submission to the ACCC Price Inquiry—Perishable Agricultural Goods*, 18 September 2020, p. 14.

153 NSW Farmers, *ACCC Perishable Agriculture Goods Inquiry Submission*, September 2020, p. 14.

154 National Farmers' Federation, p. 14.

155 ACCC, *Cattle and beef market study*, March 2017, p. 70; Sheep Producers Australia, *Perishable Goods Inquiry*, 18 September 2020, p. 2-3; NSW Farmers, *ACCC Perishable Agricultural Goods Inquiry Submission*, September 2020, p. 17.

156 Fruit Growers Victoria, *ACCC Perishable Agricultural Goods Inquiry Submission*, 17 September 2020, p. 1.

157 Professor Graeme Samuel AC, *Independent Review of the Food and Grocery Code of Conduct*, Final report, September 2018, p. 56.

158 *ibid.*

159 Queensland Farmers' Federation, *Submission ACCC Perishable Agricultural Goods Inquiry*, 25 September 2020, p. 2.

160 Fruit Growers Victoria, p. 2.

- slower productivity growth for suppliers and producers.<sup>161</sup> An example of harm could be that particular industries are not able to become productive enough to compete in export markets
- owing to information failures, producers being unable to accurately make investment or resource allocation decisions, which may result in misallocation of resources.<sup>162</sup> As noted in chapter 1, one example of this could be a producer deferring investing in new machinery, when the investment would improve their efficiency
- as many producers consider their share of the retail price is unfairly low, this can weaken producer confidence in markets and undermine incentives to invest
- where producer's margins are thin, they will have less capacity to respond to future disruptions, climate impacts and natural disasters when they occur.<sup>163</sup>

The ACCC considers some harms may have occurred in PAG industries as a result of reported market failures. While we have not been able to quantify the extent to which this has occurred, we have identified throughout the chapter the potential outcomes of harmful conduct, and some specific examples where this may have happened.

### 3.3 Market practices—the processor and producer relationship

This section analyses conduct and behaviours that take place between processors and wholesalers (collectively referred to as processors) and producers. The ACCC received a range of submissions regarding the processor—producer relationship. These included:

- Producers are experiencing increasing input costs because of drought, as well as rising costs of energy and labour,<sup>164</sup> while for some producers prices received from processors are not increasing at a similar rate.<sup>165</sup>
- Producers can be offered prices and contracts on a take it or leave it basis.<sup>166</sup>
- Producers can be subject to one sided contracts which favour processors.
- These contracts and bargaining power imbalances can result in producers being allocated uneven levels of risk.<sup>167</sup>
- Some processors consider producers receive fair prices and terms, and that processors in fact bear the majority of risk.

The analysis below focuses on key issues raised in particular industries and in past studies to demonstrate the types of conduct and behaviour that can result from bargaining power imbalances or market failures. While the ACCC received submissions regarding all PAG industries, the majority of submissions that raised concerns were about the processor-producer relationships in the dairy, chicken meat and horticulture industries.

161 Queensland Farmers' Federation, p. 2; National Farmers' Federation, p. 6.

162 ACCC 2019, *Wine grape market study*, p. 6.

163 NSW Farmers, p. 12.

164 NSW Farmers, p. 12; Red Meat Advisory Council, *ACCC Perishable Agricultural Goods Inquiry*, 18 September 2020, p. 3; Australian Meat Industry Council, *Perishable Agricultural Goods Inquiry*, 18 September 2020, pp. 1–2.

165 Queensland Farmers' Federation, p. 2; NSW Farmers, p. 12.

166 ACCC 2019, *Wine grapes market study*, p. 2; ACCC 2018, *Dairy Inquiry final report*, p. 27; Queensland Farmers' Federation, p. 3; NSW Farmers, p. 22; Farmer Power; *Submission to the ACCC's Perishable Agricultural Goods Inquiry*, p. 1.

167 Australian Chicken Growers Council Limited, p. 3; NSW Farmers, p. 10; Victorian Farmers Federation, p. 8; Otway Milk, *Perishable Agricultural Goods Inquiry*, p. 1.

### 3.3.1 Contracting practices

Each PAG industry has contracting practices between producers and processors and contract terms that are particular to the industry. However, there are some issues and practices that are common across industries, which appear to result from the degree of perishability of the products, and the processors' strength of bargaining power relative to producers. In particular, through this inquiry and analysis of contracts across many years, the ACCC has identified terms in agreements in various PAG industries that may be unfair. Examples are discussed below in relation to Mitolo and Red Rich Fruits. As noted in table 3.1, not all contracts which are more favourable to the stronger party are likely to cause market failure, particularly if the terms are reasonably necessary to protect the stronger parties' legitimate interests.

#### Contracting overview

Producers typically enter written contracts with processors. However, in the past, unwritten contracts were common in some industries, such as dairy and horticulture.<sup>168</sup> Written contracts are important to ensure parties clearly know their rights and obligations and have protection when disputes arise.<sup>169</sup> Information obtained for this inquiry indicates that despite the operation of the Horticulture Code, some agreements are still unwritten, which may be a breach of the Horticulture Code.<sup>170</sup> The ACCC will examine these submissions further.

Longer term contracts generally provide more certainty for producers than shorter term contracts. Not all producers choose to enter longer term contracts and some prefer to keep their options open year to year, depending on the contract and price options available. Where there are fewer switching options for producers owing to oversupply in an industry or high concentration of processors, some producers prioritise certainty of a contract ahead of the best price.<sup>171</sup> In the wine grape industry, some producers prefer to enter longer term contracts that give no price certainty, rather than risk having no buyer, in exchange for the possibility of achieving a better price at harvest through a short term contract.<sup>172</sup> The ACCC has also heard reports that in the chicken meat industry, where some producers have very few processor options, they have chosen to accept price decreases rather than risk having no contract.<sup>173</sup>

#### Potential unfair contract terms

As identified in chapter 1, an outcome of the imbalance in bargaining power between processors and producers is that producers are often offered contracts on a 'take-it-or-leave-it' basis, also known as standard form contracts. The ACCC acknowledges that processors may offer standard form contracts to avoid the high transaction costs associated with negotiating contract terms separately with individual producers.

During the ACCC's studies into the dairy and wine grapes industries,<sup>174</sup> and through our enforcement function, the ACCC has identified some standard form contract terms that shift significant uncertainty and risk onto producers. These may be unfair contract terms within the meaning of the law. These include, for instance, terms which allow:

- unilateral changes to contract terms, including the price paid to producers and price and quality requirements:
  - in the wine grape industry, some wine processor contracts allowed processors to issue final price offers that changed the quality specifications in the initial contract<sup>175</sup>
  - in the dairy industry prior to the introduction of the Dairy Code, some dairy processor contracts contained terms that allowed processors to retrospectively decrease price paid to producers

168 ACCC 2018, *Dairy inquiry final report*, p. 141; ACCC, *Perspectives in horticulture and viticulture*, October 2016, p. 9.

169 ACCC 2016, *Perspectives in horticulture and viticulture*, p. 10.

170 NSW Farmers, p. 14.

171 ACCC 2019, *Wine grape market study*, p. 95; Victorian Farmers Federation, p. 6.

172 ACCC 2019, *Wine grape market study*, p. 95.

173 Victorian Farmers Federation, p. 6

174 In October 2016 the Australian government directed the ACCC to hold an inquiry into the competitiveness of prices, trading practices and the supply chain in the Australian dairy industry (Dairy Inquiry), which ran until 2018. The Dairy Inquiry is discussed in more detail in chapter 4.

175 ACCC 2019, *Wine grape market study*, p. 100.

mid-season<sup>176</sup>

- limitations on producers' ability to switch processor
  - In the dairy industry prior to the introduction of the Dairy Code, some contracts contained terms that required significant notice periods for contract terminations (e.g. a 12 month termination period).<sup>177</sup>
- unilateral rights to terminate the agreement:
  - in the wine grape industry, some processors contracts contained terms that allowed winemakers to terminate contracts when grapes become surplus to requirements, at short notice.<sup>178</sup>

The ACCC has not determined if these terms are present in all PAG industries. However, terms such as these have previously arisen in some PAG industries.

The ACCC has also considered concerning terms in the chicken meat industry in box 3.2.

### **Box 3.1: Business to business unfair contract terms (UCT)**

The business to business UCT protections were introduced to protect small businesses from unfair terms in standard-form contracts, by empowering a court to declare terms unfair and void. These laws are discussed further in chapter 5.

In PAG industries, the ACCC has taken actions against UCTs in contracts between processors and producers. Notwithstanding these outcomes, the ACCC has found that contracts in PAG industries continue to contain terms which may be unfair. The ACCC considers this reflects the current formulation of the law, in which UCTs are not illegal or subject to penalties, and that this limits the incentive for larger businesses to comply.

#### **Mitolo Group Pty Ltd**

The ACCC instituted proceedings against Mitolo Group Pty Ltd (**Mitolo**) in June 2018 alleging that some of its contract terms were in breach of the UCTs and the Horticulture Code. Mitolo is Australia's largest potato wholesaler.

The Federal Court declared that certain terms in contracts between Mitolo and potato producers were UCTs and void. The terms allowed Mitolo to unilaterally determine or vary the price Mitolo paid producers for potatoes, unilaterally vary other contract terms, declare potatoes as "wastage" without a mechanism for proper review, and prevent producers from selling potatoes to alternative purchasers.

The Court also declared that terms in Mitolo's contracts preventing producers from selling their own property unless the prospective purchaser entered into an exclusive potato farming agreement with Mitolo were unfair contract terms.

#### **Red Rich Fruits**

M.V Napolene & Co Pty Ltd, trading as Red Rich Fruits, agreed to change some of its horticulture produce agreements with producers after the ACCC raised concerns the agreements likely contained a UCT, and terms in breach of the Horticulture Code. Red Rich Fruits is a trader in apples, pears and other fresh fruits.

The term that was likely to be a UCT allowed Red Rich Fruits to seek credit from a producer for produce Red Rich Fruits had on-sold to a third party, but which was then rejected by the third party. The producer was required to provide credit for the amount the third party had contracted to pay Red Rich Fruits for the rejected produce, which was likely to include the trader's profit margin.

<sup>176</sup> ACCC 2018, *Dairy inquiry final report*, p. 143.

<sup>177</sup> *ibid*, p. 148.

<sup>178</sup> ACCC 2019, *Wine grape market study*, p. 106.

### 3.3.2 Chicken meat producers' concerns

The ACCC received several submissions raising strong concerns about chicken meat processors' dealings with producers. The ACCC considers the claims below represent instances of behaviours that are likely to result in a misallocation of resources by producers.

#### Outcomes of imbalances in bargaining power

Submissions have claimed that low levels of competition have caused various negative outcomes for producers in many chicken growing regions of Australia.<sup>179</sup>

The ACCC has heard that when processors have exited a region, they have generally terminated producer contracts, at times with up to 12 months' notice.<sup>180</sup> Chicken growing requires significant capital investments, as producers must build multiple sheds at approximately \$1 million each, which take many years to pay off.<sup>181</sup> When a contract is terminated, the ACCC understands the value of their farm will be based on the land only.<sup>182</sup> If producers cannot supply any other processor, their assets are likely to be substantially devalued.<sup>183</sup> The Richmond Valley Council has estimated that the termination of producer contracts on the NSW north coast will have a negative economic impact of \$20 million to the local economy and \$32 million to the state as a result of direct and indirect job losses.<sup>184</sup>

In circumstances where producers have few alternative processors to supply, they are likely to lack the bargaining power necessary to protect themselves from serious financial detriment from their investments becoming stranded.<sup>185</sup> Submissions reported multiple accounts of producers being left with no remaining supply options, which worsens their bargaining position and vulnerability to practices that cause them significant detriment.<sup>186</sup> For example, one submission stated that after a major processor exited a region, the remaining processor used the opportunity to require producers to accept a decrease in payment mid-contract, or risk having their contract terminated.<sup>187</sup>

The ACCC understands producers are sometimes willing to accept fee decreases and one-sided terms to prevent the processor exiting a region and leave them with no supply options.<sup>188</sup> We understand contracts allow for annual price increases, but some producers report they cannot enforce these rights if processors are not forthcoming.<sup>189</sup> Some producers submit they are struggling to cover their costs under current conditions.

Producers are also concerned about the shortening duration of contracts and the uncertainty this creates.<sup>190</sup> Given the financial risk producers have assumed through their capital investments, they submit they are highly reliant on receiving new contracts, which exacerbates their weaker bargaining position and vulnerability to detrimental conditions of supply.<sup>191</sup> The ACCC heard that contract lengths vary but longer-term contracts of up to 10 years were more common in the past, with an assumption between processors and producers that contracts would be ongoing, subject to terms being met.<sup>192</sup>

Producers have also raised significant concerns about the pool system.<sup>193</sup> In a pool system, producers compete against one another for a share of a bonus, and are paid based on a series of factors, such as bird size and quality. Producers have raised concerns that these pools lack transparency, cause

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179 Australian Chicken Growers Council Limited, pp. 2-3; NSW Farmers, p. 12; Victorian Farmers Federation, p. 6.

180 Richmond Valley Council, *Submission ACCC Perishable Agricultural Goods Inquiry*, 18 September 2020.

181 Victorian Farmers Federation, p. 8; Australian Chicken Growers Council Limited, p. 4.

182 NSW Farmers, p. 13; Richmond Valley Council, p. 2.

183 Australian Chicken Growers Council Limited, p. 3.

184 Richmond Valley Council, p. 1.

185 Australian Chicken Growers Council Limited, p. 3; NSW Farmers, p. 13.

186 Richmond Valley Council, p. 1; NSW Farmers, p. 13.

187 Australian Chicken Growers Council Limited, p. 3.

188 Victorian Farmers Federation, p. 6.

189 Australian Chicken Growers Council Limited, p. 4; Victorian Farmers Federation, p. 8.

190 Victorian Farmers Federation, p. 5; Australian Chicken Growers Council Limited, p. 4.

191 *ibid.*

192 Victorian Farmers Federation, p. 5.

193 National Farmers' Federation, p. 10.

producers' income to become dependent on factors outside of their control (such as processor inputs i.e. feed, birds, pickup schedule), and can be manipulated to the detriment of growers as inputs across producers are not uniform. For example, it was stated that over 10% of the value of a bonus pool can be withdrawn by processors, reducing the share available to producers.

From the perspective of processors, producers face little risk as they earn a fixed income and are not subject to cost increases as a result of market or environmental factors. Some processors have reported compensating producers for above-usual contract capital requirements. Some processors reported facing downward pressure on contracts because of short retail supply arrangements, and therefore face pressure to have shorter term contracts with producers. Shorter term contracts can also impact processors' certainty of supply.

While the ACCC has not substantiated these claims, they illustrate ways in which processors can exercise their stronger bargaining position at the expense of producers and competition in the processing and wholesaling sectors of the chicken meat industry. If verified, this conduct would be likely to undermine the efficiency of the market, as it may cause some producers to misallocate their resources (such as investment capital), or it could raise wholesale prices above competitive levels (a loss of allocative efficiency).

### Box 3.2: Chicken meat industry contract terms

During this inquiry, the ACCC has assessed some chicken meat growing standard form contracts under the business-to-business UCT law. The ACCC has not reached a view on whether the standard form contracts meet the law's threshold requirements, but has considered the extent to which terms result in an imbalance in parties' rights that may cause significant financial detriment to the producer if the processor were to rely on the terms.

The ACCC has considered some similar terms to be unfair contract terms in other PAG industries. Some terms that the ACCC considers may be harmful include:

- Terms that allow processors to unilaterally vary the income of producers:
  - For example, a term may allow a processor to vary the producer's batch density or rate.<sup>194</sup> As producers are paid a fee per bird, a term such as this would allow the processor to change the producer's agreed income. This term may be unfair as it requires the producer to carry the risk of processor volume and supply adjustments.
- Terms that require producers to make significant capital investments:
  - For example, terms that require producers to make capital investments during the contract term.<sup>195</sup> While capital upgrades are important for the safe and efficient operation of chicken meat growing facilities, such a term places significant risk on the producer that they may be required to make unplanned investments, potentially at their own cost and without contractual certainty.<sup>196</sup>
- Imbalanced termination terms:
  - For example, a term may allow a processor to terminate a producer's contract with a shorter notice period than if the producer seeks to terminate the contract.<sup>197</sup> It is not clear why the processor is permitted to provide shorter notice than the producer, which demonstrates an imbalance in rights which could cause detriment.
- Terms which allow the processor to unilaterally vary the contract:
  - For example, terms that allow the processor to update policy manuals mid-contract. This could subject producers to additional terms in the processors favour.
- Terms that allow processors to impose additional costs on producers, as a result of the processors decision.

194 Australian Chicken Growers Council Limited, p. 3.

195 National Farmers' Federation, p. 8; Australian Chicken Growers Council Limited, p. 4.

196 Australian Chicken Growers Council Limited, p. 4

197 National Farmers' Federation, p. 9.

These are only some of the terms that the ACCC has assessed that raise concerns, but indicate the types of one sided contract terms some chicken meat producers may be subject to.

The ACCC considers that the application of the UCT provisions to chicken meat contracts, the terms within these contracts, and the circumstances around some of the contract terminations in the industry, require an in-depth investigation by the ACCC as an outcome of this inquiry.

### 3.3.3 Allocation of risk

Industry participants in agricultural supply chains face a variety of commercial risks. These include varying production costs and prices, sometimes volatile export markets, and end customer demand.

It is a normal part of business to face risks. In well-functioning markets, companies can internalise risk as a cost of doing business and act accordingly. However, in some markets where there are significant imbalances in bargaining power, risks faced by one party can be reallocated through commercial agreements. The reallocation of risk will not always be a market failure, but it can cause harm where risk is passed onto a party that is not well-placed to manage it and cannot negotiate or avoid it. In these circumstances risk is inefficiently allocated along the supply chain, reducing the confidence of those who are most exposed and reducing their incentives to invest and maximise production.

Risk is often transferred through the supply chain in proportion to parties' respective levels of bargaining power.<sup>198</sup> Supermarkets often appear to bear low levels of risk as they can use their significant bargaining position to shift risk to suppliers.<sup>199</sup> Processors, through their stronger bargaining position in relation to producers, in turn are able to pass risk onto producers.<sup>200</sup>

Producers in PAG industries can be price takers.<sup>201</sup> The ACCC understands that the more perishable a product, the more vulnerable producers are to being pressured to accept particular terms, as there is a limited ability to withhold or negotiate better supply terms.<sup>202</sup>

Many processors are exposed to considerable risks because of the volatility of export markets and other uncertain arrangements. For example, in the wine grape industry, the ACCC found that winemakers bear significant risk in their dealings with wholesale buyers as they have little certainty regarding volumes and prices and may have product lines de-listed at short notice.<sup>203</sup> Likewise, dairy processors reportedly bear the majority of the risk of having their products de-listed by supermarkets, and having to find alternative uses for perishable raw milk. Nevertheless, processors can be well-placed to manage some of these risks as they usually have better access to industry information and multiple sales channels.

Contract terms are a particularly common way for processors to allocate risk to growers who are not well-positioned to manage it. Examples of terms which require producers to manage significant financial risks include:

- Lengthy payment terms in the wine grapes industry of up to nine months for full payment.<sup>204</sup> The ACCC found that this payment timeframe exposed producers to significant financial risk, as they generally had to finance their businesses with overdrafts which incur interest at a rate of between six to 12%.<sup>205</sup> An imbalance arose from these terms as the winemaker had taken ownership of the product without having to promptly pay for it, while producers were still required to pay invoices for agricultural inputs, increasing the risk of continued farming or new investment. The ACCC considers that winemakers are in a better financial position to bear the cost of holding inventory than

198 ACCC 2018, *Dairy inquiry final report*, p. 30.

199 *ibid.*

200 *ibid.*, p. 32.

201 ACCC 2019, *Wine grape market study*, p. 98; ACCC 2016, *Perspectives in horticulture and viticulture*, p. 7; ACCC 2018, *Dairy inquiry final report*, p. 39; Queensland Farmers' Federation, p. 3.

202 Dairy Connect Ltd, *Submission*, 24 September 2020, p. 3; Fruit Growers Victoria, p. 1; National Farmers' Federation, p. 13.

203 ACCC 2019, *Wine grape market study*, p. 97.

204 *ibid.*, p. 2.

205 *ibid.*, p. 103.

producers as they have greater visibility of changing industry conditions and scope to respond to mitigate the risks to their profits than many producers do.

- In the dairy industry, ‘step-down’ clauses which pass on the risk of commercial decisions in export markets to producers, by retrospectively decreasing farmgate prices.<sup>206</sup> The ACCC found that this inappropriately transferred onto producers the risks of international commodity price movements.<sup>207</sup> Processors were best placed to manage these risks, given their visibility over their own market exposure and a better understanding of commodity price trends than producers.<sup>208</sup> Dairy processors were also able to lock-in significant export sales under contracts before announcing their opening prices each year.<sup>209</sup> Producers were unable to reposition themselves to manage such market risks owing to the perishability of raw milk and barriers to switching processors. The Dairy Code now prohibits retrospective step-downs of the minimum price payable under a milk supply agreement in all circumstances.<sup>210</sup> It also significantly limits the extent to which a milk supply agreement can give a processor a unilateral right to prospectively step-down the minimum price payable.<sup>211</sup>
- In the chicken meat industry, multiple contract terms that reportedly attempt to shift financial risk to producers.<sup>212</sup> These include terms that allow processors to unilaterally vary producer densities and rates<sup>213</sup>, and reported terms that would broadly allow processors to suspend contracts because of economic or industry pressures which reduce the demand for the product, and which could shift the risk of changing industry conditions onto producers.<sup>214</sup> The ACCC considers processors are likely better placed to manage these risks, as they would have better visibility over their supply arrangements and downstream industry conditions.

In Australia, the vulnerability of producers is increased as there are few tools available to manage the input and output price risks that they face. One key tool is the Australian Government’s Farm Management Deposit scheme, which manages income volatility by allowing producers to set aside pre-tax income in years of good cash flow to draw on in years where it is lower.<sup>215</sup>

Derivatives exchanges are not a significant feature of Australian PAG industries. These allow not only speculation by investors, but also aid producers and downstream buyers to manage risk, protect against volatility, and secure cash flows. The Australian Stock Exchange (ASX) offers futures and options markets for wheat and feed barley, but no derivatives for the outputs of PAG production systems. An ASX futures exchange for cattle operated from 2002 to 2009<sup>216</sup>, but was reportedly delisted owing to insufficient liquidity.<sup>217</sup> While there are global exchanges, such as the Chicago Board of Trade, these are not particularly relevant for Australian producers as they are designed to cater to industries with different production systems, seasons and costs and also involve basis and exchange rate risk for Australian producers.

Instead, Australian producers must risk transacting for inputs and outputs on spot markets (where available), or rely on a combination of risk management techniques, such as entering into forward contracts for inputs or outputs, and storing an inventory of inputs on farm. The cattle and sheep industry has access to a small number of over the counter forward and options contracts.<sup>218</sup> The Australian Milk Price Initiative (AMPI) is developing a hedge market, which they submit would allow

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206 ACCC 2018, *Dairy inquiry final report*, p. xiii.

207 *ibid.*, p. 52.

208 *ibid.*

209 *ibid.*

210 ACCC, *Step-downs under the Dairy Code*, <https://www.accc.gov.au/business/industry-codes/dairy-code-of-conduct/step-downs-under-the-dairy-code#retrospective-step-downs>, viewed 20 November 2020.

211 *ibid.*

212 Victorian Farmers Federation, p. 8.

213 Australian Chicken Growers Council Limited, p. 3.

214 *ibid.*, p. 4; Victorian Farmers Federation, p. 8.

215 ACCC 2018, *Dairy inquiry final report*, p. 36.

216 Australian Securities Exchange, SFE Bulletin, [https://www.asx.com.au/asx24/content/bulletins/sfe/2002/sfe2002\\_070.pdf](https://www.asx.com.au/asx24/content/bulletins/sfe/2002/sfe2002_070.pdf), viewed 20 November 2020; Australian Securities Exchange, Delisting of MLA / SFE Cattle Futures Contracts, [https://www.asx.com.au/asx24/content/notices/2009/notice2009\\_147.pdf](https://www.asx.com.au/asx24/content/notices/2009/notice2009_147.pdf), viewed 20 November 2020.

217 Beef Central, *New cattle forward contract hedging tool hits the market*, <https://www.beefcentral.com/markets/new-cattle-forward-contract-hedging-tool-launched-this-week/>, viewed 20 November 2020.

218 Riemann, <http://riemann.com.au/products/>, viewed 20 November 2020.

dairy producers to better manage milk price risks.<sup>219</sup> AMPI submitted that some changes to the Dairy Code may be required to allow the initiative to operate as planned.<sup>220</sup>

These examples demonstrate that because of their lesser bargaining power, producers can be allocated harmful risks that processors would be better placed to manage. This is an outcome that the ACCC considers can result in inefficient industry outcomes, as producers are exposed to the risk of financial losses arising from factors they cannot manage.

### 3.3.4 Lack of transparency

As discussed in chapter 1, information asymmetry is a market failure that exists in some agricultural supply chains. While there are many unknowns in agricultural industries, the type of information available for decision-making throughout the supply chain varies significantly. Processors generally have access to more information than producers regarding industry factors and the value of the product at the wholesale level, and the terms on which it is supplied.

When producers have access to accurate and reliable industry information, they are more likely to make investment decisions that will enhance the productivity of the industry, rather than misallocating their resources. Where there is a significant lack of transparency, this can contribute to bargaining power imbalances and harm to producers through misuse of their resources. The ACCC has identified a number of instances of insufficient transparency in PAG industries through past ACCC studies and submissions.

#### Lack of price transparency

Competitive markets ensure that resources are allocated to their most valuable use by sending price signals to buyers and sellers. If price signals are distorted, buyers and sellers are hindered in their ability to make choices that best meet their needs.

The use of auctions in some PAG industries, such as beef, lamb and seafood, can increase price transparency for producers. This is because the bidding prices are visible to all present, which is an efficient way to clearly communicate price.<sup>221</sup> However, there are some risks to auctions; they can result in potential buyers coordinating their bids (known as 'bid-rigging') which reduces competition and potentially prices for the produce.<sup>222</sup>

Lack of transparency over price is a common issue nevertheless. Examples include:

- In the horticulture industry, producers have indicated they have no forward indication of prices, meaning they regularly grow crops without a guaranteed buyer or any sense of likely prices. While producers in other PAG industries may also not have visibility over the wholesale price, there are lower costs associated with bringing the horticultural produce to market, so the retail price should correlate more closely to their expected returns. There were also submissions that producers do not have visibility over the price that supermarkets pay wholesalers for produce.<sup>223</sup> This occurs in situations where agents or wholesalers accept produce on consignment from producers, which they sell on the producers' behalf, after which the proceeds (less charges) are remitted to producers.<sup>224</sup> It was submitted that some of these agreements with wholesalers do not give producers the right to know the price paid for their produce by supermarkets,<sup>225</sup> which means they do not know what margin the wholesaler has taken.
- The cattle and beef market study found that producers were unable to compare prices across sales channels, which hindered their abilities to make farm production decisions as well as to decide what

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219 Australian Milk Price Initiative, *Submission to ACCC Perishable Agricultural Goods Inquiry*, September 2020, p. 1.

220 *ibid.*, p. 3.

221 ACCC 2017, *Cattle and beef market study*, p. 78.

222 *ibid.*; Bid-rigging is a form of cartel conduct, when competitors agree or make arrangements such that they do not compete with each other. Cartel conduct can involve express, formal agreements between competitors, as well as arrangements where competitors deliberately coordinate their conduct indirectly, including through third parties. Bid-rigging is illegal and may result in criminal penalties.

223 National Farmers' Federation, p. 14.

224 *ibid.*

225 *ibid.*

their best options for selling cattle were.<sup>226</sup> At the time of the study, there were no robust forward pricing mechanisms in the industry, which meant producers used historical prices to assess expected future prices and returns.<sup>227</sup> Price reporting for saleyard and over the hook prices were reported inconsistently and price grids used by processors to indicate prices for specific carcass attributes varied in format and complexity.<sup>228</sup> The ACCC observed in 2019 that some processors had begun publishing their price grids online following the ACCC's recommendations for this.<sup>229</sup>

These examples indicate that bargaining power imbalances can lead to a lack of price transparency in PAG industries. While some of the issues outlined above may have been remedied to some degree by implementing recommendations for improved transparency, these are the types of harmful market outcomes that affect some producers, and impact their ability to make informed investment decisions.

### Box 3.3: Wine grapes case study

The ACCC's market study into wine grapes in 2018–19 identified a significant lack of transparency in relation to pricing.

Ripening and harvest of grapes takes place between January and April.<sup>230</sup> In line with the industry's voluntary code, many winemakers in warm climate regions would advise producers of indicative prices by 15 December or 15 January of each year, and final prices close to harvest time.<sup>231</sup> Prices were not published by winemakers, and were generally required to be kept confidential by producers.<sup>232</sup>

As the majority of Australian wine is exported (63% in 2018)<sup>233</sup>, international supply conditions have a significant impact on Australian wine export prices, which therefore have a strong impact on warm climate grape prices.<sup>234</sup> While some current global trend data was available publicly, producers did not have visibility over how these trends would impact future wine prices or how they impacted the price of an individual winemaker.<sup>235</sup> Winemakers were generally better positioned than producers to independently assess how future market conditions would affect demand for grapes, and they regularly made these assessments during their planning forecasts.<sup>236</sup>

The ACCC found that the lack of price transparency increased barriers to switching and dampened competition between winemakers, as producers were not able to make switching decisions based on accurate price information.<sup>237</sup> The ACCC recommended that price transparency should be improved by:

- warm climate grape grower representative organisations delivering accessible, relevant and timely analysis of market trends to warm climate growers<sup>238</sup>
- for grapes purchased from warm climate regions, wine grape buyers being required to provide pricing information to Wine Australia. Wine Australia should aggregate and publish this information by winemaker, for each variety in each warm climate region, before the end of each financial year.<sup>239</sup>

226 ACCC 2017, *Cattle and beef market study*, p. 59.

227 *ibid.*

228 *ibid.*, p. 59–61.

229 ACCC, *Transparency improving in cattle and beef industry*, <https://www.accc.gov.au/media-release/transparency-improving-in-cattle-and-beef-industry>, viewed 20 November 2020.

230 ACCC 2019, *Wine grape market study*, p. 23.

231 *ibid.*, p. 78.

232 *ibid.*, p. 79.

233 *ibid.*, p. 31.

234 *ibid.*

235 *ibid.*, p. 86.

236 *ibid.*, p. 71.

237 *ibid.*, p. 85.

238 *ibid.*, p. 11.

239 *ibid.*

## Lack of non-price transparency

The ACCC received reports to the inquiry and during past studies that the way produce is graded and tested is not transparent.<sup>240</sup> The grade allocated to produce can significantly impact producer payments and a lack of robust grading and testing processes can therefore generate a lack of trust. Producers' ability to make effective decisions in response to competing price offers and industry demands is impacted, and can result in harm through an inefficient allocation of resources.

In the horticulture industry, the ACCC was notified of concerns in relation to grading of produce. At times, producers who deliver their produce to a processor or wholesaler will reportedly not have their produce graded for 48 hours. During that 48 hour period the risk of product deterioration can remain with the producer. They might also not receive feedback about what produce is within specifications until a number of days after produce is delivered, and may not receive clear reasons for the produce rejection, which makes disputing decisions difficult. This may result in the produce being unnecessarily wasted.

The cattle and beef market study heard that carcass grading was not transparent and found this was generating a general lack of trust.<sup>241</sup> Producers were also concerned that carcass grading raised a conflict of interest, as the grader is an employee of the processor, and the quality of cattle can deteriorate while they are in the processor's care prior to slaughter.<sup>242</sup> Grading systems varied between processors, and could either be processor defined or an industry standard.<sup>243</sup> The ACCC found that while theoretically beef processors could grade carcasses in a way that minimises prices paid to producers, this was unlikely to be a frequent practice, but recommended ways to increase the transparency of the process to give producers more confidence.<sup>244</sup>

The ACCC has received feedback that new objective carcass measurements technology has not improved the issues with carcass grading, as there has been a low take up of it by processors.<sup>245</sup> The sheep meat industry also considers introducing objective carcass measurement would improve transparency.<sup>246</sup>

The wine grape market study identified similar concerns that quality assessment lacked transparency, as producers commonly believe this lack of transparency is deliberate, and enables processors to minimise the price they pay for grapes.<sup>247</sup> The ACCC found that quality specifications were generally clearly described in supply agreements.<sup>248</sup> However, the mechanisms for testing, the standards to ensure accuracy and the points in time when testing would occur were rarely specified.<sup>249</sup> In addition, producers had limited visibility over the testing process which would occur at wineries, and producers perceived they were given insufficient evidence to support quality assessment decisions.<sup>250</sup> The ACCC understands the industry is now seeking to address a number of these challenges.

These examples of low industry transparency can result in significant harm, as it can lead to a misallocation of resources and low levels of trust.

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240 NSW Farmers, p. 17; South Coast Beef Producers, *ACCC—Perishable Agricultural Goods Inquiry*, September 2020, p. 3; Sheep Producers Australia, p. 2; ACCC 2018, *Dairy inquiry final report*, p. 63; ACCC 2019, *Wine grapes market study*, p. 5; ACCC 2017, *Cattle and beef market study*, p. 70.

241 ACCC 2017, *Cattle and beef market study*, p. 77.

242 *ibid.*, p. 70.

243 *ibid.*

244 *ibid.*, p. 77.

245 NSW Farmers, p. 17.

246 Sheep Producers Australia, p. 2.

247 ACCC 2019, *Wine grapes market study*, p. 57.

248 *ibid.*

249 *ibid.*

250 *ibid.*

### 3.3.5 Producers' low returns

Some submissions raised concerns that some processors are earning such low returns from supermarkets that this has a flow on effect to producers,<sup>251</sup> as processors inevitably reduce payments to producers as much as possible. Some producers also consider they cannot recoup basic costs of production.<sup>252</sup>

The ACCC acknowledges this concern and the frustration that many producers experience when they see their produce being retailed at a price they consider devalues their hard work. An analysis of the profitability of the supply chains from producers, to processors to supermarkets is not within the scope of this inquiry, however some of the ACCC's findings in the Dairy Inquiry are likely to be broadly applicable to other PAG industries given some of the structural similarities between them.

In industries where there are many producers competing to supply only a few processors it is a likely outcome that producers will largely compete away their profits, accepting a lower price in order to secure a supply contract. Further, as outlined in chapter 1, the market structures common in PAG industries result in significant imbalances in bargaining power between processors and producers which results in the processors having the power to set prices paid to producers and being in a position to extract more of the value that is generated by the produce. This means that even when processors are earning substantial profits, they have no incentive to share those profits with producers. Therefore, even if supermarkets did pay processors more, this would not necessarily result in higher prices passing to producers.

Processors and supermarkets need sufficient volumes to satisfy customer demand, and so, generating sufficient supply from producers is likely to influence farmgate prices set by processors. Some producers will have higher costs than others, making it difficult to generate a profit based on the prevailing farmgate price. Producers able to achieve lower costs (because of their location, the production methods they choose or the efficiency with which they operate) will be profitable when facing the same prevailing price. There is also a small number of producers who have achieved such scale of production that they are able to negotiate higher prices and better terms with processors.<sup>253</sup>

In contrast, while processors are generally in a weaker bargaining position than the supermarkets they supply, many of them are not subject to take-it-or-leave-it terms and are often able to negotiate to pass on cost increases. The ACCC's findings in this regard are outlined below. Further, where processors supply significant volumes into export markets, processors may be less beholden to the supermarkets and the wholesale prices and profitability of processors is more likely to be driven by prevailing export market conditions.<sup>254</sup>

For the reasons outlined above, the ACCC considers that prices paid by processors to producers are more likely to be driven by factors other than the wholesale prices paid by supermarkets. These factors include:

- i. the degree of competition between processors competing for supply from producers
- ii. the extent of the bargaining power imbalance between processors and producers (which is largely influenced by point i. above), and
- iii. supply and demand conditions in the domestic market and export markets if the goods are exportable.

To improve the functioning of PAG industries and quality of outcomes for producers the ACCC's recommendations in this inquiry and previous related studies are therefore targeted towards improving:

- iv. competition between processors
- v. the bargaining power of producers and limiting the harmful practises they may otherwise be subject to, and

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251 NSW Farmers, p. 10; Queensland Farmers' Federation, p. 3.

252 Fruit Growers Victoria, p. 2; NSW Farmers, p. 12.

253 ACCC 2018, *Dairy inquiry final report*, p. 29.

254 Red Meat Advisory Council, p. 2; Sheep Producers Australia, p. 1.

vi. the flow and transparency of industry information for producers.

The ACCC acknowledges that many suppliers will not receive the prices they would like as a result of commercial negotiations. While it is not the role of competition, consumer protection and fair trading laws to determine the distribution of value among supply chain participants, protecting competitive markets and fair trading assists producers and suppliers to participate and compete in markets on their merits.

## 3.4 Market practices—the supermarket and supplier relationship

This section considers the practices and behaviours of supermarkets when dealing directly with suppliers, which can include processors, wholesalers, and producers. While suppliers generally have access to other supply channels, such as food service or export markets, the ACCC has focused on supermarket conduct, as it was the subject of the majority of submissions received.

The ACCC received a range of submissions about the relationship of supermarkets and suppliers. These included differing views that:

- The concentrated number of supermarkets in Australia means that supermarkets usually have significantly more bargaining power than suppliers.<sup>255</sup>
- It takes some suppliers a considerable amount of time and evidence to negotiate a wholesale price increase with supermarkets.
- Supermarkets can extract a disproportionate level of profits from products.
- Supermarkets require suppliers to comply with onerous compliance standards.
- While dealings with supermarkets are highly competitive<sup>256</sup>, overall they are fair and reasonable.<sup>257</sup>
- Concerns may arise as part of normal commercial negotiations, and supermarkets have implemented ways for suppliers to raise their concerns, and are committed to the ongoing operation of the Food and Grocery Code of Conduct (Food and Grocery Code).<sup>258</sup>

The level of concern in submissions varied between industries. In some industries, such as beef, sheep meat and seafood, which have highly diversified supply channels and are therefore less reliant on supermarkets, the ACCC received fewer concerns regarding supermarket conduct.<sup>259</sup> This demonstrates that suppliers that can supply into multiple channels, such as the export channel, are potentially less impacted by supermarket bargaining power.<sup>260</sup> Further, suppliers with popular or differentiated products generally have stronger bargaining power with supermarkets.<sup>261</sup> The ACCC received significant concerns from the dairy industry in relation to retail pricing,<sup>262</sup> while in the horticulture industry the ACCC received submissions regarding supermarket bargaining power and industry specific schemes.

### 3.4.1 Overview of commercial relationships between supermarkets and suppliers

As chapter 1 explained, bargaining power imbalances can exist along PAG supply chains owing to there being a large number of producers, a small number of processors and in the domestic sector, only

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255 Huon Aquaculture Group Limited, *ACCC Public Enquiry*, 17 September 2020, p. 1.

256 Seafood Industry Australia, *ACCC Perishable Agricultural Goods Inquiry Submission*, 18 September 2020, p. 6.

257 Australian Pork Limited, *ACCC Inquiry into Perishable Agricultural Goods*, September 2020, p. 4, Huon Aquaculture Group Limited, p. 1.

258 Coles, *Competition and Consumer (Price Inquiry—Perishable Agricultural Goods) Direction 2020*, 18 September 2020, pp. 3-4; Woolworths Group Limited, *Perishable Agricultural Goods Inquiry Submission*, 18 September 2020, pp. 3-5.

259 Sheep Producers Australia, p. 1; Seafood Industry Australia, p. 6; Australian Meat Industry Council, p. 1.

260 Australian Meat Industry Council, p. 1; Sheep Producers Australia, p. 1.

261 ACCC 2018, *Dairy inquiry final report*, p. 26.

262 NSW Farmers, p. 11; Queensland Farmers' Federation, p. 3.

three national supermarkets. The major supermarkets, Woolworths, Coles and ALDI, account for over 75% of industry revenue.<sup>263</sup> Woolworths and Coles make up approximately 65% of the national sector.<sup>264</sup> Despite there being high levels of concentration in the industry, supermarkets compete closely on some perishable agricultural goods as 'key value items' to attract end customers.<sup>265</sup>

Coles submitted that supermarkets do not purchase the highest total volume of perishable agricultural goods in Australia, and that suppliers have other supply channel options.<sup>266</sup> As an example, Coles estimates that of the 9.1 billion litres of raw milk produced in Australia in 2018, Coles' private label milk volumes only accounted for 3.1% of that volume.<sup>267</sup>

However, the substantial scale and national presence of these supermarkets means they clearly have substantial bargaining power as they are generally the largest supply channel of perishable products to end customers. Suppliers who deal with supermarkets can be subject to hard bargaining in what is a competitive industry. Outcomes which result from this bargaining power imbalance and which are frustrating for suppliers, but not necessarily harmful to markets include:

- Supermarkets having the ability to extract lower prices from some suppliers.
- Some suppliers finding it difficult to negotiate favourable supply terms.
- Some suppliers having products de-listed as part of supermarket range reviews.

Conduct the ACCC considers goes beyond hard bargaining and is harmful to market efficiency includes:

- Claims that supermarkets sometimes engage in commercial retribution by de-listing supplier's products, as it dampens suppliers' ability to attempt negotiations.
- Reports that supermarkets sometimes require suppliers to inefficiently allocate their resources through requiring cost increases to be offset.<sup>268</sup>
- Concerns that supermarkets at times require suppliers to disclose confidential information.<sup>269</sup>

## 3.4.2 Supermarket pricing

### Private label products

All of the major supermarkets offer their customers private label products, which are processed by another company to be sold under the supermarket's own brand.<sup>270</sup> As ALDI mainly supplies private label products, it does not compete to the same extent with suppliers' brands or for shelf space.

The pricing of private label products raises concerns for some suppliers. The ACCC heard that private label products have the ability to erode the value of supplier's branded products and limit available shelf space, particularly where there is little differentiation between the private label and branded product.<sup>271</sup> For example, consumers are strongly influenced by price when purchasing fresh drinking milk, as they are likely to view private label milk as a close substitute for many branded milk products.<sup>272</sup> The Dairy Inquiry heard that private label prices can also constrain the wholesale prices suppliers can charge to smaller retailers and food service providers.<sup>273</sup>

Some suppliers are also concerned that private label products can be exploited by supermarkets to the disadvantage of suppliers. The Dairy Inquiry found that some suppliers earn lower profits from private

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263 IBISWorld, *An Industry (ANZSIC) Report G4111—Supermarkets and Grocery Stores in Australia*, November 2020, pp. 35, 37 and 39.

264 *ibid.*, p. 28.

265 ACCC 2018, *Dairy inquiry final report*, p. 111.

266 Coles, p. 2.

267 *ibid.*, p. 3.

268 Professor Graeme Samuel AC, pp. 29, 56.

269 *ibid.*, p. 56.

270 ACCC 2018, *Dairy inquiry final report*, p. x.

271 Queensland Farmers' Federation, p. 4.

272 ACCC 2018, *Dairy inquiry final report*, p. 130.

273 *ibid.*, p. 116.

label contracts than they earn from the branded contracts.<sup>274</sup> Some submissions also claimed that supermarkets use private label products as a bargaining tool, and refuse to stock branded products unless wholesale prices for private label products are lowered.

Private label products represent a low cost alternative to branded products for consumers. Moreover, some suppliers offset low private label margins through higher margins earned on branded products.<sup>275</sup> Various perishable agricultural goods can be supplied as private label products, such as dairy products (discussed in chapter 4), eggs and chicken meat.<sup>276</sup> Some of these products may be sold at a consistent national price, for example private label milk is used by supermarkets to reinforce their branding and perceptions of affordability.<sup>277</sup> These strategies benefit consumers as they know they will pay the same price for these products regardless of location.<sup>278</sup> Some consumers living in specific regions experience lower prices, than if the full costs of supplying that region were passed through to the retail price.<sup>279</sup>

As such, while private label products are a function of competition and represent a lower cost alternative for end customers, they often place additional pressure on supplier margins.

### Wholesale price negotiations and price increases

Some submissions have argued that supermarkets have been using their bargaining power to lower supplier margins, which they either keep or pass on to consumers through retail prices. In general, parties submitted that supermarkets are reluctant to agree to price rises as they are seeking to compete on price with other supermarkets. The ACCC acknowledges this concern, but does not consider that suppliers receiving lower margins is of itself a market failure. However, the ACCC considers that some practices during these negotiations can be harmful to market efficiency, such as the following.

During price increase negotiations, external information sources such as public price indexes are sometimes used by suppliers as a justification for a proposed price increase. However, it has been submitted that suppliers may be asked to disclose commercially sensitive information, which can remove any information advantage they have in the negotiation.<sup>280</sup> It is reported this may include intellectual property or details of input providers, which is of particular concern when the supermarket also retails a competing private label product.<sup>281</sup> However, the ACCC understands upcoming amendments to the Food and Grocery Code will prohibit supermarkets from requiring suppliers to disclose commercially sensitive information during the price rise negotiation process.<sup>282</sup>

Some suppliers of perishable agricultural goods have reported sometimes being pressured to provide supermarkets with some form of offset in exchange for an increase in wholesale prices, such as to pay for promotional activity to an extent that almost negates the price increase.<sup>283</sup> Some suppliers have also reported experiencing retribution for initiating a cost increase discussion, by the de-listing of other products on some occasions. Under the Food and Grocery Code, products must be de-listed for genuine commercial reasons.<sup>284</sup> However, some submissions claimed that suppliers are unlikely to complain about suspected breaches of the Food and Grocery Code due to their fear of retribution.<sup>285</sup>

As a result of their role and strong bargaining position, supermarkets have significant power regarding the pricing of products. They can control the wholesale price a supplier can charge as they purchase a product at a price agreed by them<sup>286</sup>, and can also determine the retail price of the product. Some suppliers submit they therefore have difficulty in negotiating a price they consider is fair, or negotiating

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274 *ibid*, p. 130.

275 *ibid*; Australian Dairy Farmers, p. 19.

276 Egg Farmers Australia and Commercial Egg Producers' Association of WA, *Submission*, 18 September 2020, p. 2.

277 ACCC 2018, *Dairy inquiry final report*, p. 100, 104.

278 *ibid*, p. 110.

279 *ibid*.

280 Professor Graeme Samuel AC, p. 56.

281 *ibid*.

282 Schedule 3 section 17 of the Food and Grocery Code Amendment, which will be section 27A(5) of the Food and Grocery Code.

283 Professor Graeme Samuel AC, p. 56.

284 Section 19 of the Food and Grocery Code.

285 Professor Graeme Samuel AC, p. 6.

286 *ibid*, p. 56.

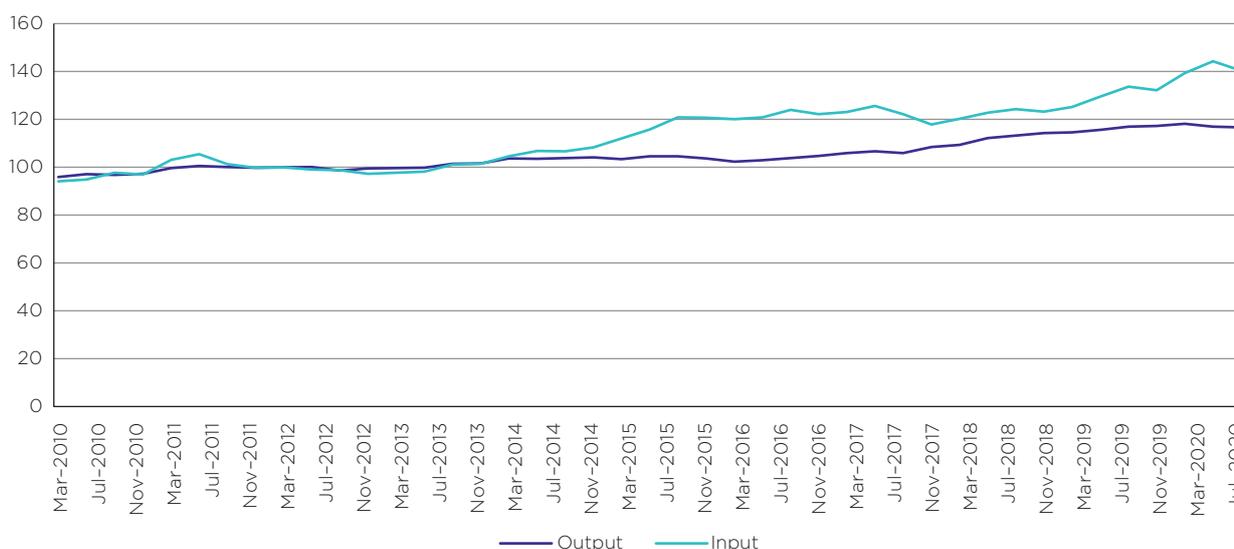
a price increase. Past ACCC investigations and the review of the Food and Grocery Code in 2018 found that this power dynamic exists between supermarkets and a wide range of suppliers, not just those which supply perishable agricultural goods.

Many large scale suppliers of perishable agricultural goods have indicated they are unable to negotiate price with supermarkets. Examples provided to the ACCC include:

- Supermarkets are increasingly using tender processes to procure supply of chicken meat. It was submitted that these processes have increasingly reduced margins to barely viable levels, as supermarkets are able to bargain down prices with reference to price guides which may not be current or are below viability. It was submitted that despite these issues, suppliers cannot afford to lose a tender because of the need to maintain efficient processing volumes.
- Concerns that some suppliers in the horticulture sector have very little time to negotiate prices with a supermarket in circumstances where their products have a very short shelf life.<sup>287</sup> These concerns are analysed further in box 3.4.
- Some suppliers of wild-catch fish also consider they are in a weak negotiating position relative to supermarkets, because the highly perishable nature of their product means there is significant time pressure to sell the product.<sup>288</sup>

Suppliers require an increase of the wholesale price from time to time to cover input cost increases.<sup>289</sup> Over the past 10 years, input prices for food product manufacturers in general (as opposed to only of perishable agricultural goods), have increased by 49% between 2010 and 2020, as shown in figure 3.1.<sup>290</sup> Suppliers of perishable agricultural goods have reported difficulties in achieving price increases, which may have resulted in the average selling prices of food product manufacturers only increasing by 21% since 2010.<sup>291</sup>

**Figure 3.1: Food product manufacturing output and input prices over time<sup>292</sup>**



ACCC analysis based on data from the Australian Bureau of Statistics (ABS) Producer Price Index, tables 12 and 14.

287 Fruit Growers Victoria, p. 1.

288 Seafood Industry Australia, p. 4.

289 Professor Graeme Samuel AC, p. 56.

290 Based on ABS data, *Producer Price Index*, 2010 to 2020, tables 12 and 14.

291 *ibid.*

292 *ibid.*

The ACCC understands that negotiations initiated by suppliers over price increases for variable inputs can take up to 12 weeks to finalise.<sup>293</sup> Some suppliers find the process to be onerous and supermarkets tactics to be unfair, as identified above.

As supermarkets can use their bargaining power to extract lower wholesale prices, it is not surprising that the ACCC has received the above submissions. On the whole, the ACCC considers much of this conduct reflects the commercial reality of negotiations, which tend to favour the stronger party, particularly when seeking price increases. It is reasonable for supermarkets to test suppliers' claims for price increases, to ensure that inefficient cost increases do not increase the price of goods unnecessarily. Meanwhile, pressure to lower costs may result in efficiencies being found, which is a function of competitive markets. However, the ACCC notes the concerns raised by suppliers. Conduct can become damaging if it moves beyond hard bargaining, such as the claims that supermarkets at times require suppliers to offset cost increases and sometimes use de-listing of products as retribution for genuine attempts at negotiations.

### Price reviews in supermarket contracts

Some supermarket supply agreements allow suppliers costs to 'pass-through' to the wholesale price, or seek a price review in response to increases or decreases in certain cost components. Many private label dairy product agreements contain these mechanisms, as discussed in chapter 4.

The ACCC understands that some supermarket contracts for other perishable agricultural goods are not long term, and do not contain pass-through mechanisms. For example, some horticulture produce arrangements are entered between suppliers and supermarkets on a weekly basis. Some contracts for the supply of red meat are short term and contemplate fixed prices. Supermarkets can also purchase livestock directly through saleyard auctions, and therefore pay the auction-clearing price.

Longer term agreements are more likely to contain price review mechanisms. Some contracts across a number of commodities can contain price review mechanisms triggered by changes in the cost of key inputs such as feed. Some of these contracts contain review periods, at which time the price may be reviewed. Branded PAG contracts are often supplied pursuant to the supermarkets' usual trade terms, and do not contain pass-through mechanisms. The wholesale price initially negotiated would generally be expected to cover the suppliers' costs. Suppliers may be able to negotiate price increases, as discussed above.

While the presence of price review mechanisms may allow for some suppliers to obtain a price increase, they are unlikely to wholly alleviate pressures on supplier margins, as they are only present in some contracts.

### Box 3.4: Horticultural produce case study

Horticultural produce suppliers acknowledge that their products are subject to fluctuations in supply and demand, which impacts price.<sup>294</sup> Nevertheless, some consider supermarkets offer low wholesale prices, at times below the cost of production.<sup>295</sup> There is a strong perception among producers that supermarkets are unfairly retaining a disproportionate amount of the value in the supply chain.<sup>296</sup>

#### Contracting and pricing concerns

Some suppliers of horticultural produce participate in weekly supermarket tenders to supply their produce. There is a reported information asymmetry during these tender processes, as supermarkets have greater visibility of competitors' price offers.<sup>297</sup>

293 Coles, *Proprietary Supplier Cost Alterations Process*, <https://www.supplierportal.coles.com.au/csp/wps/portal/web/Administration/CostAlterations>, viewed 23 November 2020.

294 Fruit Growers Victoria, p. 2.

295 *ibid.*

296 NSW Farmers, p. 14.

297 Fruit Growers Victoria, p. 1; National Farmers' Federation, p. 13.

Because the produce being supplied can be highly perishable, suppliers submit they have a very short window to negotiate price.<sup>298</sup> Suppliers consider they ultimately have minimal bargaining power as it is crucial to find a supply channel for the produce before its shelf life expires.<sup>299</sup> If a supplier does not agree to the supermarket price, the alternative may be the wholesale market, which the ACCC understands can offer lower prices than supermarkets, given the suppliers' minimal outside options. Some submissions discussed a recent incident where some supermarkets reportedly pressured horticulture produce suppliers to supply below the cost of production in order to meet a competitor's price. This type of short term contracting arrangement is reportedly common, and results in considerable uncertainty for producers, as they are planting and growing produce with no buyer or price certainty.

The ACCC has also been advised that after an agreement is reached on the price to supply a certain volume, the volume may be reduced at the last minute by the supermarket. The ACCC considers this type of conduct, if engaged in, to be particularly harmful to market efficiency as the produce may be wasted or sold at a loss.

### **Quality and specifications concerns**

Some suppliers consider that supermarkets reject produce on the basis of quality, but are in fact controlling their inventory. Suppliers state that at times produce is presented to the supermarkets' distribution centre and is rejected in the first instance on quality, only to be later accepted.

Suppliers are concerned that there is a lack of transparency and reasonableness over the specifications imposed by supermarkets on produce.<sup>300</sup> Producers submit there are inconsistencies over which produce is within specifications. Further, it was submitted that where a portion of a suppliers' consignment is not within specification, the supplier will only receive payment for the amount of the delivery within specification and may have no visibility over what happened to the remainder. Some suppliers consider they are not given adequate reasons for the rejection, and suppliers are generally unwilling to address issues with supermarkets for fear of retribution.<sup>301</sup> The ACCC notes the Food and Grocery Code sets out how supermarkets are permitted to reject fresh produce.<sup>302</sup>

The ACCC notes that the above are submissions which are difficult to assess given how quickly perishable agricultural goods transactions occur.

### **3.4.3 Allocation of risk**

In agricultural supply chains, industry participants face a variety of commercial risks. Supermarkets face some risks, such as end customers changing their preferences, but they appear to be able to allocate much of this risk to suppliers. It is often the case that risk allocation is proportionate with relative bargaining power, which is likely the scenario in the relationships between many suppliers and supermarkets.<sup>303</sup> The ACCC does not consider that this is harmful where suppliers are able to manage these risks, as is often the case.

### **Supermarket range reviews**

Supermarkets are in a very strong bargaining position in relation to suppliers, as they have the ability to de-list a suppliers' product at a range review and control access to shelf-space. Commercially, it is not surprising that they track the performance of products and de-list those that are underperforming, responding to customers' changing expectations in order to remain competitive.<sup>304</sup> The Food and Grocery Code requires that supermarkets provide suppliers with reasonable notice of the range

298 Fruit Growers Victoria, p 1; National Farmers' Federation, p. 13.

299 National Farmers' Federation, p. 13.

300 NSW Farmers, p. 14.

301 Fruit Growers Victoria, p. 1.

302 Section 21 of the Food and Grocery Code.

303 ACCC 2018, *Dairy inquiry final report*, p. 30.

304 Professor Graeme Samuel AC, p. 56.

review.<sup>305</sup> De-listing a suppliers' product of itself is not necessarily a market failure as supermarket suppliers will know in advance that this is a potential outcome which they should be prepared to manage.

Nevertheless, because supermarkets can change their ranging decisions at short notice, this shifts some of the risk associated with changing customer preferences onto suppliers.<sup>306</sup> If a product is de-listed, some suppliers submit they may have committed to acquire a certain volume of produce from producers, which they will have to quickly find an alternative use for. For example, in the wild-catch industry, the ACCC was advised that at times some supermarket's place weekly product orders, which they change at short notice if they find a better price. This may result in the supplier having to quickly find another sales channel for the product, potentially at a loss because of the perishability of the product.

While range reviews are part of the way the major supermarkets do business, suppliers are concerned that they may lose significant distribution or income if a product is de-listed, and may be more likely to compromise on margins and terms. Some processors also have long-term contracts with producers, but short term contracts with supermarkets, which increases their risk. Further, the ACCC heard that having uncertain supply arrangements with supermarkets can have flow on effects through the supply chain, as suppliers may be unwilling to enter longer term contracts with producers.

Range reviews can also impact the supply and investment decisions of suppliers. If a supplier has invested significant resources in a facility for products which are de-listed, this may result in a significant loss.<sup>307</sup> The ACCC heard concerns that the outcomes of the reviews may not always correlate to the products' performance, and that these decisions can lack transparency.

Suppliers face less risk when they have more certainty, such as supplying under a long term contract. However, during the Dairy Inquiry the ACCC found that longer term contracts for the supply of private label milk generally came with lower wholesale prices and some suppliers being required to incur substantial capital expenditure in order to secure these arrangements.<sup>308</sup>

Supermarkets, like any retailer, own and control the shelf space which suppliers are vying to be displayed on, and which the major supermarkets also compete for with their private label products. This results in a situation where supermarkets compete directly with suppliers for the retail sale of certain products, which they have pricing control over. As noted at section 3.4.2, there may be little product differentiation between the private label and branded product, such as for fresh milk.<sup>309</sup> The ACCC was advised that if the price of the branded product, which is generally set by the supermarket, is much higher than the private label product, the branded product may achieve fewer sales and have its value diminished.<sup>310</sup>

Suppliers advised that supermarkets preference the position of their private label products on the shelf.<sup>311</sup> Suppliers are also concerned that supermarkets can reduce processor shelf space if suppliers do not agree to price decreases.<sup>312</sup> Submissions also asserted that supermarkets' control over shelf space means that there is less space for branded products, and increases competition between suppliers for the space which remains.

The ACCC acknowledges it is difficult for some suppliers to manage the risk of being de-listed and to compete for shelf space with the supermarkets' private label products. However, supermarkets are ultimately able to decide what products to display to end customers in their stores. The ACCC considers range reviews and supermarket control of shelf space is an unavoidable aspect of the supply chain and not a cause of market failure in itself. However, supermarkets' strong bargaining position means behaviours around such practices should be closely scrutinised.

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305 Section 26 of the Food and Grocery Code.

306 ACCC 2018, *Dairy inquiry final report*, p. 30.

307 Fruit Growers Victoria, p. 2.

308 ACCC 2018, *Dairy inquiry final report*, p. 30.

309 Queensland Farmers' Federation, p. 4; ACCC 2018, *Dairy inquiry final report*, p. 130.

310 Queensland Farmers' Federation, p.4.

311 Australian Dairy Farmers, p. 22.

312 Queensland Farmers' Federation, p. 4.

## Supermarkets trade spends

The ACCC received submissions claiming that the supermarkets' bargaining power enables them to extract certain payments from suppliers. The ACCC understands these payments may be for the benefit of the supplier and supermarket, but can be at the supplier's expense.

The ACCC understands that suppliers are often required to invest in 'trade spends'. This refers to financial contributions by suppliers to supermarkets to support brands and products, which can include sales promotions, in store displays and merchandising. The ACCC understands that suppliers can pay for the full amount of the sale promotion so that the supermarket's margin is not impacted. The ACCC heard that trade spends can represent significant costs for suppliers. Some submissions advised that suppliers are pressured into these trade spends, and may be required to engage in promotions which have not been productive for them previously. Concerns have been raised about having to pay for access to data about a product's sales, in order to understand its sales performance.

While there may be legitimate reasons for trade spends, and potential for both suppliers and the supermarkets to benefit, the ACCC understands that suppliers may be frustrated by being pressured to pay for these promotions, particularly when the supermarkets benefit most from them. In cases where the terms of these trade spends are agreed upon and sufficiently clear and complete in their terms, it is an example of supermarkets exercising their bargaining power to extract the majority of the value created from their trade with suppliers (and in passing some of this value onto customers). If the terms of trade spends are not sufficiently clear and are at the discretion of the supermarkets, then they may result in significant uncertainty for suppliers and an inefficient allocation of risk in PAG supply chains.

### Box 3.5: Coles and Woolworths unconscionable conduct cases

The ACCC instituted two proceedings against Coles Supermarkets Australia Pty in 2014, alleging that Coles had engaged in unconscionable conduct in 2011 in its dealings with certain suppliers, in contravention of the Australian Consumer Law (ACL).

The first set of proceedings related to Coles Active Retail Collaboration (ARC) program, whereby Coles introduced rebates into the trading terms of its suppliers. Coles took steps against those suppliers who declined to make payment of the ARC rebate, including threats such as refusing to meet or negotiate with suppliers, refusing to acquire or stock products (or changing the ranging of products) or not providing suppliers with forecasting or ranging information.

In the second set of proceedings, the ACCC alleged that in 2011 Coles pursued some suppliers for a variety of payments, including payments for 'profit gaps', waste and fines or penalties for alleged short or late deliveries. These payments were demanded of suppliers without prior agreement, on an arbitrary basis, or imposed without regard to the suppliers' level of responsibility or financial situation.

In both proceedings, the Federal Court found that Coles had engaged in unconscionable conduct in circumstances where it had greater bargaining power in relation to suppliers.

In December 2015, the ACCC instituted proceedings in the Federal Court against Woolworths Limited, alleging it engaged in unconscionable conduct in circumstances where it had greater bargaining power than its suppliers. This related to Woolworths "Mind the Gap" scheme where category managers and buyers contacted many suppliers asking for urgent payments (outside of trading terms) to "support" Woolworths. Not agreeing to a payment would be seen as not "supporting" Woolworths.

The Court ruled that Woolworths' requests for these payments were not unconscionable within the meaning of the ACL, and justified by the nature of the trading relationship between Woolworths and its suppliers.

## Supermarket compliance standards

Supermarkets also require suppliers to comply with a range of food safety and other standards for the supply of products. It is important for supermarkets to ensure the safety and consistency of products.

Some parties submitted that a number of supermarkets require suppliers to comply with onerous food safety standards. In the horticulture sector, producers who supply supermarkets are required to comply with the Harmonised Australian Retailer Produce Scheme (HARPS), a food safety certification program.<sup>313</sup> While suppliers acknowledge the importance of food safety, they submit that HARPS has increased red tape, includes an onerous audit program that does not reflect the level of food safety risks, and is not paid for by supermarkets, but by wholesalers or producers. The ACCC understands HARPS is of particular concern to smaller producers because of the time and costs involved.

Suppliers submit that the industry has not been adequately consulted when new HARPS requirements are implemented and are concerned that HARPS is duplicating the requirements of base food safety standards. The ACCC was informed that in high demand periods, HARPS audits are more lax than when there is an oversupply, and that there is no obligation on supermarkets to not acquire non-HARPS certified produce when volumes are low. The ACCC heard submissions that supermarkets import fresh produce from non-HARPS certified producers. However, the ACCC learned supermarkets only acquire approximately 4% of fresh produce from outside Australia when local supply does not meet demand.<sup>314</sup> Imported produce is likely imported by Australian wholesalers, who would be HARPS certified.

Fruit and vegetable producers are also required to be SEDEX or Fair Farms certified to ensure that suppliers are ethically employing staff. Suppliers reportedly pay for the cost of this accreditation, and receive no price premium from the supermarkets or acknowledgement in stores that a supplier is certified. Some suppliers also suspect that supermarkets supplement their supply volumes with non SEDEX certified produce.

The ACCC acknowledges that there is an additional cost for suppliers when supermarkets require compliance with standards that may go further than national or state food safety or fair work standards. However, the ACCC considers it is ultimately for supermarkets to decide what standards to impose providing the design and implementation does not substantially damage competition or otherwise breach the competition and consumer laws, and they are clear and consistently applied.

### **Fears of supermarket retribution**

A frequent concern raised by suppliers throughout this inquiry and in previous studies, is that industry participants are reluctant to report concerning supermarket conduct, for fear of retribution.<sup>315</sup> The types of retribution suppliers have reported include having a product de-listed for no other apparent reason, or having purchase volumes significantly reduced.<sup>316</sup> This again stems from the bargaining power imbalance between supermarkets and suppliers, as supermarkets can have such significant control over suppliers' products in their stores and suppliers have fewer outside options.

The ACCC was told that despite the Food and Grocery Code, suppliers remain afraid to make complaints. As discussed at section 3.4.2, the ACCC has heard that there sometimes can be a correlation between suppliers negotiating a price increase and a key product being de-listed, which indicates there could be a real basis for these concerns. If this is the case, then concerning conduct is continuing unchecked, which creates significant uncertainty and fear for suppliers. The ACCC considers that if retribution does occur, it is a practice that is harmful to market efficiency.

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313 Horticulture Innovation Australia, *Harmonised Australian Retailer Produce Scheme*, <https://harpsonline.com.au/faqs/>, viewed 23 November 2020.

314 *ibid*, FAQ—What about produce that is imported and sold on the domestic market?

315 Fruit Growers Victoria, p. 1.

316 *ibid*.

## Suppliers' channels to market

As discussed in chapter 1, some suppliers are able to diversify their supply options, by supplying into the domestic retail, food service and export channels. The ability to adjust the focus of their business enables suppliers to lessen their exposure to supermarket bargaining power to some extent.<sup>317</sup> In the seafood industry, suppliers value their numerous supply channel options and some can choose whether to interact with supermarkets.<sup>318</sup>

Coles and Woolworths have expanded into many channels beyond supermarkets, which include liquor retailing, petrol retailing, hotels and business to business grocery supply. Woolworths recently launched its Woolworths at Work business stream and Coles operates Coles Online for Business, which supply groceries to businesses.<sup>319</sup> Woolworths is also proposing to acquire PFD Food Services Pty Limited (which the ACCC is currently reviewing), which would see it enter the supply of wholesale food services.

Some submissions raised significant concerns about supermarkets' potential entry into the food service channel. Suppliers consider that supermarkets will quickly expand in these channels at the expense of smaller foodservice suppliers, leaving suppliers to deal largely with the major supermarkets. Submissions also stated that supermarkets may leverage their extensive buying power and extract lower prices and high trade investment from suppliers.

The ACCC notes that at the time of writing the report, Woolworths' proposed acquisition of PFD Foods was the subject of an ACCC public merger review.<sup>320</sup>

## Vertical integration by supermarkets

As noted in chapter 1, at times supermarkets bypass the traditional wholesale level of the supply chain to acquire produce directly from producers. The ACCC understands this is not uncommon, and sometimes occurs in relation to horticulture produce and some beef, lamb and fish products.<sup>321</sup> It is not necessarily a market failure, and represents supermarkets vertically integrating, which is also common in PAG industries.

Woolworths has been acquiring raw milk directly from dairy producers for its Farmers Own brand since 2013.<sup>322</sup> Woolworths collectively negotiates with the Manning Valley Dairy Farmers Collective Bargaining Group for this raw milk, acquiring raw milk from farms in NSW, WA, Victoria, Queensland and SA.<sup>323</sup> Coles now also directly acquires some raw milk from producers in WA, SA, Victoria and central NSW for use in its private label milk products.<sup>324</sup> Coles offers fixed price contracts to its producers for up to three years.<sup>325</sup>

The ACCC understands these arrangements may provide a higher raw milk price for the producers than they would otherwise earn from processors.<sup>326</sup> It was submitted that supermarkets tend to target and contract with the largest and most efficient dairy farms. This has reportedly resulted in some other buyers being left to acquire milk from smaller farms, which increases costs.

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317 Australian Meat Industry Council, p. 1; Sheep Producers Australia, p. 1; Seafood Industry Australia, p. 6.

318 Seafood Industry Australia, p. 6.

319 Woolworths Group Limited, *Woolworths at Work*, <https://atwork.woolworths.com.au/>, viewed 23 November 2020; Coles, *Shopping online for your business*, <https://shop.coles.com.au/a/national/content/coles-online-for-business>, viewed 23 November 2020.

320 ACCC, *Woolworths Group Limited—PFD Food Services Pty Ltd*, <https://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/woolworths-group-limited-pfd-food-services-pty-limited>, viewed 23 November 2020.

321 Seafood Industry Australia, p. 6; Sheep Producers Australia, p. 1; National Farmers' Federation, p. 13.

322 Woolworths Group Limited, *Farmers' Own*, <https://www.woolworths.com.au/shop/discover/our-brands/farmers-own-milk>, viewed 23 November 2020.

323 *ibid*; ACCC 2018, *Dairy inquiry final report*, p. 205.

324 Coles, *Submission*, p. 5.

325 *ibid*, p. 6.

326 Otway Milk, p. 2.

Some producers which are contracted to the major supermarkets have reported a positive experience.<sup>327</sup> This is because their contract provides the producer with a fixed price over a fixed period, which provides certainty and allows them to make informed investment decisions.<sup>328</sup>

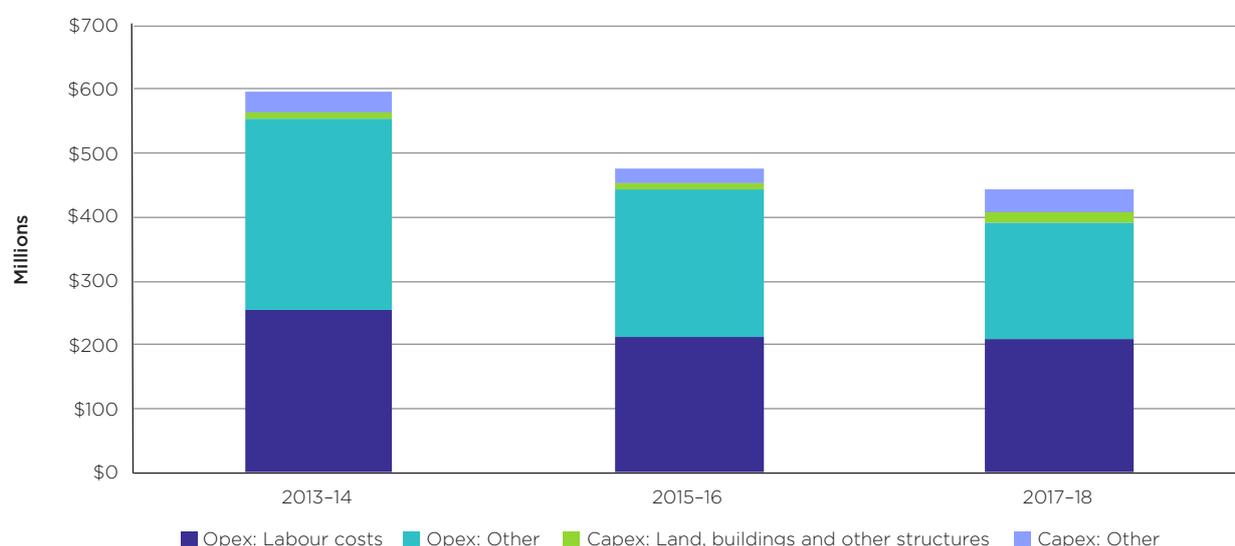
The ACCC considers this is an example of larger producers using their superior bargaining position because of their size to achieve better terms, and is likely a competitive outcome. However, supermarkets bypassing suppliers also has the ability to further erode suppliers' bargaining power, as they become less vital in the supply chain.

### Potential economic impacts of the supplier—supermarket relationship

Some submissions have stated that the price pressure imposed by supermarkets has reduced the ability for suppliers to innovate and make capital investments. The reported outcome of this is potentially less new products that meet the current needs of end customers.

ABS data indicates that for all food product manufacturers (not just those of perishable agricultural goods) there has been a decrease in research and development (R&D) expenditure over the period from 2013 to 2018.<sup>329</sup> As is shown in figure 3.2, Opex, the dominant component of R&D expenditure, has reduced by approximately 29% over five years, and R&D expenditure has reduced by 26% overall.<sup>330</sup>

**Figure 3.2: Food Product manufacturer R&D spend from 2013 to 2018<sup>331</sup>**



ACCC analysis based on data from the ABS Research and Experimental Development Businesses survey.

The ACCC has also heard concerns that food manufacturer capital investment has not grown for over a decade, which makes expansion and growth in the sector challenging.

This indicates that across broader food product manufacturing industries, innovation and growth has reduced or been stagnant over time. However, the Dairy Inquiry found that investment in more efficient facilities was still occurring in that industry, albeit sometimes partially underwritten by contracts to supply supermarkets.<sup>332</sup> However, it has not been possible to draw conclusions about other sectors given the time and scope of this inquiry or to draw a clear link between capital investment levels and the bargaining power of supermarkets.

<sup>327</sup> *ibid.*

<sup>328</sup> *ibid.*

<sup>329</sup> Based on ABS data, *Research and Experimental Development, Businesses, Australia survey, 2013 to 2018.*

<sup>330</sup> *ibid.*

<sup>331</sup> *ibid.*

<sup>332</sup> ACCC 2018, *Dairy inquiry final report*, p. 122.

## 3.5 Conclusion

The practices and behaviours that result from imbalances in bargaining power and market failures vary. They can result in harmful outcomes for market participants, and harm the broader efficiency of industries. The consequences of market failure include resources being inefficiently allocated, which leads to markets not operating as well as they could.

The ACCC has identified some harmful conduct in PAG industries resulting from insufficient competition and information failures. By contrast, it is a normal part of commercial dealings that parties with superior bargaining power can achieve more favourable terms than those with lesser bargaining power, and some of the concerns raised with the ACCC during the inquiry likely fall into this category.

The information submitted to the ACCC for this inquiry indicates some harm has likely resulted from imbalances in bargaining power in PAG supply chains. While not all suppliers and producers are likely to have been impacted equally, there are some trends in behaviour which are likely to lead to inefficient outcomes. Chapters 5 and 6 discuss how current laws deal with these concerns and whether any reform is needed.

# 4. The supply chain for dairy products

## Key points

- While industry codes regulate the conduct of market participants in their dealings with one another, they are not intended to, or capable of, distributing value in a supply chain among participants.
- Challenging environmental conditions in recent years have increased dairy producers' costs of production. In the 2018-19 season, average farmgate prices did not increase in line with cost of production, and therefore average profits declined. However, costs of production differ significantly between farms and over time, with some years and farms being more profitable than others.
- Producers in northern regions are generally paid considerably higher farmgate prices than their southern counterparts. In the last five years, the average Queensland farmgate price was between 26 and 63% higher than the Victorian price.<sup>333</sup> In recent years the gap between prices in the two states has narrowed to around 13 cents per litre as the Victorian price has risen and the Queensland price has remained relatively steady. Milk can be transported between regions, including from Victoria to Queensland at times.
- Farm costs of production are one of several variables that processors take into account when setting farmgate prices, but these are not the key determinant from year to year. Processors set a farmgate price only as high as they need to in order to acquire the volume of milk that meets their demand in that region. The prices that processors need to pay are generally higher when there is stronger competition between processors for purchasing milk.
- The ACCC has reviewed the operation of price pass-through mechanisms, and found that most private label milk contracts and some contracts for other private label dairy products allow processors to pass-through increased farmgate milk or commodity prices to the wholesale prices paid by the retailer. Changes to farmgate prices and wholesale prices are not always perfectly aligned in real time. Farm production costs are often a factor when processors rely on these mechanisms.
- Some in the industry are concerned that private label milk pricing has removed substantial value from the dairy supply chain.<sup>334</sup> However, historical pricing data indicates that higher retail prices do not lead to higher farmgate prices or farmer income. Higher retail prices extract increased revenue from consumers, and redistribute this to retailers and processors.

## 4.1 Introduction

The inquiry terms of reference direct the ACCC to consider the effectiveness of the Competition and Consumer (Industry Codes—Dairy) Regulations 2019 (Dairy Code). In doing so, the ACCC is directed to have regard to a number of matters, including farm level costs and productivity, and the extent to which those matters are properly taken into account by processors and retailers. This chapter sets out analysis relevant to these factors.

333 2014-15 to 2018-19 seasons, ACCC calculations using indicative factory paid milk prices by state, from Dairy Australia, *The Australian dairy industry in focus 2019*, p. 10.

334 Australian Dairy Farmers, *Inquiry into perishable agricultural products and the dairy industry code*, 18 September 2020, p. 19; NSW Farmers, *ACCC Perishable Agricultural Goods Inquiry Submission*, September 2020, p. 10; Queensland Farmers Federation, *ACCC Perishable Agricultural Goods Inquiry*, 25 September 2020, pp. 3-4.

### 4.1.1 Private label milk and retail pricing

In 2011, Coles introduced pricing for private label milk of \$1 per litre, which was quickly followed by Woolworths and ALDI and subsequently by some other retailers.<sup>335</sup> This has been a source of considerable concern in the dairy industry. Many farmers consider that this pricing devalues the work they, their families and staff do to produce high quality milk.<sup>336</sup> At the time of the Dairy Inquiry, farmers were frustrated that the retail price of milk had stayed the same, and declined in real terms, from 2011 to 2019, when this would not have been the case for most grocery items.<sup>337</sup> In 2019 the price of private label milk per litre increased to \$1.10, and then \$1.20.

During this inquiry, stakeholders have continued to raise concerns about the impact of private label milk and low retail and wholesale prices on the supply chain.<sup>338</sup>

The Dairy Inquiry did not obtain any evidence that domestic retail pricing strategies, including private label milk pricing, had a direct impact on farmgate prices, and found that farmers were unlikely to benefit from an increase in the retail (or wholesale) prices of private label milk or other dairy products.<sup>339</sup> This finding was informed by data and documents covering each level of the dairy supply chain.<sup>340</sup>

Additionally, evidence obtained during the Dairy Inquiry through the ACCC's compulsory information gathering powers showed that almost all contracts for the supply of private label milk allowed processors to pass-through movements in farmgate prices to supermarkets. As a result, we found that there was no direct relationship between retail private label milk prices and farmgate prices.<sup>341</sup>

For this inquiry, the ACCC has used our information gathering powers to update our assessment of the treatment of farmgate prices in supermarkets' contracts with processors.

Pass-through clauses in private label milk and other dairy contracts mean that processors do not compete for these contracts on the basis of setting the lowest farmgate milk price. In most instances, they are able to increase the price over time in line with market movements. The ACCC saw evidence of processors using these clauses. By contrast, branded dairy contracts with supermarkets do not contain pass-through clauses, and processors are price takers in export markets.<sup>342</sup> The farmgate price that processors choose to pay therefore does impact the profitability of branded and exportable dairy products.

### 4.1.2 Processors and wholesale prices

The majority of raw milk produced by Australian dairy farmers goes into products other than private label drinking milk. This includes milk produced in domestic focused regions such as Queensland and northern NSW.<sup>343</sup> The Dairy Inquiry found that branded products are much more profitable for processors than private label products.<sup>344</sup> Consequently, while processors may have the ability to increase the farmgate price and pass the increase on to retailers, they do not have the incentive to do so, because they would have to pay higher prices to all of their suppliers, but would only be able to pass the increase onto the retailer for a small proportion of their sales (private label milk). Therefore, increasing farmgate prices would reduce processors' profits on branded dairy products.

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335 ACCC, *Dairy inquiry final report*, April 2018, p. xix.

336 *ibid.*

337 *ibid.*

338 Australian Dairy Farmers, p. 19; NSW Farmers, p. 10; Queensland Farmers Federation, p. 3.

339 ACCC 2018, *Dairy inquiry final report*, p. xiii.

340 *ibid.*

341 *ibid.*, p. xxi.

342 *ibid.*, p. xviii.

343 Based on the national split between supermarket branded and non-branded milk and non-supermarket milk, as shown in figure 4.7.

344 Based on findings in the *Dairy Inquiry final report*, p.130. The ACCC found that processors earn the highest margins on flavoured fresh drinking milk, yoghurt, branded fresh drinking milk and premium cheese, ranging from 30 to 60% gross margin.

The Dairy Inquiry found that processors set farmgate prices and that farmers have very little bargaining power in this relationship.<sup>345</sup> In this environment, processors will always pay the minimum price they can to secure their desired volume of supply.<sup>346</sup> In contrast, while processors may have a weaker bargaining position to supermarkets, the Dairy Inquiry found that there are significant differences between the retailer-processor relationship and the processor-farmer relationship. Processors are generally better resourced to negotiate their commercial relationship with supermarkets than farmers are with processors, and some have the ability to negotiate terms and prices, including price increases when costs have increased, whereas farmers almost never have this option.<sup>347</sup>

While there are concerns that processor margins are falling to unsustainable levels, the Dairy Inquiry found a number of examples of processors making investments in new and more efficient processing facilities<sup>348</sup>, indicating they perceive opportunities for profit growth in the future.

Forecast milk supply relative to milk requirements is one factor that processors take into account when setting farmgate prices.<sup>349</sup> If, over the long run, farm costs of production are higher than milk prices, farms will not be profitable and producers will exit. However, the price at which a processor can obtain the milk volumes they need may not cover costs of production for all farmers in each year. Farm costs of production vary widely, even within a given region.

### 4.1.3 Farm costs of production

While farm costs of production do not strongly influence fluctuations in farmgate prices from year to year, they are a significant influence on farmgate prices over the long run.

Dairy farms face changing costs of inputs and other costs of production, and cannot respond quickly to price signals. However, if farming is unprofitable over the long run, farm businesses will exit and processors will lose supply. Consequently, over time these two factors are linked, although other variables such as volatile farm input costs, wide variations in production costs between farms, the influence of export markets, and processors' smoothing farmgate prices year-to-year, means that the timing of changes to prices and costs are not perfectly correlated. The price at which a processor can obtain required volumes may not cover costs of production for all farmers in each year.

It is therefore very important that farmers have access to timely and reliable price signals before the commencement of a dairy season, so that they can best manage their costs of production and supply decisions in relation to expected income. The introduction of the Dairy Code sought to address shortcomings in these areas that were identified by the Dairy Inquiry.

## 4.2 Previous ACCC consideration of the dairy industry

The ACCC has undertaken extensive analysis of the Australian dairy industry at various times over the last two decades, in particular:

- In 2001, a study of prices, costs and profits following farmgate price deregulation.<sup>350</sup>
- In 2018, an inquiry into the competitiveness of prices, trading practices and the supply chain in the Australian dairy industry (Dairy Inquiry).<sup>351</sup>

Additionally, the ACCC has analysed the industry in the course of investigating proposed mergers and collective bargaining arrangements, and other alleged breaches of the competition and consumer protection laws.

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345 This is discussed in chapter 2 of ACCC 2018, *Dairy Inquiry final report*.

346 ACCC 2018, *Dairy inquiry final report*, p. 37.

347 *ibid*, p. 31.

348 *ibid*, p. 98.

349 *ibid*, p. 39.

350 ACCC, *Impact of farmgate deregulation on the Australian milk industry: study of prices, costs and profits*, [www.accc.gov.au/publications/impact-of-farmgate-deregulation-on-the-australian-milk-industry](http://www.accc.gov.au/publications/impact-of-farmgate-deregulation-on-the-australian-milk-industry), viewed 11 November 2020.

351 ACCC, *Dairy Inquiry final report*, April 2018, [https://www.accc.gov.au/system/files/1395\\_Dairy%20inquiry%20final%20report.pdf](https://www.accc.gov.au/system/files/1395_Dairy%20inquiry%20final%20report.pdf), viewed 25 November 2020.

This inquiry is informed by that previous work. In addition, we have sought new and updated information regarding the relationship between farmgate prices and wholesale and retail pricing arrangements.

#### 4.2.1 ACCC reviews and investigations in the dairy industry

Since 2016, the ACCC's analysis of the industry has included:

- Investigating terms in the contracts offered by dairy processors to farmers under the business-to-business unfair contract terms law. In response to concerns raised by the ACCC, Brownes Food Operations, Lion Dairy & Drinks, Norco Co-operative Limited, Parmalat Australia, Fonterra Australia and Warrnambool Cheese and Butter Factory Company Holdings Limited agreed to amend specific terms in their milk supply agreements.<sup>352</sup>
- Instituting proceedings in the Federal Court, following which Murray Goulburn admitted to making false or misleading representations in breach of the ACL about the farmgate milk price it expected to pay dairy farmers during the 2015-16 milk season. Former managing director Gary Helou admitted he was involved in the misleading representations. The ACCC did not seek a penalty against Murray Goulburn because it was a co-operative. This was to avoid any penalty imposed against it ultimately being paid by the very farmers that were misled. The Federal Court ordered Mr Helou to pay \$200,000 in penalties for being knowingly concerned.<sup>353</sup>
- Investigating whether Coles fully passed on to Norco a 10 cents per litre price rise it charged consumers for Coles branded fresh milk, as it claimed it would do in Coles' marketing materials. Following this investigation, Coles committed to pay around \$5.25 million to Norco suppliers to resolve concerns about the representations Coles had made.<sup>354</sup>
- Reviewing and not opposing Saputo's proposed acquisition of Murray Goulburn's assets, after accepting a court-enforceable undertaking from Saputo to divest Murray Goulburn's Koroit plant.<sup>355</sup>
- Closely considering the potential impact on competition of the proposed acquisition of Lion Dairy & Drinks Pty Ltd by China Mengniu Dairy Company Ltd, which we did not oppose.<sup>356</sup>
- Reviewing the proposed acquisition of Lion Dairy & Drinks' Tasmanian-based cheese business by Saputo Dairy Australia, which we did not oppose.<sup>357</sup>

#### 4.2.2 Dairy Inquiry and mandatory code recommendation

In October 2016 the Australian government directed the ACCC to hold an inquiry into the competitiveness of prices, trading practices and the supply chain in the Australian dairy industry (Dairy Inquiry).

The Dairy Inquiry followed late-season retrospective changes to the farmgate prices paid by Australia's two largest dairy processors in April 2016 which caused substantial detriment to dairy farm businesses in the southern regions of the Australian dairy industry. These 'step-downs' caused severe and unforeseen reductions in the incomes of more than 2,000 dairy farmers and significantly impacted

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352 ACCC, *Dairy processors agree to amend farmer contract terms*, <https://www.accc.gov.au/media-release/dairy-processors-agree-to-amend-farmer-contract-terms>, viewed 11 November 2020; ACCC, *Warrnambool Cheese and Butter amends contract terms*, <https://www.accc.gov.au/media-release/warrnambool-cheese-and-butter-amends-contract-terms>, viewed 11 November 2020.

353 ACCC, *ACCC takes action against Murray Goulburn*, [www.accc.gov.au/media-release/accc-takes-action-against-murray-goulburn](http://www.accc.gov.au/media-release/accc-takes-action-against-murray-goulburn), viewed 11 November 2020; ACCC, *Former Murray Goulburn MD Gary Helou to pay \$200,000 penalty*, [www.accc.gov.au/media-release/former-murray-goulburn-md-gary-helou-to-pay-200000-penalty](http://www.accc.gov.au/media-release/former-murray-goulburn-md-gary-helou-to-pay-200000-penalty), viewed 11 November 2020.

354 ACCC, *Coles to pay Norco dairy farmers around \$5.25 million following ACCC investigation*, [www.accc.gov.au/media-release/coles-to-pay-norco-dairy-farmers-around-525-million-following-accc-investigation](http://www.accc.gov.au/media-release/coles-to-pay-norco-dairy-farmers-around-525-million-following-accc-investigation), viewed 11 November 2020.

355 ACCC, *Saputo Dairy Australia Pty Ltd proposes to acquire Murray Goulburn's operating assets*, [www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/saputo-dairy-australia-pty-ltd-proposes-to-acquire-murray-goulburns-operating-assets](http://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/saputo-dairy-australia-pty-ltd-proposes-to-acquire-murray-goulburns-operating-assets), viewed 11 November 2020.

356 ACCC, *China Mengniu Dairy Company Limited—Lion Dairy & Drinks Pty Ltd*, [www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/china-mengniu-dairy-company-limited-lion-dairy-drinks-pty-ltd](http://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/china-mengniu-dairy-company-limited-lion-dairy-drinks-pty-ltd), viewed 11 November 2020.

357 ACCC, *Saputo Dairy Australia Pty Ltd—Lion Dairy and Drinks Pty Ltd cheese business*, [www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/saputo-dairy-australia-pty-ltd-lion-dairy-and-drinks-pty-ltds-cheese-business](http://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews/saputo-dairy-australia-pty-ltd-lion-dairy-and-drinks-pty-ltds-cheese-business), viewed 11 November 2020.

the productivity of the industry. Farmers exited the industry and the volume of milk produced fell substantially in the following season.

During the Dairy Inquiry, which ran until 2018, the ACCC analysed the performance of the dairy industry and the structural and behavioural features which contribute to this performance. The ACCC's analysis and findings are detailed in the Dairy Inquiry final report.

The key recommendation of the Dairy Inquiry was that the government should introduce a mandatory code of conduct for the industry. The inquiry found that dairy farmers typically have very limited bargaining power when negotiating with processors, and limited scope to reposition their businesses or switch to a different farm enterprise.<sup>358</sup> Processors also have access to better information about prices and general market conditions than farmers.<sup>359</sup> Imbalances in bargaining power, information asymmetries and the historical use of cooperative contracting models in the industry have resulted in contracts and practices that favour processors and/or reduce farmers' ability to switch, such as:

- processors' ability to vary farmgate milk prices throughout a season or within a contract period
- processors' ability to unilaterally vary terms in contracts, including indirectly by changing requirements detailed in ancillary contract documents
- farmers having limited time and information with which to make critical decisions about which processor to supply
- farmers being subject to unnecessary switching barriers in contracts, such as conditional loyalty bonuses and extended notice periods, and
- the absence of effective dispute resolution processes.

The ACCC found that these practices lead to inappropriate risk allocation between producers and processors, a weakening of competition between processors for raw milk supply, and potentially inefficient investment decisions by farmers. The ACCC determined that a mandatory code was the best way to address these systemic issues over the long term.

The ACCC therefore welcomed the government's introduction of the Dairy Code, which came into effect on 1 January 2020. The ACCC is responsible for enforcement of the Dairy Code. This involves monitoring compliance by assessing reported breaches of the code, and conducting compliance checks. Sections 51ADD–51ADG of the CCA give the ACCC an audit power to make a compulsory request for information or documents that businesses are required to keep, generate or publish under an applicable industry code. The ACCC also provides industry with general information about the requirements of the Dairy Code. The ACCC is not a dispute resolution body and does not provide legal advice.

The Dairy Code broadly aims to reduce barriers to competition and reduce price uncertainty: the latter allows farmers to make better informed production and investment decisions with more confidence. While improved competition might be expected to deliver a slightly higher farmgate milk price than would otherwise occur, the purpose of the Dairy Code is not to directly strengthen the relationship between farmgate milk prices and costs of production.

## 4.3 Dairy industry background

The key characteristics of the dairy industry that impact on bargaining power are outlined in figure 4.2. The industry is characterised by a large number of producers, several major processors, and a large number of smaller processors.<sup>360</sup> The number of processors that a producer may be able to supply varies by region, typically being the highest in Victoria, and in some regions as low as one or two.<sup>361</sup> The major supermarkets are a significant channel to end consumers, and exports provide an important alternative for some processors (see figure 4.2). With the exception of fresh drinking milk (which

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358 ACCC 2018, *Dairy inquiry final report*, p. xii.

359 *ibid.*, pp. xiii, 40.

360 ACCC 2018, *Dairy inquiry final report*, p. 13.

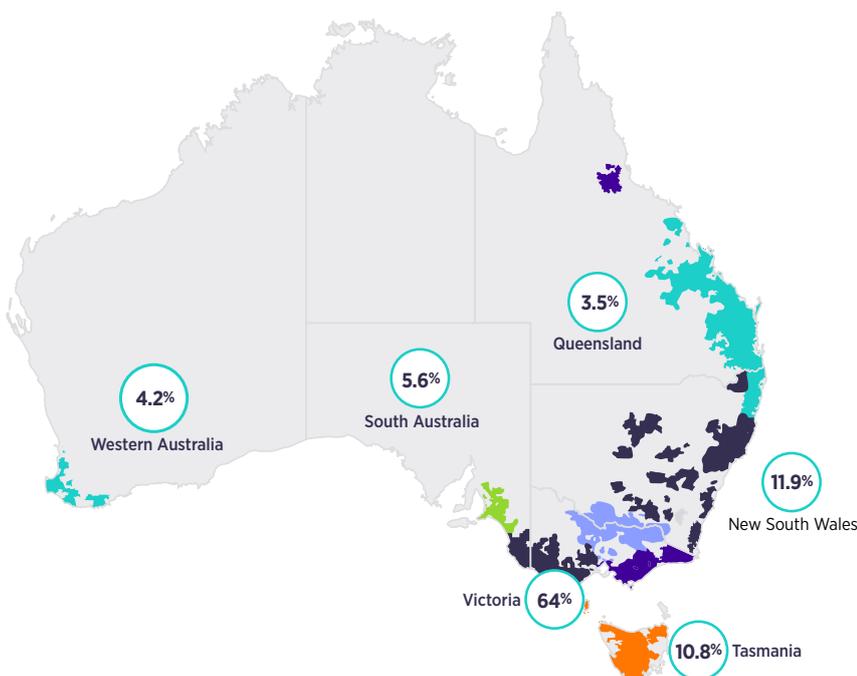
361 *ibid.*, pp.8, 70. Competition for acquiring milk is discussed in detail in the ACCC Dairy Inquiry final report, chapter 4.

accounts for less than 28% of total national milk production<sup>362</sup>), dairy products manufactured in Australia compete with imported dairy products.

Perishability varies across the sector and product groups, from fresh milk on-farm, which is extremely perishable, to semi-perishable or non-perishable processed products that can be stored at room temperature. Perishability necessitates timely access to market. Milk must be refrigerated on farm and during transport to the processing facility, and pasteurised within 72 to 120 hours.<sup>363</sup> Further processing converts milk into longer shelf life products such as cheese, butter, yoghurt and milk powder.

### 4.3.1 Structure at the farmgate

Figure 4.1: Dairy: proportion of national production, by state, 2019–20



Source: Dairy Inquiry final report, with state production updated using Dairy Australia data.

The typical farm is family owned and operated, has significant investment in infrastructure and capital, high fixed costs and requires year-round intensive work amid uncertain climate conditions.<sup>364</sup>

Most dairy producers have little bargaining power, and limited scope to reposition their businesses or switch to a different farm enterprise to mitigate this. Larger-scale farms can sometimes receive more favourable prices and trading terms, but this is not the typical producer experience.<sup>365</sup>

Production regions can be broadly grouped as either northern or southern<sup>366</sup>, with the northern region<sup>367</sup> and WA focusing on shorter shelf life products for domestic consumption, and southern regions also producing longer shelf life products.<sup>368</sup> The majority of milk production occurs in the southern regions (64% of 2019-20 national production occurred in Victoria alone<sup>369</sup>, see figure 4.1). The total supply of raw milk in southern regions far exceeds total domestic fresh drinking milk demand.<sup>370</sup>

362 According to Dairy Australia, *The Australian dairy industry in focus 2019*, p.18, 28% of milk production is utilised as drinking milk. However, some of this is long life or UHT, rather than fresh drinking milk.

363 ACCC 2018, *Dairy inquiry final report*, p. 3.

364 *ibid*, p. xiii.

365 *ibid*, p. xii.

366 Includes eastern Victoria, Murray region, western Victoria, SA, Tasmania.

367 Includes Far North Queensland (FNQ), northern NSW/southern Queensland, and central NSW.

368 ACCC 2018, *Dairy inquiry final report*, p. 1.

369 ACCC calculation from data in Dairy Australia, *The Australian dairy industry in focus 2019*, p. 14.

370 *ibid*, pp. 14 and 23.

The primary downstream sales option for a producer is selling to a processor, although they may sell to an intermediary such as a milk broker, or directly to a supermarket. These downstream parties rarely negotiate contract terms with producers, offering standard form contracts on a 'take-it-or-leave-it' basis.<sup>371</sup> The industry has a unique approach to pricing. While some fixed-price contracts exist, variable price arrangements are most common, with processors setting a milk price at the commencement of each season and amending this as likely profits became more certain.<sup>372</sup>

Effective competition for raw milk appears to be weakest in central Queensland and FNQ. Producers in these regions have only one major processor that they can sell to. In other regions such as WA, central NSW and northern NSW/southern Queensland, producers have at least three processors they can supply. Producers in Victoria have significantly more options to sell raw milk than producers in other states.<sup>373</sup>

### 4.3.2 Access to buyers and consumers

Processors produce a range of dairy products. While most processors acquire milk directly from producers, some smaller processors acquire milk from larger processors, and milk brokers also play a role in the industry.<sup>374</sup>

The majority of dairy is consumed domestically, primarily as drinking milk, cheese, yoghurt and butter.<sup>375</sup> The major supermarkets account for the majority of supply to domestic consumers, accounting for over 50% of domestic drinking milk, butter and cheese sales, and the vast majority of yoghurt sales (see figure 4.2). Consequently, the supermarkets have significant bargaining power when dealing with processors. Processors that supply both export and domestic markets, or differentiated and premium products, are relatively less exposed to supermarkets' bargaining power.<sup>376</sup>

Supermarkets compete strongly on certain dairy products that they consider to be important to customers' perceptions of value.<sup>377</sup> All the major supermarkets include private label milk, in addition to other private label dairy, in their product offering. Private label milk was priced at \$1 per litre between 2011 and 2019 by all supermarkets, and is currently \$1.20 per litre. Information obtained for the Dairy Inquiry indicated that each supermarket closely follows the pricing and promotional activities of competitors on dairy products.<sup>378</sup> In particular, supermarkets have been quick to follow each other's pricing strategies in regard to national pricing, and the prices of private label milk and cheese.<sup>379</sup> The supermarkets are reluctant to increase prices on these key value items as any price increase risks a loss of sales.<sup>380</sup>

Some processors have toll processing arrangements with major supermarkets for the production of drinking milk. Coles announced direct sourcing arrangements with producers for its private label fresh white milk in June 2019, and toll processing arrangements with Saputo Dairy Australia in Victoria, Southern and Central NSW; in May 2020 it announced expansion of the scheme, to SA and WA, and processing arrangements with Lion Dairy and Drinks, Brownes Dairy and Lactalis Australia.<sup>381</sup> Woolworths has direct sourcing arrangements with producers in Victoria, NSW, QLD, SA and WA for its Farmers' Own brand milk.<sup>382</sup>

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371 ACCC 2018, *Dairy inquiry final report*, p. 31.

372 *ibid.*, pp. 38–39.

373 *ibid.*, pp. 8, 70.

374 *ibid.*, p. 82.

375 Dairy Australia, *The Australian dairy industry in focus 2019*, p. 22.

376 ACCC 2018, *Dairy inquiry final report*, pp. xii, 122, 125.

377 *ibid.*, p. 111.

378 *ibid.*

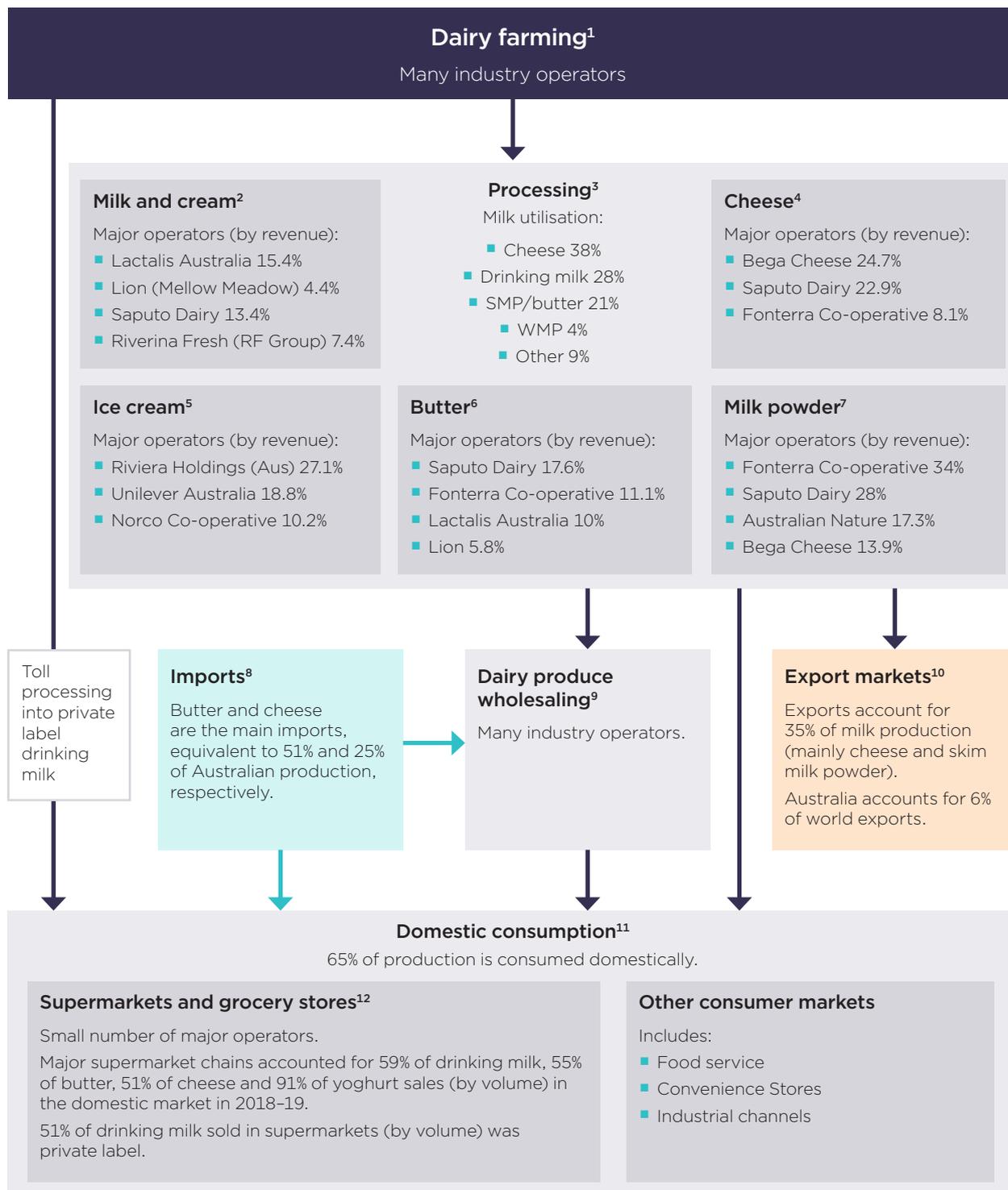
379 *ibid.*

380 *ibid.*

381 Coles Group 2019, *Coles to buy milk directly from farmers for Coles Brand milk*, [www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-directly-from-farmers-for-coles-brand-milk](http://www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-directly-from-farmers-for-coles-brand-milk), viewed 20 October 2020; Coles Group 2020, *Coles to buy milk directly from SA, WA farmers for Own Brand milk*, [www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-direct-from-sa--wa-farmers-for-own-brand-milk](http://www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-direct-from-sa--wa-farmers-for-own-brand-milk), viewed 20 October 2020.

382 Woolworths Group Limited 2020, *How we Source Our Milk*, [www.woolworths.com.au/shop/discover/our-brands/farmers-own-milk-sources](http://www.woolworths.com.au/shop/discover/our-brands/farmers-own-milk-sources), viewed 20 October 2020.

Figure 4.2: Dairy supply chain



Note: Includes key supply chain sectors and participants, however is illustrative of general industry features only, and is not intended to be exhaustive.

- 1 IBISWorld, Dairy Cattle Farming in Australia, 2019
- 2 IBISWorld, Milk and Cream Processing in Australia, 2020
- 3 Dairy Australia, Australian Dairy In Focus 2019, p, 18
- 4 IBISWorld, Cheese Manufacturing in Australia, 2020
- 5 IBISWorld, Ice Cream Manufacturing in Australia, 2020
- 6 IBISWorld, Butter and Dairy Product Manufacturing in Australia, 2020
- 7 IBISWorld, Milk Powder Manufacturing in Australia, 2020
- 8 Derived from data in Dairy Australia, Australian Dairy In Focus 2019
- 9 IBISWorld, Dairy Produce Wholesaling in Australia, 2020
- 10 Dairy Australia, In Focus 2019, p, 2
- 11 Dairy Australia, Australian Dairy In Focus 2019, p, 2
- 12 IBISWorld, Supermarkets and Grocery Stores in Australia, 2020; ACCC calculation derived from data in Dairy Australia, Australian Dairy In Focus 2019

## 4.4 Dairy farm costs of production and long term farmgate milk prices

Dairy processors announce an opening price at the start of each season.<sup>383</sup> Processors generally aim to minimise their input costs while ensuring they have sufficient supply volumes.<sup>384</sup> A number of factors influence the price processors can, and are willing to pay for milk.

The Dairy Inquiry found that processors use a range of measures to estimate the volume of milk they need to fulfil product orders and to maximise earnings.<sup>385</sup> They then estimate the farmgate milk price they need to pay to attract this, generally taking into account<sup>386</sup>:

- competition for the acquisition of raw milk
- forecast milk supply for the period
- forecast revenues for the period
- processing capacity and costs
- for co-operatives, how returns to members will be allocated (farmgate price or dividends).

These factors influence changes in the farmgate price from year to year.

In the long term, farmgate milk prices are significantly influenced by the cost of production, because, if too many farmers are unprofitable and exit, processors will not have sufficient milk supply. Because costs of production are volatile, output cannot be changed quickly, and farmers are unlikely to make the decision to exit in a single unprofitable season, this is not a year-to-year proposition but a longer term one. Further, some processors aim to smooth out farmgate prices over seasons, rather than fully pass on fluctuations in commodity prices. This can involve absorbing losses in the short term.<sup>387</sup>

In any given year, production costs in domestic focused regions, such as Queensland, are more likely to be aligned with farmgate prices than is the case in southern regions. Relative farmgate prices vary between regions and are generally higher and more stable in domestic focused regions, as shown in table 4.1.

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383 ACCC 2018, *Dairy inquiry final report*, p. 39.

384 *ibid.*

385 *ibid.*

386 *ibid.*

387 *ibid.*, p. 40.

**Table 4.1: Indicative farmgate milk prices by state**

		2014-15	2015-16	2016-17	2017-18	2018-19(p)
NSW	cents/litre	52.8	51.0	49.0	50.5	54.7
	\$/kg milk solids	7.31	7.06	6.81	6.99	7.67
Victoria	cents/litre	47.1	42.8	38.0	44.2	48.2
	\$/kg milk solids	6.24	5.68	5.04	5.87	6.40
Queensland	cents/litre	57.4	58.5	60.0	57.7	61.0
	\$/kg milk solids	7.84	7.99	8.22	7.84	8.31
SA	cents/litre	4.61	42.5	37.1	42.9	47.2
	\$/kg milk solids	6.53	6.03	5.19	6.06	6.62
WA	cents/litre	51.0	52.3	50.6	49.9	50.2
	\$/kg milk solids	7.17	7.32	7.06	6.97	7.05
Tasmania	cents/litre	49.6	43.7	39.0	47.0	50.3
	\$/kg milk solids	6.33	5.61	4.97	6.01	6.37
Australia	cents/litre	48.5	44.9	40.9	46.0	49.7
	\$/kg milk solids	6.49	6.01	5.46	6.14	6.64

Source: Dairy Australia, *The Australian dairy industry in focus 2019*, p.10 (Dairy Australia analysis and data from Dairy manufacturers).

The Dairy Inquiry examined movements in farmgate prices, farming costs, raw milk production volumes and revenue generated by farmers over time.<sup>388</sup> We also looked at the most likely influences on these movements<sup>389</sup>.

The Dairy Inquiry found that dairy farm profitability is volatile as a result of significant movements in either farming costs and/or farmgate prices.<sup>390</sup> Movements in both vary across states, owing to climatic conditions and the degree to which dairy products are sold into export markets versus the domestic market.<sup>391</sup>

388 ACCC 2018, *Dairy inquiry final report*, p. 134.

389 *ibid.*

390 *ibid.*, p. 135.

391 *ibid.*

### Box. 4.1: Section uses data from both ABARES and Dairy Farm Monitor Project

This section uses data and charts from the annual ABARES Farm Survey, the Dairy Farm Monitor Project (DFMP) and the Queensland Dairy Accounting Scheme (QDAS).<sup>392</sup>

The DFMP (including QDAS) provides analysis of 250 dairy farms across Australia. The DFMP records financial and production data of participating dairy farms in all major dairying regions. Participants are selected for the project in order to represent a distribution of farm sizes, herd sizes and geographical locations within each region. The results presented do not represent population averages, as the participant farms are not selected using random sampling and may not be representative of the whole dairy industry or dairy regions.<sup>393</sup> QDAS farms have larger herds and produce more milk per farm than the Queensland average.<sup>394</sup>

The annual ABARES Farm Survey estimates the financial performance of Australian dairy farms, and is available for a longer time series than the DFMP and QDAS data.

While we have used both data sources within this section, there are several differences in methodology between the DFMP and the ABARES Farm Survey, so the series may not be directly comparable.

#### 4.4.1 Drivers of farmgate milk prices

Processors aim to set milk prices at the lowest level necessary to obtain the volumes they need<sup>395</sup>, meaning competition is an important influence on the year to year movements in farmgate prices. Greater competition results in higher farmgate prices as processors try to capture their required volumes of milk.<sup>396</sup> The degree of competition between processors in Australia varies from region to region, as set out in 4.3.1, and therefore so does the impact of competition on movements in farmgate price.

National and regional milk production fluctuates year to year owing to a variety of factors. Since 2006–07, national production has been between nine and 9.8 billion litres. In 2018–19, national production fell to 8.8 billion litres, with declines in all states.<sup>397</sup> The ACCC understands that in recent years competition for milk has been strong in southern regions in response to a supply shortage.<sup>398</sup> This is reportedly a consequence of producers exiting the industry, particularly in the Murray region and in the northern states, as a result of a number of factors including severe drought conditions<sup>399</sup>, and the 2016 step-downs. While competition has led to higher farmgate prices, this has not necessarily translated to higher returns for farmers.<sup>400</sup>

While the ACCC acknowledges concerns within the industry about national pricing, in industries where businesses compete, it is rational that the majority of raw milk is procured at the lowest possible cost. For producers in domestic-focused regions directly impacted by this, the personal consequences are significant. However, higher cost producers moving out of a national industry, and the deficit itself, does not signify a market failure as long as total production (including inter-state transfers) meets total demand.<sup>401</sup>

392 ABARES, [www.agriculture.gov.au/abares/research-topics/surveys/farm-survey-data](http://www.agriculture.gov.au/abares/research-topics/surveys/farm-survey-data); Dairy Australia Farm Monitor Report, [www.dairyaustralia.com.au/dairyfarmmonitor](http://www.dairyaustralia.com.au/dairyfarmmonitor); and Queensland Dairy Accounting Scheme, [dairyinfo.biz/technical-information/farm-business-management/qdas/](http://dairyinfo.biz/technical-information/farm-business-management/qdas/).

393 Dairy Australia 2020, *Dairy Australia Farm Monitor Report*, [www.dairyaustralia.com.au/dairyfarmmonitor](http://www.dairyaustralia.com.au/dairyfarmmonitor), viewed 16 November 2020.

394 Subtropical Dairy Programme Limited 2020, [dairyinfo.biz/technical-information/farm-business-management/qdas/](http://dairyinfo.biz/technical-information/farm-business-management/qdas/), viewed 16 November 2020.

395 ACCC 2018, *Dairy inquiry final report*, p. 39.

396 *ibid.*

397 Dairy Australia, *The Australian dairy industry in focus 2019*, p. 14.

398 Australian Dairy Farmers, p. 18.

399 Australian Dairy Plan, *Australian Dairy Situation Analysis—Appendix B*, May 2019, p. 3.

400 Australian Dairy Farmers, p. 18.

401 ACCC 2018, *Dairy inquiry final report*, p. 138.

## Exporting regions

In southern regions, world commodity prices are the key influence on movements in farmgate prices. Each processor has a different product mix, and is affected differently by changes in global prices.<sup>402</sup> World dairy prices can be volatile, and consequently demand for milk can be much more volatile year-to-year in the southern region.<sup>403</sup> Broadly speaking, when global demand for dairy products declines, production cannot easily be redirected into domestic sales, so processors try to adjust the amount of milk they purchase. When global demand and prices rise, these processors have an incentive to increase production, and therefore to secure more raw milk, which prompts higher farmgate prices.<sup>404</sup>

## Farmgate prices and costs of production in domestic regions

Average costs of production may be given more weight by buyers in domestic regions. In WA, Queensland and northern NSW, demand for raw milk is driven predominantly by demand for domestic drinking milk, which is relatively stable. Movements in farmgate prices reflect the state of competition between processors, overall domestic demand for raw milk and the relative bargaining positions of farmers and processors.<sup>405</sup>

Queensland and WA provide clear historical examples of the long run link between farmgate prices and cost of production. In these regions, following deregulation, it was no longer economically feasible to convert excess milk into non-perishable products and overall production needed to decrease. In both Queensland and WA, processors decreased the farmgate price, encouraging marginally profitable farmers to exit and the remaining farmers to improve productivity.<sup>406</sup> At the same time, milk consumption grew, and in around 2007–08, milk production in both states began approaching the minimum levels required to keep up with demand. Processors increased the farmgate price substantially to encourage an increase in milk production.<sup>407</sup>

As raw milk can be transported from one region to another, farmgate milk prices in parts of the northern and WA regions (such as Queensland) can be, to a degree and over time, influenced by prices in parts of the southern region (such as Victoria).<sup>408</sup> However, this influence is only likely when global commodity prices (and therefore relative farmgate prices in the southern region) are particularly low. This is because when Victorian farmgate prices are high, the additional cost of transporting milk to Queensland generally makes it cheaper to source milk locally, despite the higher farmgate price.<sup>409</sup> The ACCC understands that the transport cost from Victoria is currently around 20 cents per litre.

### 4.4.2 Cost of production

Profitability relies on the difference between a farm's cost of production, and the price received for milk. Ultimately, whether or not a farm is profitable over the medium to long term will determine whether it continues in dairying. Costs of production vary widely between states, and year to year. They are a function of factors including farm location, the production system chosen (or dictated by local demand), management skill, and seasonal conditions. Average costs of dairy production in each state are shown in figure 4.3.

Buyers learn about farm costs of production through DFMP reports, and other similar local data sources. They also receive regular feedback from producer representative groups and councils, and from producers individually, particularly through buyer field officers.

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402 *ibid.*, p. 41.

403 *ibid.*, pp. 42–4.

404 *ibid.*, p.41.

405 ACCC 2018, *Dairy inquiry final report*, p. 136.

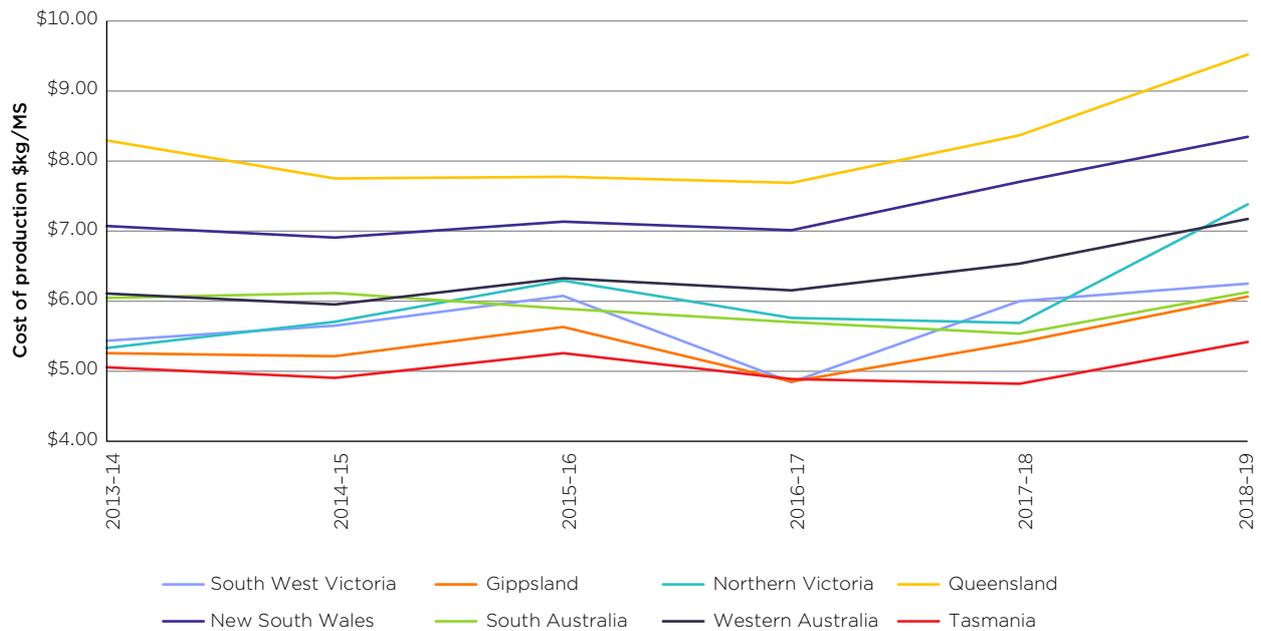
406 *ibid.*

407 *ibid.*, pp. 136–7.

408 *ibid.*, p. 43.

409 *ibid.*

**Figure 4.3: Costs of production by state over time (\$ per kilograms of milk solids (MS))**



Note: Cost of production includes farm working expenses (cash variable and overhead costs), imputed labour, depreciation, and changes in inventory of livestock, feed and water. Cash variables costs include herd, shed and feed costs such as AI and herd testing; animal health and calf rearing; shed power and dairy supplies; feed costs including fertiliser, irrigation, hay/silage making, pasture and cropping, fuel and oil and purchased feed. Cash overhead costs includes employed labour, repairs and maintenance, and other costs such as administration, motor vehicle expenses, miscellaneous and overheads.

Source: Dairy Farm Monitor Project.

In regions focused on domestic drinking milk, the requirement for milk year round affects production systems and calving patterns (see box 4.2). As cows need more energy when producing more milk, it is generally considered to be cheaper to calve in spring, when pasture growth is greatest. Autumn, split or year-round calving requires producers to use more supplementary feed. As the price of supplementary feed is relatively high and volatile compared to pasture, this increases both production costs and risk exposure. The climate in the southern regions better supports year round pasture growth<sup>410</sup>, while producers are more reliant on supplementary feed in northern regions where pasture growth is less consistent.<sup>411</sup>

### Box 4.2: Calving systems

Calving systems can be broadly described as seasonal (where all cows calve in a single time period, generally spring or autumn), split (cows calve in two or three distinct time periods, generally spring and autumn), or year-round (cows calve throughout the year).

Of the seasonal calving systems, spring calving results in a strong peak in milk production in the spring months, autumn calving an autumn peak, split calving both spring and autumn peaks, and year-round calving produces more consistent production throughout the year.

Consequently, favoured calving practices vary depending on the focus of the region, and the processors that can be supplied by a farm. Processors who manufacture fresh drinking milk require consistent volumes throughout the year as consumer demand is constant. By contrast, processors who produce longer shelf life products are generally able to accommodate variations in the volume of raw milk supply (these processors are typically located in export-focused regions). While year-round calving occurs to some extent in all states, it is the predominant system used by farmers in NSW, Queensland and WA. In southern regions, a larger proportion of farmers adopt split and seasonal calving production processes.

410 ACCC 2018, *Dairy inquiry final report*, p. 9.

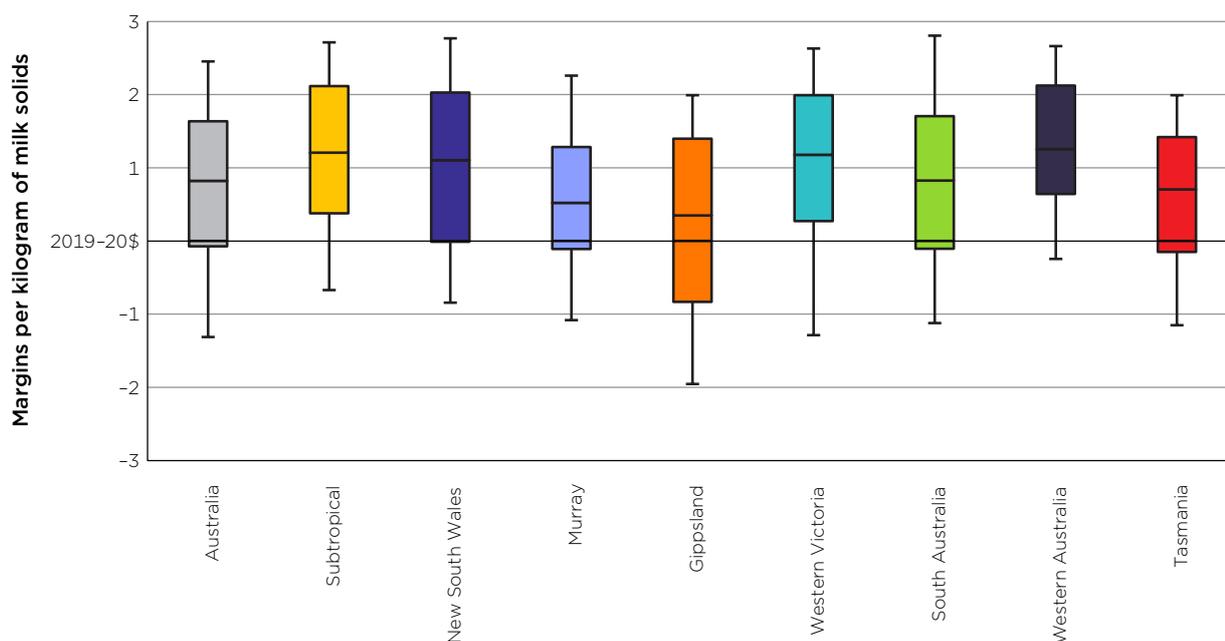
411 *ibid.*

### 4.4.3 Profitability

Producers in northern regions are generally paid considerably higher farmgate prices than their southern counterparts; indeed, in the last five years, the average Queensland farmgate price was between 26 and 63% higher than the Victorian price. As the Victorian price is much more volatile than the Queensland price, the gap between prices in the two states widens and narrows over time. In the most recent two seasons, it has been around 13 cents per litre, having narrowed from 22 cents per litre in 2016-17.<sup>412</sup>

ABARES data shows that in most years since 2015-16, most dairy farms surveyed earn a positive operating margin, demonstrating that farmgate prices are higher than cash costs (see figure 4.4). However it also shows that, as in most industries, not all businesses make a profit in each year.

**Figure 4.4: Distribution of operating margin, dairy farms, by region, 2015-16 to 2019-20**



Note: Cash costs per kilogram of milk solids. Distributions show the spread of individual observations from 2015-16 to 2019-20. Boxes represent the middle 50% of farms. The horizontal line within each box is the median. Vertical lines represent the spread from the 10th percentile to the 90th percentile.

Source: Aruni Weragoda and James Frilay 2020, *Australian dairy: financial performance of dairy farms, 2017-18 to 2019-20*, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra, p. 11, figure 9, [www.agriculture.gov.au/abares/research-topics/surveys/dairy](http://www.agriculture.gov.au/abares/research-topics/surveys/dairy), viewed 26 October 2020.

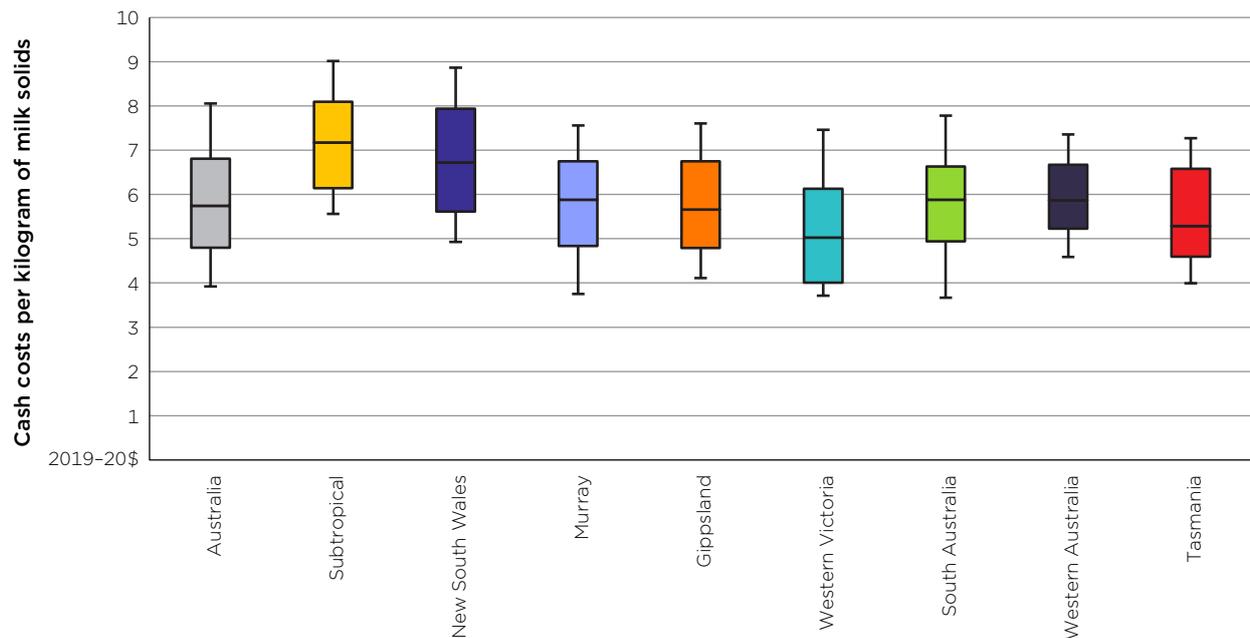
Most of the difference in margins for surveyed farms is driven by varying farm cash costs.<sup>413</sup> Figure 4.5 shows that cash costs vary widely across farms and regions, being highest in the subtropical region and lowest in western Victoria. Seasonal conditions impact both home-grown feed production and the cost of purchased feed. Consequently, poor seasons, the production system used (see box 4.2), and exposure to fodder and water markets can have a significant impact on variable costs of production. Other important factors impacting cost of production include managerial skills and use of hired labour.<sup>414</sup>

412 2014-15 to 2018-19 seasons, ACCC calculations using indicative factory paid milk prices by state, from Dairy Australia, *The Australian dairy industry in focus 2019*, p. 10.

413 "Total cash costs" refer to payments made by the business for materials and services and for permanent and casual hired labour, and excluding imputed labour: Aruni Weragoda and James Frilay 2020, *Australian dairy: financial performance of dairy farms, 2017-18 to 2019-20*, ABARES, Canberra, p. 4, [www.agriculture.gov.au/abares/research-topics/surveys/dairy](http://www.agriculture.gov.au/abares/research-topics/surveys/dairy), viewed 26 October 2020.

414 *ibid*, p. 11.

**Figure 4.5: Distribution of cash costs, dairy farms, by region, 2015-16 to 2019-20**



Note: Margins are based on unit milk prices minus cash costs per kilogram of milk solids. Distributions show the spread of individual observations from 2015-16 to 2019-20. Boxes represent the middle 50% of farms. The horizontal line within each box is the median. Vertical lines represent the spread from the 10th percentile to the 90th percentile.

Source: Aruni Weragoda and James Frilay 2020, *Australian dairy: financial performance of dairy farms, 2017-18 to 2019-20*, ABARES, Canberra, p. 13, figure 11, [www.agriculture.gov.au/abares/research-topics/surveys/dairy](http://www.agriculture.gov.au/abares/research-topics/surveys/dairy).

DFMP figures show that by far the most significant contribution to variable costs is feed.<sup>415</sup> During 2018-19, high fodder, grain and water prices considerably reduced farm profitability across the country, and this can be seen in increased average farm working expenses. The widespread increase in feed costs was broadly owing to:<sup>416</sup>

- NSW and northern Victoria being exposed to severe drought.
- In northern Queensland it was first too dry and then too wet, while dryland cropping was seriously reduced by hot, dry weather in the inland regions
- Gippsland had a good spring followed by a dry summer and a failed autumn, while the northern and western parts of south-west Victoria reported a poor autumn break
- In SA there was reduced average rainfall and drier conditions, reducing pasture production and increasing purchased feed costs. The warmer and drier conditions were conducive to good pasture growth in the South East of the state.
- Despite Tasmanian seasonal conditions being more favourable, high grain prices were a factor; and
- Grain and fodder prices also affected margins in WA.

### Box 4.3: Return on assets and Earnings Before Interest and Tax

Return on assets effectively measures the efficiency with which the funds invested in a farm (for example in land, machinery and livestock) have been used to generate profit, and can be compared to those generated by other potential uses of capital, such as debt and equity investments.

Earnings before interest and tax (EBIT) is gross farm income minus variable and overhead costs; the return from all capital used in the business. It is often referred to as operating profit.

415 See Appendix B.

416 Dairy Australia, *The Australian dairy industry in focus 2019*, p.12.

As a result of these conditions, although farmgate prices were generally slightly higher in 2018–19 than 2017–18, this did not translate to higher average EBIT or return on assets for most DFMP regions.<sup>417</sup> For surveyed farms, average farmgate prices did not increase in line with cost of production, and indeed the average cost of production was higher than the average milk income in most states and regions (excluding Tasmania and SA)<sup>418</sup>, and average profits declined.

The cost-price squeeze resulted in relatively low average return on assets for surveyed farms in some regions in comparison to the two preceding years. Return on assets can fluctuate significantly depending on the year and conditions. For example, surveyed producers in WA had an average return on assets of nearly 7% in 2016–17, which declined to approximately 3% in 2018–19.<sup>419</sup> To take another measure of farm financial performance, according to QDAS the average EBIT for surveyed producers in Northern Queensland fell from \$0.72/kgMS in 2017–18 to -\$0.23 in 2018–19.<sup>420</sup> Figures B.2 and B.3 in appendix B demonstrate that farm business profits have varied substantially between 1990 and 2017.<sup>421</sup>

#### 4.4.4 Characteristics of profitable farms

The range of return on assets varied considerably across surveyed farms, reflecting that some farms made losses, and others profits. The lowest return on assets for a surveyed farm in 2018–19 was -12.6%, in northern Victoria, and the highest 15.5%, in Tasmania. The average return on assets was positive for surveyed farms in most states and regions, with the exceptions being northern Victoria and northern Queensland. Even in the northern regions where costs of production are higher, some surveyed producers are still making positive returns. The highest return on assets in WA was 10.6%<sup>422</sup>, and in Queensland, just over half of QDAS participants are making positive returns.<sup>423</sup> These calculations include ‘imputed labour’, an allowance for the cost of owner/operator, family and sharefarmer time in the business, at \$72,800 for 2018–19 in DFMP reports.<sup>424</sup> See appendix B, tables B.1 to B.3, for DFMP and QDAS data including return on assets and EBIT for all regions from 2016–17 to 2018–19.

There are consistent themes that emerge regarding the top performing farms surveyed. They generally exhibit significantly lower variable and overhead costs, attributable to factors such as lower feed costs, a higher proportion of home-grown feed, greater water use efficiency, higher production per cow and per hectare, and greater labour efficiency. While in some cases these farms had slightly higher milk income, lower variable and overhead costs made a much greater contribution to profits.<sup>425</sup>

Increasing productivity is one of the ways that producers improve profitability. It relies on increasing the efficiency with which resources such as land, water, capital (cows, infrastructure, tools and machinery), labour and technology are used. Technological progress and more efficient resource reallocation have resulted in gradual industry productivity growth since 1979. National total factor productivity (TFP)<sup>426</sup> has increased by 4% since deregulation in 2000<sup>427</sup>, partly because farm exits facilitated resource movement to more productive farms that wanted to increase scale and improve technology use.<sup>428</sup>

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417 Tables B.1, B.2 and B.3 in appendix B contain greater detail regarding variable and overhead cost line items, and extend over years 2016–17 through 2018–19. Average return on assets and EBIT fell between 2017–18 and 2018–19 in all regions except Southwest Victoria and Northern NSW.

418 ACCC analysis of DFMP data.

419 See figure B.1 in appendix B.

420 See tables B.1 and B.2 in appendix B.

421 ACCC 2018, *Dairy inquiry final report*, p. 185, based on ACCC analysis of ABARES data.

422 DFMP report WA 2018–19; see tables B.1, B.2 and B.3 in appendix B.

423 QDAS report 2018–19, see figure 15.

424 DFMP report NSW 2018–19, p. 61.

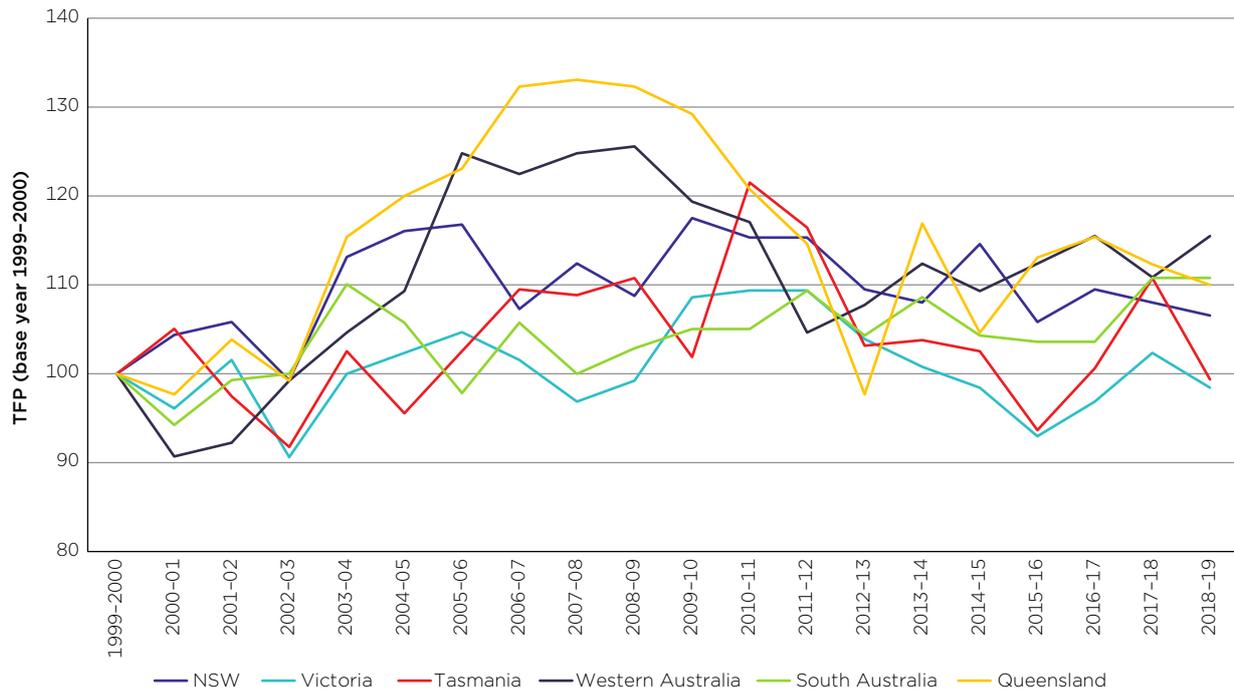
425 ACCC analysis of DFMP and QDAS reports for all regions from 2016–17, 2017–18 and 2018–19.

426 The ratio of aggregate output to aggregate inputs.

427 ACCC analysis of ABARES data for national dairy TFP.

428 Yu Sheng, Will Chancellor and Thomas Jackson, *Deregulation reforms, resource reallocation and aggregate productivity growth in the Australian dairy industry*, *The Australian Journal of Agricultural and Resource Economics*, 59, pp. 1–28, 2019.

Figure 4.6: Dairy TFP 1999–2000 to 2018–2019, by state



Note: The TFP indexes shown demonstrate relative changes in productivity since 1999–2000, rather than relative absolute productivity. For example, that Queensland made greater productivity gains than other states between 1999–2000 and 2006–07, rather than that Queensland is relatively more productive than other states.

Source: ACCC analysis and chart using ABARES data.

Pressure to improve productivity resulted in the consolidation of farms for several decades prior to deregulation. However, the end of regulated prices for drinking milk meant further structural adjustment. In addition, many farms accepted deregulation exit payments and left the industry.<sup>429</sup> Deregulation resulted in resource reallocation between states, and within states using a year-round (rather than seasonal) production system.<sup>430</sup> This is particularly clear in productivity trends for each state (see figure 4.6). Queensland and WA made the most significant productivity gains between deregulation and 2008 (the end of adjustment payments), followed by NSW and Tasmania.

While large numbers of small-scale producers exited, others expanded, and consolidation has resulted in increased average milk production per farm in all states.<sup>431</sup> Consequently, while the number of farms has fallen in all states, the largest declines occurred where milk was produced mostly for the fresh drinking market, being Queensland, NSW, WA and SA.<sup>432</sup> While milk production in the higher cost states decreased through this process, it increased in lower cost states such as Tasmania.

In the years following deregulation, productivity gains have become more stagnant, and a strong seasonal influence can be seen year to year as weather conditions and input costs influence the productivity of farming land.

429 Dairy Australia, *History of Australian dairy industry deregulation*, [www.dairyaustralia.com.au/about-dairy-australia/about-the-industry/history-of-australian-dairy-industry-deregulation](http://www.dairyaustralia.com.au/about-dairy-australia/about-the-industry/history-of-australian-dairy-industry-deregulation), viewed 15 October 2017.

430 Yu Sheng, Will Chancellor and Thomas Jackson, *Deregulation reforms, resource reallocation and aggregate productivity growth in the Australian dairy industry*, *The Australian Journal of Agricultural and Resource Economics*, 59, pp. 1–28, 2019.

431 Peter Martin, Walter Shafron and Paul Phillips, *Australian dairy: Financial performance of dairy farms 2013–14 to 2015–16*, Australian Bureau of Agriculture and Resource Economics and Sciences, 2016.

432 ACCC 2018, *Dairy inquiry final report*, p. 5.

## 4.5 Retail prices and wholesale prices

Private label milk pricing is not the reason that some dairy farmers are struggling to remain profitable, and domestic retail pricing strategies are unlikely to have a direct impact on farmgate prices.

The Dairy Inquiry found that there is no direct relationship between retail private label milk prices and farmgate prices.<sup>433</sup> Pass-through clauses in private label milk contracts mean that processors have no incentive to compete for these contracts on the basis of setting the lowest farmgate milk price.<sup>434</sup> However, if processors exercise these clauses they have to pay more for all the milk they purchase from farmers, despite the majority of it being used in branded or export products. This decreases their margins. While there is evidence that retail pricing has reduced processor profits<sup>435</sup>, processors will always pay the minimum price they can to secure their desired volume of supply, and consequently increasing retail and wholesale prices would not necessarily result in higher farmgate prices.

### Box 4.4: ACCC investigation of producer costs of production and price pass-through mechanisms

The ACCC used its compulsory information gathering powers under section 95ZK of the CCA to request information and documents from industry participants. The ACCC requested the following types of information:

- The key mechanisms and limitations in PAG contracts which allow suppliers to pass-through the price paid to producers
- The extent to which other supply chain participants take dairy producer costs of production into account when setting farmgate prices and in supermarket contract negotiations.

The ACCC also requested contracts and copies of correspondence regarding pass-through requests from industry participants.

### 4.5.1 Submissions regarding retail and wholesale dairy prices

During this inquiry the ACCC received submissions that:

- Private label milk limits the capacity for prices to be increased throughout the rest of the supply chain.<sup>436</sup> Consumers shifting from branded to private label milk also reduces capacity to increase prices throughout the supply chain.<sup>437</sup>
- National pricing for private label milk does not take into account differing regional costs of production, and results in thin margins in Queensland and WA.
- Private label milk is used as a loss leader by supermarkets, and does not cover the costs of production in some regions.<sup>438</sup> If supermarkets choose to use milk as a loss leader, this should result in losses for the supermarket and not for processors and producers.<sup>439</sup>
- Low retail and wholesale prices are deterring investment and growth in the supply chain in domestic and southern regions. The perception of the impacts of private label milk are also impacting industry confidence and farm investments.
- The retail price of milk does not reflect cost increases that might result from significant natural events, such as drought or fire. For other perishable goods, such as bananas, where there is a cyclone which wipes out the majority of the harvest, retail prices increase significantly. Distribution of margin throughout the supply chain is not fair.

433 *ibid*, p. xxi.

434 *ibid*, p. 119.

435 *ibid*, p. 123.

436 Australian Dairy Farmers, p. 19; NSW Farmers, p. 11; Queensland Farmers Federation, p. 3.

437 Australian Dairy Farmers, p. 22.

438 NSW Farmers, p. 11, South Australian Dairyfarmers' Association, *Submission*, 18 September 2020, p. 3.

439 South Australian Dairyfarmers' Association, p. 3.

- NSW Farmers submitted that the ACCC’s finding in the Dairy Inquiry that supermarket prices did not have an observable impact on farmgate prices and farm numbers was incorrect, because any farmgate price pass-through to producers in private label contracts is determined by the average price paid by processors, which means if the average retail price of milk falls, the average farmgate price will also fall.<sup>440</sup>

## 4.5.2 Pass-through clauses

### Private label dairy contracts

Evidence obtained during the Dairy Inquiry demonstrated that almost all contracts for the supply of private label milk allowed processors to pass-through movements in farmgate prices to supermarkets.<sup>441</sup> It found that supply contracts between supermarkets and processors commonly apportion the wholesale price into separate price components for raw milk and processing. The raw milk component was typically a floating price based on the weighted average farmgate milk price paid by the processor over the year, or some other publicly available benchmark.<sup>442</sup>

Either way, for private label milk, changes in farmgate prices, and their impact on margins, were found to be a risk generally faced by supermarkets rather than processors.<sup>443</sup> In other words, when competing for a private label contract, processors will not have an incentive to reduce farmgate milk prices because raw milk acquisition costs are directly passed through to the wholesale prices charged to supermarkets.<sup>444</sup> In addition, during the Dairy Inquiry the ACCC found no evidence of supermarkets seeking to influence farmgate prices, and no processors submitted to that inquiry that wholesale prices for private label milk directly influenced farmgate prices.<sup>445</sup>

As a result, the Dairy Inquiry concluded that there is no direct relationship between retail private label milk prices and farmgate prices.<sup>446</sup> This finding was informed by data and documents from supermarkets and processors.<sup>447</sup> This revealed that although wholesale and retail prices and profits were substantially higher for the supply of branded than for private label milk<sup>448</sup>, there was no material difference in the prices earned by farmers.<sup>449</sup> This confirmed that processors do not pay farmers any more than they need to.

For this inquiry, the ACCC has updated our assessment of the treatment of farmgate prices in supermarkets’ contracts with processors.

The ACCC has confirmed that most private label milk and some other private label dairy product contracts allow farmgate prices or commodity price changes to be passed through to the supermarkets. The ACCC saw evidence of processors using these clauses, and learned that a farmgate price pass-through is almost always agreed to by supermarkets. Higher farm costs of production are often included in the processors’ reasons for seeking a wholesale price increase.

Pass-through mechanisms generally allow for a wholesale price variation in the event of the farmgate price or linked commodity price index moving up or down. The way these mechanisms operate varies between contracts, and the timing of changes in wholesale prices and farmgate or commodity prices is not always perfectly aligned in real time:

- Contracts may provide that prices can be reviewed at specific times (e.g. annually). However, we have seen that supermarkets will consider price rises outside of the contractual review periods.

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440 NSW Farmers, p. 11.

441 ACCC 2018, *Dairy inquiry final report*, p. xxi.

442 *ibid.*, p. 31.

443 *ibid.*

444 *ibid.*, p. 119.

445 *ibid.*, p. 107.

446 *ibid.*, p. xxi.

447 *ibid.*, p. xiii.

448 *ibid.*, p. xx-xxi.

449 *ibid.*, p. 107.

- Shorter term contracts, typically of 12 months duration, are less likely to include price variation mechanisms.
- Supermarkets can scrutinise a proposed variation to the price.
- The ACCC notes that global prices for processed commodities are not always a good comparison to domestic production costs, as farmgate prices may be higher or lower than the commodity index.

### **Branded dairy contracts**

During the Dairy Inquiry, the ACCC found that supermarkets and processors generally make higher margins on branded dairy products, and processors generally use these to offset low private label margins.<sup>450</sup> Processors earn the highest margins on flavoured and branded fresh drinking milk, yoghurt, and premium cheese, ranging from 30 to 60% gross margin.<sup>451</sup>

Branded dairy product agreements do not contain pass-through mechanisms. As the processor will assume the risk of fluctuating farmgate prices,<sup>452</sup> they generally agree a wholesale price which can accommodate this during the negotiation process. Price increases generally have to be negotiated, which can be difficult. Processors will at times absorb cost increases owing to complications or delays negotiating with supermarkets, and the ACCC understands some processors have not sought price increases for many years. On the other hand, the ACCC saw evidence indicating that increases were accepted relatively swiftly in some instances.

### **Private label milk as a proportion of total milk production**

Twenty-eight per cent of raw milk produced in Australia is processed into drinking milk, and 9% of total raw milk is processed into private label drinking milk (see figure 4.7). Even in Queensland, where consumption is higher than local production, the majority of raw milk is destined for branded, rather than private label, product.<sup>453</sup>

This impacts processor incentives regarding the use of pass-throughs in private label contracts.

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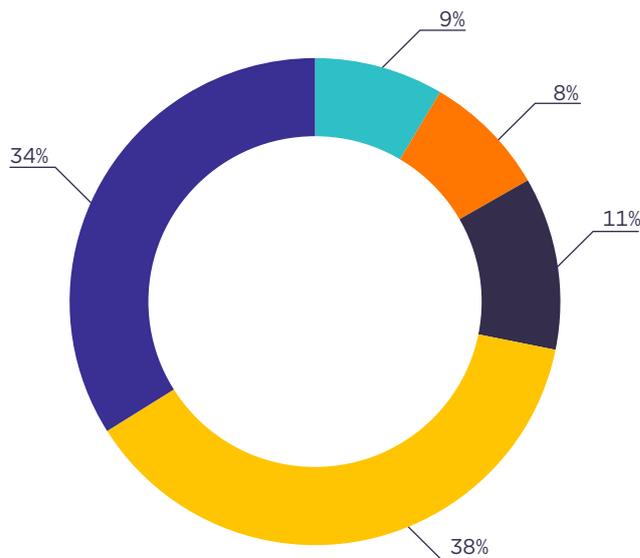
450 *ibid.*, p. 130.

451 *ibid.*

452 *ibid.*, p. 31.

453 Based on ACCC analysis of data on drinking milk sales by state, supermarket sales, and the national split between private label and branded supermarket sales, from Dairy Australia, *The Australian dairy industry in focus 2019*.

**Figure 4.7: Utilisation of Australian national milk production 2018-19**



■ Supermarkets: Private Label milk ■ Supermarkets: Branded milk ■ Non-supermarket milk ■ Cheese ■ Other

Source: ACCC analysis of Dairy Australia data from *The Australian dairy industry in focus 2019*, pp.18,23,41 (Dairy Australia analysis and data from milk processors and State Milk Authorities and Information Resources (Australia) Pty Ltd)

### Some private label milk is sourced directly from producers by retailers

Some processors have toll processing arrangements with major supermarkets for the production of drinking milk, as discussed in section 4.3.2. While Woolworths has had direct sourcing arrangements with producers for its Farmers' Own brand milk for some years,<sup>454</sup> Coles commenced direct sourcing arrangements with producers for its private label fresh white milk in June 2019.<sup>455</sup> Consequently this is a change in the industry since the Dairy Inquiry. This is discussed in detail in chapter 3, section 3.4.3.

These direct sourcing arrangements do not enable retailers to depress the farmgate price. Private label milk forms a small portion of the end use for Australia's milk production. As such, retailers are price takers in the market for raw milk, regardless of whether they purchase directly from farmers or from processors.

### 4.5.3 Total value of the dairy industry

Some in the industry are concerned that private label milk prices have removed value from the dairy supply chain. The Dairy Inquiry found that processor margins on private label milk had gradually declined, that private label milk prices constrained the retail and wholesale price of most branded milk, and that private label products can erode brand value.<sup>456</sup>

While wholesale prices are constrained by the supermarkets' strong bargaining power, this is a normal outcome of commercial negotiations. The Dairy Inquiry found that despite low margins, many processors continued to compete strongly for private label contracts, to reduce their average costs of production and access the stability of a long term contract.<sup>457</sup>

Total supply chain profits would be likely to rise if there was an increase in retail prices. However, this by itself would be unlikely to benefit farmers. Any increases in margins flowing from an increase in the retail

454 Woolworths Group Limited, [www.woolworths.com.au/shop/discover/our-brands/farmers-own-milk-sources](http://www.woolworths.com.au/shop/discover/our-brands/farmers-own-milk-sources), viewed 20 October 2020.

455 Coles Group 2019, *Coles to buy milk directly from farmers for Coles Brand milk*, [www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-directly-from-farmers-for-coles-brand-milk](http://www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-directly-from-farmers-for-coles-brand-milk), viewed 20 October 2020; Coles Group 2020, *Coles to buy milk directly from SA, WA farmers for Own Brand milk*, [www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-direct-from-sa--wa-farmers-for-own-brand-milk](http://www.colesgroup.com.au/media-releases/?page=coles-to-buy-milk-direct-from-sa--wa-farmers-for-own-brand-milk), viewed 20 October 2020.

456 ACCC 2018, *Dairy inquiry final report*, pp. xx, xxii, 100, 106, 112, 115, 129.

457 *ibid.*, p. 129.

price would likely be captured by the major supermarkets, or at best shared between the supermarkets and processors. Farmers' weak bargaining power means that an increase in processors' profits would not necessarily result in higher farmgate milk prices. Higher retail prices extract increased revenue from consumers, and redistribute this to retailers and processors.

#### 4.5.4 Wholesale industry investment

There are concerns that processors' margins are falling to unsustainable levels because of a shortage of milk volumes and inability to pass on costs, resulting in processors selling assets and reducing labour costs, and reducing investment. The ACCC has also heard that low wholesale prices are deterring investment and growth in northern regions, and competition that would otherwise result from this.

If supermarkets were to force wholesale prices down to such an extent that processors exit, it would result in lower local competition for private label tenders, and may expose supermarkets to more volatile prices if they had to transport all fresh drinking milk from NSW and Victoria.

The Dairy Inquiry found national pricing has particular significance for the northern regions, as costs of production are higher and processors likely earn lower margins.<sup>458</sup> This has made it difficult to sustain multiple processors and likely places a limit on investment in NSW, Queensland and WA.<sup>459</sup>

However, the ACCC considers that if processors in northern regions were to make investments, they would likely be directed at improving production efficiencies to lower their costs, or expanding their product range in domestic regions, and potentially seeking to compete in export markets.

Investment in production efficiency would be unlikely to lead to increased demand for raw milk in northern regions, and hence would not necessarily benefit producers.<sup>460</sup> It may not even increase wholesale prices, as processors may have to pass the savings on to supermarkets, who have superior bargaining power.<sup>461</sup>

There is unlikely to be significant scope for expanded product range or exports in northern regions. Processors are faced with flat demand and higher costs of production compared to export regions. This limits growth potential and profits for processors, and hence provides little incentive to signal via higher prices for producers to increase production.

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458 *ibid*, p. 120.

459 *ibid*, pp. 120-121.

460 *ibid*, p. 121.

461 *ibid*, p. 122.

# 5. Protecting competition and fair trading in perishable agricultural goods industries

## Key Points

- The regulation of agricultural markets in Australia from a competition perspective has changed significantly over the last few decades. Industries that were previously subject to statutory monopolies, or otherwise shielded from competition, have been exposed to competition.
- The CCA, including the ACL, seeks to protect competition and fair trading in PAG industries in a variety of ways, including by preventing anti-competitive acquisitions that change market structures, prohibiting anti-competitive behaviour, and by prohibiting key types of economically harmful and unfair behaviour. To varying degrees, these laws can help to mitigate some of the harmful effects of bargaining power imbalances in PAG industries identified in previous chapters.
- However, these laws were not intended to, and cannot adequately, prevent or address all the harmful effects of bargaining power imbalances. In particular, there are regulatory gaps in the ACL and applicable industry codes that mean that some harmful practices are currently not being adequately dealt with.
- Chapter 6 examines some options to improve the ability of regulatory arrangements to address these harmful practices.

## 5.1 Introduction

The regulation of agricultural markets in Australia from a competition perspective has changed significantly over the last few decades. Prior to the National Competition Policy agreements of 1995 and their associated reforms, agricultural markets were largely shielded from competition.<sup>462</sup> The last few decades have seen a fundamental shift in the competition regulation of agricultural markets, as policy makers have progressively exposed markets to competition to improve efficiency, remove costs on taxpayers, and increase consumer welfare.

Vigorous competition and hard bargaining between market participants are now recognised as important components of any well-functioning agricultural market. However, anti-competitive conduct and unfair trading practices can distort markets, leading to reduced confidence and under-investment. Key provisions in the CCA, the ACL, and industry codes aim to protect competition and fair trading, through protecting competitive market structures, prohibiting behaviour that substantially lessens competition, and prohibiting key categories of economically harmful and unfair behaviour.

This chapter examines:

- the role of Australian competition laws in prohibiting anti-competitive acquisitions that change market structures, and prohibiting anti-competitive behaviour
- the role of collective bargaining and collective boycott arrangements in mitigating some of the harmful effects of bargaining power imbalances
- the role of the ACL in addressing some of the harmful effects of bargaining power imbalances
- the role of industry code provisions that aim to protect the fairness of bargaining and dispute resolution processes
- the role of industry code provisions that delineate the scope of acceptable outcomes in contractual negotiations, with the aim of ensuring greater fairness.

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<sup>462</sup> See, for example, Productivity Commission, *Regulation of Australian Agriculture*, No.79, November 2016, p. 31.

However, the scope of these laws does not encompass all the economically harmful effects of bargaining power imbalances in PAG industries that have been identified in previous chapters. Some regulatory gaps exist, which means that some seriously harmful effects of bargaining power imbalances are not currently being dealt with adequately.

## 5.2 The role of Australian competition law

Australia's competition laws prohibit various forms of anti-competitive conduct, including conduct that has the purpose, effect, or likely effect of substantially lessening competition.

However, these laws are aimed at preserving competition, and were not intended to address all the harmful effects of bargaining power imbalances that have been identified in this report. The competition laws were also not aimed at restoring or improving competition in markets where, for various reasons, competition has been substantially reduced.

### 5.2.1 The focus of Australia's merger law

Mergers can have different effects on the level of competition in a market.

Some mergers enable the merged business to meet customer demand in a way that facilitates more intense competition.<sup>463</sup> Many mergers do not affect the level of competition at all because there are sufficient substitution possibilities to effectively constrain the merged business.<sup>464</sup>

Other mergers, however, lessen competition by reducing or weakening competitive constraints or reducing the incentives for competitive rivalry.<sup>465</sup> For example, if there are limited competitive constraints on a merged business for a sustained period following a merger, then it will be profitable for that business to maintain prices at a higher or lower level (depending on whether the business is buying or selling) than would otherwise be possible in a market with effective competition.<sup>466</sup>

These are the kinds of changes in market structure that Australia's merger law seeks to prohibit. Section 50 of the CCA prohibits acquisitions of shares or assets that would be likely to substantially lessen competition in any market. This focus on the effects of individual mergers or acquisitions requires the ACCC to compare, for each proposed merger, the likely future states with the merger and without the merger, and determine whether the difference amounts to a substantial lessening of competition. The law also sets out a non-exhaustive list of factors that must be taken into account when determining whether a merger would be likely to substantially lessen competition.

Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable.<sup>467</sup> In PAG industries, a merger at the wholesale level would be likely to substantially lessen competition if it is likely to result in the merged firm being able to significantly and sustainably decrease prices paid to primary producers.

The ACCC has recently raised concerns about the challenges it faces in successfully opposing contested mergers in the Federal Court or the Australian Competition Tribunal. These concerns relate to the difficulties inherent in the forward-looking merger test, in proving on the balance of probabilities what will happen in the future. The ACCC is presently considering ideas for possible reforms to enhance the effectiveness of the merger laws.

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463 ACCC, *Merger Guidelines*, November 2017, p. 8.

464 *ibid.*

465 *ibid.*

466 If the merged business is selling goods or services, then this concern is about the merged business offering higher prices to its customers. However, if the merged business is buying, as may more often be of concern in PAG industries, then this concern is about the merged business offering lower prices to its suppliers, for example, a merged processor offering lower prices for raw milk to dairy farmers.

467 ACCC, *Merger Guidelines*, November 2017, p.9.

## 5.2.2 Consolidation in agricultural markets

Since the National Competition Policy agreements in 1995, there has been market consolidation and a reduction in the number of companies competing to purchase farm products, in virtually every post-farm sector.<sup>468</sup>

For example, there has been significant consolidation in grain marketing, and some of the major bulk-handling companies now have monopolies over grain storage and handling within their respective markets, and the number of competing exporters has declined. Similar changes have occurred in the red meat, dairy, horticulture, and intensive livestock sectors, and Australia's retail food sector has also experienced significant consolidation.

While this has enabled access to economies of scale and resulted in some other market efficiencies at times, it has also had detrimental effects at times. As noted in previous chapters, PAG industries are now typically characterised by many primary producers, but few processors or wholesalers, and even fewer major retailers. This market structure, combined with the perishable nature of the goods being considered in this inquiry, can lead to a range of market failures, including insufficient competition for the acquisition of goods and information asymmetries. In turn, these market failures can undermine the efficiency of the market, with results that can be harmful to market participants and Australian consumers more broadly.

## 5.2.3 ACCC merger reviews in PAG industries

While post-farm sectors have become more consolidated over time, the ACCC does not consider that this consolidation has resulted from anti-competitive acquisitions in contravention of Australia's merger law. This is because consolidation in these sectors has largely been the result of organic growth or businesses exiting the sector, either by closing their operations or by selling to a business that raises no competition concerns.

There have also been a number of acquisitions in PAG industries which the ACCC considered as part of its merger review process, including in the processing sectors of the chicken meat, dairy, and red meat industries.

Where the ACCC has raised concerns about merger proposals in these industries, this was typically because the proposed merger would remove a source of close competitive constraint in markets where market concentration and barriers to entry were high. In these cases, the ACCC was concerned that the merger would result in the merged business having sufficient market power to be in a position to significantly and sustainably reduce the prices paid to farmers.

Where the ACCC has assessed and decided not to oppose proposed mergers, the primary reason has been that it considered that the presence of existing competitors would constrain the merged business from exercising market power in this way.

Box 5.1 outlines some examples of merger assessments in PAG industries where the ACCC expressed competition concerns in relation to the proposed merger, and these concerns were addressed by divestiture undertakings accepted by the ACCC.

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<sup>468</sup> ACCC (Mick Keogh), 'Consolidation in agriculture: impacts to the farm, research, and agribusiness', speech to UWA Institute of Agriculture Industry Forum, 18 July 2017.

## Box 5.1: Examples of ACCC merger reviews in PAG industries

### Baiada and Bartter merger

In 2009, the ACCC announced its decision to oppose chicken meat processor Baiada's proposed acquisition of chicken meat processor Bartter Enterprises. At the time, Baiada was the third largest chicken meat processor in Australia, while Bartter was the second largest.

The ACCC concluded that the proposed acquisition was not likely to result in a substantial lessening of competition in relation to acquiring chicken growing services. However, the ACCC concluded that the proposed acquisition would be likely to result in a substantial lessening of competition in markets for the wholesale supply of processed chicken, particularly the market for the wholesale supply of processed chicken to Quick Service Restaurants.

Following the ACCC's announcement of its opposition, Baiada undertook to divest itself of all of Bartter's Victorian assets, including its Geelong processing plant, breeding farms and hatcheries, and its North Melbourne feed mill.

Following the ACCC's acceptance of this undertaking from Baiada, the ACCC concluded that the proposed acquisition would no longer be likely to substantially lessen competition in the market for the wholesale supply of processed chicken, and the transaction proceeded. The divested assets were later acquired by Turi Foods Pty Ltd (owner of the La Ionica Poultry brand).

### Saputo and Murray Goulburn merger

In 2018, the ACCC raised concerns about Saputo's proposed acquisition of Murray Goulburn's operating assets. At the time, Saputo Inc., the Canadian-based parent company of Saputo Pty Ltd, was one of the top 10 dairy processors in the world.

Saputo owned one dairy processing plant in Australia (in Allansford, Victoria), and proposed to acquire all of Murray Goulburn's dairy processing assets (amongst other assets), including seven processing facilities in Victoria, one in New South Wales, and one in Tasmania.

The ACCC raised concerns that the proposed acquisition would be likely to substantially lessen competition in the market for the acquisition of raw milk in south west Victoria and south east South Australia, because the merged business would own the two largest processing plants in that area (Saputo's plant in Allansford and Murray Goulburn's plant in Koroit). The ACCC considered that this could result in lower farmgate prices for raw milk offered to dairy farmers in those regions.

Following the ACCC's identification of these concerns, Saputo offered an undertaking to divest itself of the processing plant at Koroit to a purchaser approved by the ACCC.

The ACCC considered the divestiture of the Koroit plant would address the substantial lessening of competition that would likely have occurred in the acquisition of raw milk in south west Victoria and south east South Australia.

As a result of Saputo's divestiture undertaking, the ACCC did not oppose Saputo's acquisition of Murray Goulburn's assets. Bega Cheese subsequently acquired the Koroit plant.

Source: ACCC, *Baiada Poultry Pty Ltd—proposed acquisition of Bartter Enterprises Pty Ltd*, 2008-09; ACCC, *Saputo Dairy Australia – proposed acquisition of Murray Goulburn's operating assets*, 2017-18.

## 5.2.4 Merger law and bargaining power imbalances

Despite the ACCC's interventions to protect competitive market structures in PAG industries, Australia's merger law has limitations in terms of preventing bargaining power imbalances in those industries.

Section 50 of the CCA does not, and is not intended to, provide the ACCC or any other party with the ability to engineer a particular level of competition in a market. As discussed above, the section prohibits acquisitions that would be likely to substantially lessen competition in a market. It does not apply to situations where market concentration is substantially increased because one or more

businesses close, or an existing business engages in more efficient or innovative behaviour to increase its market share at the expense of less skilful or less efficient competitors.

## 5.2.5 Prohibitions on anti-competitive conduct

In addition to containing Australia's merger law, Part IV of the CCA contains the CCA's core prohibitions on anti-competitive conduct (table 5.1).

These prohibitions guard against a range of anti-competitive conduct, including conduct that substantially lessens, hinders, or prevents competition.

With the exception of cartel conduct, which is strictly prohibited, these prohibitions require an investigation into the purpose of the corporation engaging in the conduct and/or the likely effect of the conduct on the level of competition in the market.

**Table 5.1: Key CCA prohibitions on anti-competitive conduct**

Prohibition	Conduct that is prohibited
Cartel conduct (Division 1 of Part IV of the CCA)	These provisions prohibit competitors from engaging in price fixing, output restrictions, market sharing, and bid rigging. The focus of the cartel prohibitions is on conduct where rival businesses coordinate rather than competing. Cartel conduct is strictly prohibited on the basis that it will always be damaging to competition. <sup>469</sup>
Anti-competitive agreements or concerted practices (section 45 of the CCA)	This provision prohibits corporations from making or giving effect to agreements, or engaging in concerted practices, that have the purpose, effect, or likely effect of substantially lessening competition in any market in which any of those corporations supplies or acquires goods or services.
Misuse of market power (section 46 of the CCA)	This provision prohibits a corporation with a substantial degree of power in a market from engaging in conduct that has the purpose, effect, or likely effect of substantially lessening competition in that market, or any other market in which the corporation supplies or acquires goods or services.
Exclusive dealing (section 47 of the CCA)	Broadly speaking, exclusive dealing occurs when a corporation trading with another corporation imposes some restrictions on the other corporation's freedom to choose with whom, in what, or where they deal. This is prohibited when it has the purpose, effect, or likely effect of substantially lessening competition in any market in which the corporation engaging in the conduct or any person whose dealings are affected by the conduct supplies or acquires goods or services.

Source: *Competition and Consumer Act 2010* (Cth)

Part IV of the CCA was significantly amended with effect from November 2017, following recommendations in the 2015 final report from the Competition Policy Review Panel (also known as the 'Harper Review'). In particular:

- Section 45 of the CCA was amended to also prohibit 'concerted practices' that had the purpose, effect, or likely effect of substantially lessening competition.

A concerted practice is any form of conduct that substitutes cooperation between two or more businesses in place of the uncertainty of competition.<sup>470</sup> However, parallel behaviour that arises simply as a result of two or more businesses independently responding to market conditions is not a concerted practice.

- Section 46 of the CCA was amended following concerns about its pre-2017 requirements to prove that a business was 'taking advantage of' its substantial market power for one of a set of proscribed purposes, including for the purpose of damaging a competitor.

The new section 46 of the CCA focuses instead on the damage that conduct causes to the process of competition, rather than to particular competitors, and introduced an 'effects test', so that

<sup>469</sup> Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2009, explanatory memorandum, paragraph 1.2.

<sup>470</sup> See, ACCC, *Guidelines on concerted practices*, August 2018, for more information.

conduct engaged in by a business with substantial market power is now prohibited where it has the purpose, effect, or likely effect of substantially lessening competition.

These amendments have strengthened the operation of Part IV of the CCA by addressing some of the key gaps in the previous law.

## 5.2.6 The focus of Part IV of the CCA

The prohibitions on anti-competitive behaviour in Part IV of the CCA are not capable of preventing all of the harmful effects of bargaining power imbalances in PAG industries.

This inquiry's analysis of bargaining power imbalances focuses on bargaining that occurs between one business with superior bargaining power relative to another business (for example, between a supermarket and a fruit and vegetable wholesaler), or between one business with superior bargaining power and multiple businesses with inferior bargaining power (for example, between a chicken meat processor and multiple chicken growers).

In these scenarios, the key concern is about the 'unilateral conduct' of the business with superior bargaining power.<sup>471</sup> The prohibitions on misuse of market power (section 46 of the CCA) and exclusive dealing (section 47 of the CCA) apply to unilateral conduct, but these prohibitions do not extend to the prevention of all the potential harmful effects of bargaining power imbalances. Each prohibition applies to a specific form of conduct, whereas imbalances in bargaining power may result in a range of harmful effects not captured by these provisions.

Firstly, these prohibitions only prohibit conduct that has the purpose, effect, or likely effect of substantially lessening competition. This means these laws will not assist where an imbalance of bargaining power disadvantages or harms a particular supplier or group of suppliers, but does not substantially impact competition more broadly in the market.

Secondly, the misuse of market power prohibition only applies where a corporation has substantial market power. This is different from having a bargaining power advantage over another party. While bargaining power and market power overlap, some corporations with a bargaining power advantage will not have market power, which is assessed against the whole market, taking into account other market participants who may not be involved in a particular transaction or negotiation. Accordingly, this provision will not assist where concerns arise in relation to the conduct of a corporation which has bargaining power in relation to a particular transaction or negotiation, but does not have a substantial degree of power in the broader market.

Thirdly, the exclusive dealing prohibition only prohibits the particular categories of exclusive dealing conduct identified in the section, and will apply only where the conduct by a corporation with superior bargaining power comes within those specific categories. This prohibition helps to protect against these specific types of anti-competitive behaviour, but where the harmful effects of bargaining power imbalances take other forms, then this prohibition will not apply.

A hypothetical example illustrates the application of Australia's competition laws to bargaining power imbalances (box 5.2).

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<sup>471</sup> A separate concern, that of potentially anti-competitive behaviour engaged in by the multiple businesses with inferior bargaining power, will be discussed in the collective bargaining and collective boycott section below.

## **Box 5.2: Quality specifications**

### **Scenario**

A chicken grower, Farmer A, has a five-year growing contract with a processor, Firm B. Firm B uses this standard form contract with all its growers.

The contract allows Firm B to vary the number of chicks that it places with a grower in each batch in two scenarios. Firstly, Firm B can vary the number depending on the grower's performance against the rest of the growing pool (if the grower is less efficient, Firm B will place fewer chicks). Secondly, Firm B can vary the number of chicks if circumstances occur that significantly change demand in the wholesale processed chicken meat market, either up or down. What constitutes a 'significant change' is set out in the contract.

There are many chicken growers in Farmer A's geographic region. Firm B is one of three processors in that region.

### **Bargaining power imbalance**

Farmer A is likely to have less bargaining power than Firm B, for all the reasons discussed in previous chapters. For example, Farmer A may have made substantial capital investments based on Firm B's farm specification requirements. In addition, Farmer A may have less time or business expertise to devote to properly understanding the risks of the contract. Finally, Farmer A may have no other processing options, if the two other processors in the region have sufficient growing capacity already.

Through the standard form contract that allows Firm B to vary placement densities based on major changes in wholesale demand levels, Firm B has used its bargaining power advantage to allocate risk to the party with less bargaining power: Farmer A.

### **Harmful economic effects**

In this scenario, the party with less bargaining power (Farmer A) has to make investment decisions well before they can know how much income they are likely to make. This includes decisions about various input costs (like labour costs, or whether to make capital investments).

Without a clear picture of their likely income, Farmer A may not be able to make the most efficient decisions. Even if Farmer A is an otherwise efficient primary producer, this inability to forecast likely income may eventually mean that Farmer A has to exit the industry. If there are multiple Farmer As in the sector, this would exacerbate the harm.

### **Application of competition laws**

Firstly, Australia's merger law does not apply, as there has been no acquisition in this scenario.

Secondly, the misuse of market power prohibition is unlikely to be able to prevent this harmful effect. Despite its superior position when bargaining with individual growers such as Farmer A, it is not clear that Firm B has substantial power in the broader market. Even if Firm B has substantial market power, there is no suggestion that it has acted for the purpose of substantially lessening competition, and Firm B's conduct is unlikely to have the effect or likely effect of substantially lessening competition in the market for the wholesale acquisition of the perishable good. This is because, even if Farmer A exits the industry there are likely to be multiple chicken growers remaining, meaning the competitive dynamics of the market are unlikely to deteriorate substantially.

Thirdly, Firm B's conduct does not fit within the exclusive dealing prohibition and, even if it did, would be unlikely to have the purpose, effect or likely effect of substantially lessening competition for the reasons noted above.

Consequently, the core prohibitions in Australia's competition laws do not prohibit this conduct.

This scenario does not assume that regulatory intervention is therefore required. Regulatory interventions will be discussed further in chapter 6. The Australian Consumer Law may also apply in this scenario.

Source: *Competition and Consumer Act 2010 (Cth)*.

Later sections of this chapter will consider key provisions in the ACL and industry codes that work alongside Australia's competition laws to seek to protect against conduct arising from bargaining power imbalances in PAG industries that can have significantly harmful effects.

## 5.3 Collective bargaining and collective boycotts

The anti-competitive conduct prohibitions in the CCA generally prevent competitors in a market, such as farmers, from agreeing with each other on the prices or other terms on which they will supply their goods to buyers.

However, the CCA also recognises that, in certain circumstances, conduct that may otherwise contravene these prohibitions, such as collective negotiations, can result in public benefits that outweigh the detriment. Therefore, the CCA enables groups to engage in collaborative actions, such as to collectively bargain with a larger business, with risk of contravening the CCA, provided these actions are notified to, or authorised by, the ACCC.

### 5.3.1 Collective bargaining

Collective bargaining is an arrangement where two or more businesses come together to negotiate jointly with a supplier or customer. Businesses can sometimes be better off negotiating with customers or suppliers as a group. Working together, the group might be able to negotiate better terms and conditions with larger businesses than could be achieved individually.

Collective bargaining may also strengthen the group's position by enabling members to pool financial resources, which makes legal advice and expert industry advice more affordable. In turn, this advice may enable the group to negotiate from a better-informed perspective than members might be in a position to do individually. This can help to combat some of the information disadvantages that primary producers may face in the bargaining process, as discussed in chapter 1.

There are currently two avenues to obtain legal protection to engage in collective bargaining without the risk of contravening competition laws:

- *Notification*—protection commences automatically 14 days after the conduct is notified, unless the notice is revoked by the ACCC in that time. Notification is only available for small businesses. A \$1,000 fee applies.
- *Authorisation*—suitable for more complex arrangements, but longer timelines of up to 6 months. A higher fee applies (\$7,500).

Both processes involve an assessment by the ACCC of whether the proposed conduct is likely to substantially lessen competition, and, if so, whether it will result in a net public benefit.

The ACCC has also recently made a 'class exemption' that will provide immediate legal protection for small businesses who meet the criteria to engage in collective bargaining, with no fee. This class exemption will come into effect in early 2021, following the expiry of the Parliamentary disallowance period. This is discussed in chapter 6.

### 5.3.2 Collective boycotts

Although the ACCC can authorise groups to engage in collective action without the risk of contravening the CCA, this does not compel the larger businesses to negotiate with the group. Collective bargaining is most effective when it provides mutual benefits for the group and target business.

In some cases, attempts by small businesses to collectively bargain with a large customer or supplier may be ineffective, without the ability to threaten and/or engage in a collective boycott. In certain circumstances, the ability for the group to collectively boycott the target business can significantly improve the effectiveness of collective bargaining and the outcomes from negotiations. For example, it enables the group to credibly threaten to withhold supply or acquisition unless and until the supplier or customer 'comes to the negotiating table', and/or an acceptable agreement can be reached.

The ACCC recognises there are public benefits that may arise from collective bargaining arrangements that include a boycott. However, a boycott can also result in public detriment, including through substantially lessening competition. A boycott can also damage the group that is engaging in the conduct, particularly where the products supplied by the group are perishable.

Accordingly, the effectiveness and appropriateness of a collective boycott will depend on the particular circumstances and the ACCC will assess collective boycott proposals on a case-by-case basis to determine whether a net public benefit is likely.

Collective boycotts are not covered by the new class exemption for small business collective bargaining.<sup>472</sup>

### 5.3.3 Challenges to protecting against bargaining power imbalances

While collective bargaining and collective boycott arrangements can assist small businesses in situations where there is an imbalance of bargaining power, there are some limitations to the extent to which they can be used to protect against the harmful effects of current bargaining power imbalances in PAG industries. These include:

- There is no requirement for the target business to engage with the bargaining group. The target business may still be in a position to offer 'take it or leave it' contracts to primary producers, with the confidence that they will continue to be able to fulfil their supply requirements without negotiating with the group.
- Collective bargaining and collective boycott arrangements will not generally change structures in the market that have led to the bargaining power imbalances in the first place. For example, they will not generally lead to more buyers appearing in a particular geographic region<sup>473</sup>, nor will they change the timing of contract durations and renewals that may mean that sellers of a particular perishable good have a limited choice of buyers open to them at any particular point in time.
- The perishable nature of the agricultural goods being considered in this inquiry can undermine the effectiveness of collective boycotts. Perishable goods cannot be stored on farm until an acceptable agreement is reached, so the primary producer may have to go without any sales-derived income until that point.
- Collective bargaining or collective boycott arrangements face a range of operational challenges. For example, one submitter noted the resources involved in running a bargaining group indicating that farmers and industry associations may not have the resources, time, or skills necessary to run a group.<sup>474</sup>

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472 Arrangements that include the possibility of a collective boycott risk contravening Part IV of the CCA, and parties intending to engage in collective boycotts should seek legal advice.

473 Although see the ACCC's final determination of 3 September 2018 granting authorisation for application AA1000421 to a group of Gippsland dairy farmers, where the ACCC accepted that one of the public benefits of the authorisation was likely to be that the increase in the group's combined volume of raw milk was likely to make it more attractive to current and potential milk purchasers, which would encourage competition.

474 Australian Dairy Farmers, submission, p. 33.

- Concerns about the ‘free rider’ problem in collective bargaining arrangements.<sup>475</sup> Non-members of the group commonly benefit from any advantages gained by the group in a negotiation process, meaning there is less incentive to contribute resources where they expect to benefit anyway.

The ACCC’s 2018 final report in the Dairy Inquiry set out some findings about the circumstances when collective bargaining arrangements in the dairy industry were more likely to be successful. These circumstances included where the group was able to offer a compelling value proposition, such as a unique or differentiated product, or the group represented a significant proportion of total supply in the market.<sup>476</sup> Primary producers in the dairy industry and other perishable agricultural goods industries may find these factors useful in guiding future decisions about whether to seek to engage in collective bargaining.

As a result of the above limitations, collective bargaining and collective boycott arrangements cannot adequately address all bargaining power imbalances. However, they remain effective arrangements in many circumstances, and can mitigate some harmful effects of bargaining power imbalances.

## 5.4 The Australian Consumer Law

The first section of this chapter, on Australia’s merger laws and anti-competitive conduct prohibitions, focused on legislation that aims to preserve competition in markets across the Australian economy. However, this is not necessarily a guard against unfair commercial behaviour. Unfair commercial behaviour can also have detrimental effects on markets.

The ACL and industry codes are focused on preventing the economic harms that occur when particular types of unfair trading practices are engaged in. The ACCC considers that the Australian Consumer Law should be renamed the Australian Consumer and Fair Trading Law, in order to increase community understanding about the broader role that this law plays, since the ACL does not only contain consumer protection legislation.

### 5.4.1 False, misleading, or deceptive conduct

Section 18 of the ACL is a broad prohibition of conduct that is misleading or deceptive, or is likely to mislead or deceive. This includes not just positive representations that are misleading or deceptive, but also misleading by omission (failing to provide certain information when it is misleading not to do so).

However, this provision does not impose a general duty of disclosure on all parties.<sup>477</sup> This is important in the context of the discussion in chapter 1 about information asymmetry between different parties in the supply chain. Section 18 of the ACL is not a complete answer to this problem of information asymmetry, although it may protect the less-informed party in certain circumstances.

In addition, section 29 of the ACL prohibits certain categories of false or misleading representations in trade or commerce in connection with the supply or promotion of goods or services. Contravention of this prohibition can result in civil or criminal penalties. However, few, if any, of the harmful practices identified in previous chapters, would fall into the categories prohibited by section 29 of the ACL.

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<sup>475</sup> RIRDC, *Collective Bargaining in the Agricultural Sector*, William van Caenegem et al, June 2015, p. 15.

<sup>476</sup> ACCC, *Dairy Inquiry Final Report*, April 2018, p. 159.

<sup>477</sup> See, for example, *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31, per Black CJ at 32.

## 5.4.2 Unconscionable conduct

There are two prohibitions against unconscionable conduct in the ACL.

Section 20 of the ACL provides that a person must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law from time to time. This ‘unwritten law’ means judge-made law, as opposed to Parliament-made laws such as statutes and regulations. Unconscionable conduct cases in equity have evolved two key elements<sup>478</sup>:

- One party must be ‘at a special disadvantage’ in relation to the other party, by virtue of some disabling condition or circumstance, and
- The other party must unconscientiously or unfairly take advantage of the ‘opportunity’ created by the first party’s special disadvantage.

The ‘special disadvantage’ in the first element is “one which seriously affects the ability of the innocent party to make a judgment as to his [sic] own best interests, when the other party knows or ought to know of the existence of that condition or circumstances and of its effect on the innocent party.”<sup>479</sup> The High Court of Australia stated in *Kakavas v Crown Melbourne* that an inequality in bargaining power between parties is not sufficient in itself to establish that one party is at a special disadvantage in relation to the other party.<sup>480</sup>

In practice, section 20 of the ACL is unlikely to be very relevant to protecting against the harmful effects of bargaining power imbalances. The second prohibition against unconscionable conduct, in section 21 of the ACL, has been acknowledged by courts as generally being wider in scope than section 20 of the ACL<sup>481</sup>, although exactly how much wider in scope has been subject to debate.<sup>482</sup> The key area where section 20 of the ACL remains wider than section 21 of the ACL is in relation to unconscionable conduct that is not in connection with the supply or acquisition of goods or services. These situations are less relevant to this inquiry.

As a result, the more relevant prohibition is section 21 of the ACL, which provides that a person must not, in trade or commerce, in connection with (a) the supply or possible supply of goods or services to a person, or (b) the acquisition or possible acquisition of goods or services from a person, engage in conduct that is, in all the circumstances, unconscionable.

Australian courts have sought to illustrate what ‘unconscionable’ means in the statutory prohibition using a variety of language, including:

*...so far outside societal norms of acceptable commercial behaviour as to warrant condemnation as conduct that is offensive to conscience.*<sup>483</sup>

Section 22 of the ACL sets out a non-exhaustive list of factors that courts must, where relevant<sup>484</sup>, have regard to in determining whether a corporation has engaged in conduct that is, in all the circumstances, unconscionable. These factors include “the relative strengths of the bargaining positions<sup>485</sup>” of the parties involved. This means that bargaining power imbalances will form part of the circumstances that courts will take into account when deciding whether conduct was unconscionable.

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478 *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, per Mason J at 462.

479 *ibid.*

480 [2013] HCA 25, at [117].

481 See, for example, *ACCC v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 254, per Sundberg J at 265–276.

482 See, for example, *ASIC v Kobelt* [2019] HCA 18, per Kiefel and Bell JJ at [49] and [50].

483 *ASIC v Kobelt* [2019] HCA 18, per Gaegeler J at [92], adopted by the Court of Appeal of the Supreme Court of Victoria in *Jams 2 Pty Ltd v Stubbings* [2020] VSCA 200, at [90].

484 *Paciocco v Australia and New Zealand Banking Group* [2016] HCA 28, per Gaegeler J at [189], referring to the cognate provisions of the ASIC Act; for the ACL, see, *ACCC v Medibank Private* [2018] FCAFC 235, per Beach J at [252].

485 Sections 22(1)(a) and (2)(a) of the ACL; for an application of this factor in an ACL unconscionable conduct case, see *ACCC v Coles* [2014] FCA 1405 throughout, but particularly per Gordon J at [102] to [105].

However, a mere imbalance in bargaining power will not, of itself, be sufficient to demonstrate that conduct is unconscionable. Rather, section 21 of the ACL should be approached with, amongst other things:

*...a recognition that inequality of bargaining power can (but not always) be used in a way that is contrary to fair dealing or conscience.<sup>486</sup>*

Accordingly, while section 21 of the ACL will capture some harmful conduct in PAG industries involving the exercise of superior bargaining power, it will only prohibit that conduct where it also meets the threshold of unconscionability.

The ACCC considers that there is scope for the ACL to prohibit harmful conduct resulting from bargaining power imbalances that does not meet the threshold for unconscionable conduct under the existing ACL provisions. This is discussed further in chapter 6.

### 5.4.3 Unfair contract terms

The ACL seeks to protect small businesses in PAG industries against unfair contract terms in business-to-business standard form contracts for the supply of goods, services, or a sale or grant of an interest in land.<sup>487</sup>

These protections can promote fairness in contracts where there is a bargaining power imbalance, and can increase certainty and confidence for small businesses.

However, in the ACCC's view, the B2B UCT framework has a number of features which undermine its effectiveness in combating unfair contracting practices, including:

- The inclusion of UCTs in standard form contracts is not prohibited by the ACL, and courts cannot impose financial penalties on businesses for including UCTs in standard form contracts. This lessens the incentives for businesses to proactively avoid including UCTs in their contracts, and to avoid relying on those UCTs.
- The automatic voiding of UCTs rather than allowing courts to determine the appropriate remedy, which can frustrate contracts that require part of an unfair term in order to continue to operate, and which are otherwise acceptable to both parties.<sup>488</sup>
- There is a 20-employee limit on what is considered to be a small business for the purposes of this provision<sup>489</sup>, which excludes some businesses from protection, even when they face the same resource and bargaining power constraints
- The contract valuation limit<sup>490</sup>, which excludes some contracts, even when the businesses face the same resource and bargaining power constraints.

Together, these issues limit the effect of compliance and enforcement action by regulators and UCTs continue to exist in many B2B standard form contracts.

The Government announced in March 2019 that it intends to strengthen the B2B UCT framework to protect small businesses<sup>491</sup>, and released a consultation regulation impact statement for feedback in December 2019. In November 2020, the consumer affairs ministers and agencies of the different Australian government jurisdictions decided that they will strengthen the B2B UCT framework in a number of ways, including in ways that will address the ACCC's concerns above. Further discussion about the upcoming changes to the B2B UCT framework are in chapter 6.

However, even with these amendments, the B2B UCT framework will not cover non-contractual conduct stemming from bargaining power imbalances, which can also have harmful effects.

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486 *Paciocco v Australian and New Zealand Banking Group* [2015] FCAFC 50, per Allsop J at [296] – [297].

487 Section 23(3) of the ACL.

488 *ibid.*

489 Sections 23(4)(b) and 23(5) of the ACL.

490 Section 23(4)(c) of the ACL.

491 The Hon Stuart Robert MP, 'Further strengthening the unfair contract term protections for small businesses', media release, 28 March 2019.

#### 5.4.4 ACL regulatory gaps

The ACL provisions identified above do not extend to prevent all the harmful effects that bargaining power imbalances can have, and are currently having, on the Australian economy. These regulatory gaps mean that some of the harmful practices identified in previous chapters are not being dealt with adequately.

The ACCC considers that the introduction of a prohibition on unfair trading practices would address some of the harmful practices that are currently not being adequately deal with. This is discussed further in chapter 6.

### 5.5 Industry codes and the fairness of bargaining processes

As a result of sector-specific concerns around harmful conduct, a number of industry codes that are relevant to PAG industries have been prescribed under the CCA in the last five years, in particular: the Food and Grocery Code (introduced in 2015), the Horticulture Code (initially introduced in 2007, and remade in 2017 following an independent review of its effectiveness), the Sugar Code (2017), and the Dairy Code (2019).

Section 51ACB of the CCA prohibits a corporation from, in trade or commerce, contravening an applicable industry code, being the prescribed provisions of either a mandatory industry code or of any voluntary industry code that binds the corporation.

Each of these industry codes contains provisions that aim to promote fairness in bargaining and dispute resolution processes. These provisions are targeted at the particular types of harmful conduct that had been identified in the various sectors. Industry codes can be an effective means of addressing harmful effects of bargaining power imbalances and improving transparency in specific markets.

However, to be effective, industry codes must be enforceable and accompanied by sufficient penalties to deter non-compliance. As discussed in chapter 6, the fact that penalties are not available for breaches of the Food and Grocery Code significantly undermines its effectiveness.

The maximum penalty that the Government can currently set for a contravention of an industry code is 300 penalty units (currently, \$66,600).<sup>492</sup> This is significantly lower than the maximum penalty for a contravention of the ACL by a corporation, which, for the provisions discussed in this chapter, is the greater of \$10 million, three times the value of the benefit obtained (if the court can determine the value of the benefit obtained), or 10% of the corporation's annual turnover in the preceding 12 months (if the court cannot determine the benefit obtained).<sup>493</sup>

Where there are not sufficient penalties available to deter non-compliance with industry codes, and in particular where there are no penalties for non-compliance at all, then an industry code risks being not just irrelevant but actively detrimental because it gives a misleading impression that a problem has been addressed through regulation when this is not the case, and, by doing so, it undermines public confidence in the ACCC and the CCA's ability to fairly and effectively regulate misconduct.

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<sup>492</sup> Section 51AE(2) of the CCA, although the Government has recently introduced the *Treasury Laws Amendment (2020 Measures No. 4) Bill 2020*, Schedule 3 of which would increase this maximum penalty to 600 penalty units.

<sup>493</sup> Section 224 of the ACL. The maximum penalty for an individual who has contravened these sections is \$500,000.

## 5.5.1 ‘Good faith’ requirements in industry codes

The Food and Grocery Code, the Sugar Code, the Dairy Code, and the Horticulture Code all contain obligations to act or deal in good faith<sup>494</sup>, which is a key protection for bargaining and dispute resolution processes.

Each code contains some guidance on what factors may be taken into account when determining whether a party has contravened this obligation. These factors include:

- whether the relationship between the parties has been conducted without duress<sup>495</sup>
- whether the relationship between the parties has been conducted in recognition of the need for certainty regarding the risks and costs of trading<sup>496</sup>
- whether the party has acted in retribution for past complaints or disputes<sup>497</sup>
- whether the other party has itself acted in good faith.<sup>498</sup>

Despite these factors, good faith remains a difficult concept to identify with precision. One submission noted this lack of clarity, saying it created uncertainty around how parties should behave in practice. The ACCC notes similar concerns about this lack of clarity were raised by the Senate Standing Committee for the Scrutiny of Delegated Legislation in its recent assessment of the Dairy Code.<sup>499</sup>

The Food and Grocery Code was recently updated to offer an enhanced list of factors for determining whether a retailer or wholesaler has acted in good faith in dealing with a supplier.<sup>500</sup> While this is not an exhaustive list of guiding factors, it is intended to make it clearer and more user friendly for industry.

Despite this, a continuing lack of clarity around key obligations can be problematic for a number of reasons.

Firstly, as a matter of fairness, regulated entities should be able to understand the laws they are required to abide by, particularly when pecuniary penalties may be imposed for non-compliance. This can be difficult, especially in circumstances where the meaning of a prohibition may only be progressively clarified by the courts.

Secondly, a lack of clarity reduces the usefulness of regulation as a prospective guide to behaviour, meaning the practical impact of the regulation can be undermined. If a supermarket does not know the limits of its good faith obligations, it may not abide by them.

Finally, if a primary producer is not sure whether a supermarket has contravened the good faith obligation, they may be less likely to put scarce resources towards seeking to enforce that obligation, which can further undermine the practical impact of the regulation.

On the other hand, performance-based regulation (which is one of COAG’s agreed “features of good regulation”<sup>501</sup>), like a good faith obligation, has a range of advantages over more prescriptive regulation.

**Performance-based regulation** requires a regulated entity to achieve particular outcomes (like acting in good faith, or not engaging in conduct that substantially lessens competition).

**Process-based regulation** requires a regulated entity to follow particular processes, which are intended to ensure a particular outcome. Both styles of regulation have advantages and disadvantages, and may be appropriate for different situations

494 Clause 6B of the Food and Grocery Code; clause 5 of the Sugar Code; clause 11 of the Dairy Code; clause 8 of the Horticulture Code.

495 Clause 6B(3)(e) of the Food and Grocery Code; clause 11(4)(e) of the Dairy Code; clause 8(3)(a) of the Horticulture Code.

496 Clause 6B(3)(f) of the Food and Grocery Code; clause 11(4)(f) of the Dairy Code.

497 Clause 6B(3)(d) of the Food and Grocery Code, clause 11(4)(d) of the Dairy Code.

498 Clause 6B(3)(h) of the Food and Grocery Code; clause 11(4)(i) of the Dairy Code.

499 Senate Standing Committee on the Scrutiny of Delegated Legislation, *Delegated Legislation Monitor No. 9 of 2020*, tabling statement, 27 August 2020, p.2.

500 Competition and Consumer (Industry Codes–Food and Grocery) Amendment Regulations 2020 (Cth).

501 Council of Australian Governments, *Best Practice Regulation: a guide for ministerial councils and national standard setting bodies*, October 2007, p.17.

Firstly, it maintains flexibility and adaptability to different circumstances. For example, the 'good faith' obligation is able to keep up with evolving contractual practices at both a wholesale and retail level across multiple perishable goods categories in a way that more rigid regulation would not.

Secondly, performance-based regulation can encourage greater behavioural change than process-based regulation because it requires the regulated entities to review their entire approach to a particular issue, rather than just engaging in 'box-ticking' compliance work that can encourage a bare minimum of conduct and may distract from the goal of the regulation.

The ACCC remains committed to best practice performance-based regulation in appropriate circumstances. It is worth noting that the Food and Grocery Code, the Dairy Code, the Sugar Code, and the Horticulture Code each contain specific provisions mandating or prohibiting certain terms in agreements or certain behaviour towards other parties (discussed in section 5.6.2 below). The ACCC considers that this balance between specificity and performance-based regulation leads to the best regulatory outcomes.

However, good faith obligations suffer from another difficulty, beyond the challenge of drawing clear lines around the obligation: compliance with the obligation turns, by its nature, on the subjective intention of the party who has the obligation. This poses an enforcement challenge, since, in order to detect or prove a contravention of a good faith obligation, it is necessary to investigate and determine what a party's subjective intention was in relation to particular conduct. This is in contrast to provisions that focus on the effect or likely effect of conduct, like the prohibition on misleading or deceptive conduct in section 18 of the ACL.

While the ACCC continues to support the inclusion of good faith obligations in industry codes, this subjective element of those obligations limits the scope of the protection that those obligations are able to provide.

## 5.5.2 Dispute resolution in industry codes

The Food and Grocery Code, the Sugar Code, the Horticulture Code, and the Dairy Code all contain dispute resolution mechanisms that aim to ensure that disputes arising under those codes may be resolved fairly and efficiently.

There are two key categories of dispute resolution mechanisms. Firstly, the Food and Grocery Code and the Dairy Code include 'internal' dispute resolution mechanisms. In other words, these industry codes impose dispute resolution obligations on parties themselves. For example, in the Food and Grocery Code, retailers and wholesalers are obliged to appoint a Code Arbiter who manages complaints in accordance with the complaints handling procedure (and whose processes can be reviewed by an Independent Reviewer).

Internal dispute resolution mechanisms will not resolve many disputes for a number of reasons, including concerns around the independence of the dispute resolution processes.

The Food and Grocery Code, the Horticulture Code, the Dairy Code, and the Sugar Code also all contain 'external' dispute resolution mechanisms, that is, mechanisms that lie outside the control of the parties. For example, in the Dairy Code, a milk supply agreement must provide for mediation as a means for resolving disputes, and may also provide for arbitration as a means for resolving disputes.

Nevertheless, a key challenge to these dispute resolution processes is in encouraging take-up by parties with less bargaining power. Where parties fear some form of retaliation, they may be unwilling to enforce their rights. In addition, bargaining power imbalances may also play out in mediation processes, and may also reduce the smaller party's incentives to participate.

## 5.6 Industry codes delineating acceptable outcomes

In addition to the provisions focusing on fairness in bargaining and dispute resolution processes, key industry code provisions also aim to promote fairness in outcomes for contractual negotiations in PAG industries.

Not all 'process' protections will be successful, for a variety of reasons. For example, a business may choose not to enforce their rights in order to maintain positive commercial relationships. As a result, regulation of what is an acceptable outcome of commercial negotiations between parties may also be necessary to prevent the serious economic harms.

### 5.6.1 Certainty over agreed terms under industry codes

One way in which certain industry codes in PAG industries delineate what constitutes an acceptable outcome is through requiring clear written documentation of the agreement to ensure parties understand their rights and obligations. The Food and Grocery Code, Dairy Code, Horticulture Code and Sugar Code all contain provisions regarding written agreements. For example, the Horticulture Code requires that traders and growers must not trade in horticultural produce unless they have a compliant written horticultural produce agreement in place.

These requirements help to minimise the impact of bargaining power imbalances during a contractual term, by ensuring that parties' rights and obligations are clearly recorded. This therefore minimises the danger that, where rights and obligations are disputed, the party with greater bargaining power will obtain a favourable outcome.

Despite this, as outlined in chapter 6, there are concerns about the voluntary nature of the Food and Grocery Code, and the ability of retailers and wholesalers to opt-out of the Code's obligations.

### 5.6.2 Directions as to specific terms in industry codes

One of the clearest ways that industry codes seek to delineate acceptable outcomes in order to protect against bargaining power imbalances is through mandating or prohibiting specific terms in agreements.<sup>502</sup> The Food and Grocery Code, Sugar Code, the Horticulture Code, and Dairy Code all require certain terms to be specified in trading agreements (table 5.2).

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<sup>502</sup> These industry codes contain more specific mandatory and prohibited terms than are listed in this report.

**Table 5.2: Key mandatory terms under industry codes**

<b>Industry code</b>	<b>Mandatory terms</b>
Food and Grocery Code	The Food and Grocery Code requires a grocery supply agreement to specify certain terms, including: <ul style="list-style-type: none"><li>▪ any circumstances in which the retailer or wholesaler can reject the groceries</li><li>▪ the payment period, and circumstances in which payment may be withheld or delayed, and</li><li>▪ any circumstances in which the agreement may be ended.</li></ul>
Sugar Code	The Sugar Code sets specific minimum terms for a supply contract between a grower and a mill owner, including a term clarifying the amount that the grower will be paid for their sugar cane, or a formula for determining the amount.
Horticulture Code	The Horticulture Code requires a horticulture produce agreement to specify certain terms, including: <ul style="list-style-type: none"><li>▪ requirements for the delivery of horticulture produce to the trader by the grower</li><li>▪ quality and quantity specifications</li><li>▪ circumstances under which produce can be rejected</li><li>▪ the pricing and fees.</li></ul>
Dairy Code	The Dairy Code requires milk supply agreements to have specific terms, including: <ul style="list-style-type: none"><li>▪ a 14 day cooling off period</li><li>▪ the processor’s requirements for the quality and quantity of milk, including testing procedures and rejection processes</li><li>▪ the minimum price to be paid for the milk.</li></ul>

Source: *Competition and Consumer (Industry Code—Food and Grocery) Regulation 2015; Competition and Consumer (Industry Codes—Sugar) Regulations 2017; Competition and Consumer (Industry Codes—Horticulture) Regulations 2017; Competition and Consumer (Industry Codes—Dairy) Regulations 2019.*

The Food and Grocery Code, the Horticulture Code, and the Dairy Code also prohibit specific terms (table 5.3).

**Table 5.3: Key prohibitions under industry codes**

Industry code	Prohibitions
Food and Grocery Code	<p>The Food and Grocery Code specifically prohibits a retailer from requiring a supplier to pay for, amongst other things:</p> <ul style="list-style-type: none"> <li>▪ groceries that become unfit for sale at the retailer’s premises</li> <li>▪ better positioning or increase in allocated shelf space</li> <li>▪ the costs of certain retailer activities, such as a buyer’s visit to the supplier, artwork or packaging design, consumer or market research, the opening or refurbishing of a store, or hospitality for the retailer’s staff</li> <li>▪ the retailer’s costs of promotions.</li> </ul> <p>These terms are only allowed where they are clearly set out in the grocery supply agreement, and they are reasonable in the circumstances.</p> <p>In addition, the Food and Grocery Code prohibits a retailer from requiring payments for shrinkage under any circumstances.</p>
Horticulture Code	<p>The Horticulture Code prohibits:</p> <ul style="list-style-type: none"> <li>▪ reducing the cooling off period by more than seven days</li> <li>▪ the merchant charging the grower a fee for a service performed under the agreement unless details of the service and the service fee are specified under the agreement</li> <li>▪ the merchant charging the grower any other amounts (including commissions) for services performed under the agreement.</li> </ul>
Dairy Code	<p>The Dairy Code prohibits the following variations by a processor to a milk supply agreement to reduce the minimum price payable for milk:</p> <ul style="list-style-type: none"> <li>▪ a retrospective step down (a reduction in the minimum price for milk that has already been supplied), and</li> <li>▪ a prospective step down (a reduction in the minimum price for milk yet to be supplied), except in limited exceptional circumstances.</li> </ul>

Source: *Competition and Consumer (Industry Code—Food and Grocery) Regulation 2015; Competition and Consumer (Industry Codes—Horticulture) Regulations 2017; Competition and Consumer (Industry Codes—Dairy) Regulations 2019.*

One aim of this specific regulation is to ensure that acceptable outcomes are delineated, even where bargaining power imbalances exist. Of course, as discussed above in relation to the performance-based ‘good faith’ obligations, codes cannot realistically and appropriately delineate every acceptable outcome. This will always be a balancing act.

### 5.6.3 Directions as to specific behaviour in industry codes

Another of the clearest ways that industry codes seek to protect bargaining power imbalances from causing market failure is through mandating or prohibiting specific behaviour. These complement the specific terms of agreements discussed in section 5.6.2 above.

An example is in the Food and Grocery Code, which sets minimum behavioural obligations for a retailer or wholesaler when dealing with a supplier, including:

- A retailer or wholesaler must pay its supplier for products within a timeframe set by the grocery supply agreement, and in any event, within a reasonable timeframe after receiving an invoice.<sup>503</sup>
- A retailer or wholesaler must provide standards or specifications to a supplier in clear written terms, and must accept all fresh produce delivered in accordance with these.<sup>504</sup> If fresh produce does not meet relevant standards or specifications, a retailer or wholesaler can reject it within 24 hours of

503 Clause 12(1) of the Food and Grocery Code.

504 Clauses 21(1) and 21(2) of the Food and Grocery Code.

delivery (provided it gives written notice to the supplier of its reasons within 48 hours).<sup>505</sup> A retailer or wholesaler cannot reject produce after accepting it.<sup>506</sup>

- A retailer or wholesaler must make any claims for damaged products or shortfalls within a reasonable time (at most 30 days) after delivery of the groceries.<sup>507</sup>
- A retailer or wholesaler must publish or provide to all of their grocery suppliers their product ranging principles and, in the case of a retailer, its shelf space allocation principles.<sup>508</sup> The code requires a retailer or wholesaler to act in accordance with these principles, keep them up to date and apply them without discrimination (including against the retailer's or wholesaler's own products).<sup>509</sup>
- A retailer or wholesaler must provide written notice within a reasonable to an affected supplier when they intend to do a product range review, including outlining the purpose and key criteria for the review.<sup>510</sup> Following the completion of the review, a retailer or wholesaler must provide the supplier with reasonable time to discuss its outcomes, including the reasons for their final decision.<sup>511</sup>

While these behavioural obligations are not strictly about specific contractual terms, like those outlined in section 5.6.2 above, they act in a similar manner, helping to clarify the limits of acceptable outcomes in the food and grocery industry.

#### 5.6.4 Longer term certainty under industry codes

Another important protection that industry codes can provide to parties with less bargaining power is to require specific terms in agreements to give those parties longer-term certainty to plan and operate their business. These protections allow them to assess risk, invest, innovate, expand capacity, and develop products.

For example, under the Food and Grocery Code, retailers or wholesalers can only delist a supplier's grocery product where permitted under the grocery supply agreement and for genuine commercial reasons.<sup>512</sup> Genuine commercial reasons include:

- a failure of the supplier to meet agreed quality and quantity requirements<sup>513</sup>
- a failure of the supplier's product to meet the retailer or wholesaler's sales or profitability targets as described in the agreement<sup>514</sup>
- a supplier's persistent failure to meet the retailer or wholesaler's delivery requirements as described in the agreement.<sup>515</sup>

"Genuine commercial reasons" expressly excludes delisting as a punishment for a complaint, concern or dispute raised by a supplier.<sup>516</sup> Also, isolated, short-term fluctuations in supply may not necessarily constitute a genuine commercial reason for delisting.

Prior to delisting a grocery product, the retailer or wholesaler must provide reasonable notice in writing setting out the reasons for delisting, and inform the supplier that it has a right to make a complaint to the Code Arbiter about the decision to delist.<sup>517</sup>

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505 Clauses 21(3) and 21(4) of the Food and Grocery Code.

506 Clause 21(3)(c) of the Food and Grocery Code.

507 Clause 21(7) of the Food and Grocery Code.

508 Clause 26(1) of the Food and Grocery Code.

509 Clauses 26(2) and 26(5) of the Food and Grocery Code.

510 Clause 26(3) of the Food and Grocery Code.

511 Clause 26(4) of the Food and Grocery Code.

512 Clause 19(1) of the Food and Grocery Code.

513 Clause 19(2)(a) of the Food and Grocery Code.

514 Clause 19(2)(b) of the Food and Grocery Code.

515 Clause 19(2)(c) of the Food and Grocery Code.

516 Clause 19(4) of the Food and Grocery Code.

517 Clause 19(5) of the Food and Grocery Code. However, under clause 19(6) of the Code, this does not apply where time is of the essence (including product safety matters) or where there have been persistent problems with the retailer being out of stock or stocked at significantly reduced levels.

The Dairy Code also provides farmers with longer term certainty by requiring processors that intend to purchase milk during the next financial year to publish standard forms of milk supply agreements on their website before 2 pm on 1 June.<sup>518</sup> A processor's standard form contract must also be accompanied by a statement of the circumstances in which it would be willing to enter into a milk supply agreement in that form (for example, the supply of a certain volume of milk in a certain location or for a certain period of time).<sup>519</sup>

## 5.7 Conclusion

The CCA, the ACL, and applicable industry codes aim to protect competition and fair trading through protecting competitive market structures, prohibiting behaviour that substantially lessens competition, and prohibiting key categories of economically harmful and unfair behaviour. To varying degrees, these laws can help to mitigate some of the harmful effects of bargaining power imbalances in PAG industries identified in previous chapters.

However, Australia's competition and fair trading laws do not address all the harmful effects of bargaining power imbalances in PAG industries, with the result that some seriously harmful practices are currently not being dealt with adequately.

This chapter has identified key regulatory gaps in relation to protecting against the harmful effects of bargaining power imbalances. In particular:

- Even with the amendments announced by the Government, the B2B UCT framework will not protect against non-contractual conduct stemming from bargaining power imbalances.
- The unconscionable conduct prohibitions are unlikely to capture the full range of harmful effects of bargaining power imbalances. While imbalances in bargaining power are taken into account by courts in determining whether a contravention of the statutory unconscionable conduct prohibition has occurred, this imbalance will not be sufficient on its own to demonstrate that conduct is unconscionable.
- Good faith obligations in industry codes, although important performance-based obligations, are subject to limitations because non-compliance can be difficult to detect and/or prove.

As such, to ensure that fair trading practices are promoted in PAG industries, improvements to the current regulatory framework are needed.

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<sup>518</sup> Australian Capital Territory time, Clause 12 of the Dairy Code.

<sup>519</sup> Clause 12(2) of the Dairy Code.

# 6. Protecting against the harmful effects of bargaining power imbalances

## Key Points

- This inquiry has established that practices are occurring in PAG industries that cause significant economic harm. These practices stem from bargaining power imbalances and market failures in PAG supply chains, and are harmful enough to justify a regulatory response.
- However, these harmful practices are occurring in different ways in different PAG industries. As a result, the ACCC considers that there is no one-size-fits-all solution that is appropriate for responding to all these practices in all the PAG industries reviewed in this inquiry. Responding to these issues will require a range of tools, including further investigation work and regulatory changes.
- The ACCC will undertake some further investigations into whether some practices identified in this inquiry contravene existing competition or fair trading laws.
- Two key reforms on the horizon (changes to the small business unfair contract terms framework, and the ACCC's new class exemption for small business collective bargaining) will help to overcome some of the harmful effects of bargaining power imbalances.
- However, some harmful practices will remain unregulated, even after these reforms. Further changes are needed, including a strengthened Food and Grocery Code, and the introduction of an ACL prohibition on unfair trading practices, to reduce these regulatory gaps.
- Consideration should also be given to whether solutions lie outside competition and fair trading laws. Other tools will need to be used in conjunction with competition and fair trading laws to ensure that PAG industries are operating in the way that Australians desire.

## 6.1 Introduction

Competition and fair trading laws should seek to protect against significant detriment, whether that be the result of the abuse of market power, or an imbalance in bargaining power. It is also desirable to attempt to address market failures (such as information asymmetries) where the harm they produce is significant. As discussed in chapter 1, market failures can harm not only supply chain participants, but the efficient supply of perishable agricultural goods to Australian consumers.

However, these objectives are different from aiming to equalise bargaining power amongst all market participants. Bargaining power imbalances are inevitable in PAG supply chains and other industries across the Australian economy. The key focus for competition and fair trading law must be on their harmful effects.

For harms that justify a regulatory response, the ACCC's framework for considering the best means of addressing those harms is:

- Can the harms be addressed by ACCC action under existing laws?
- If ACCC action is not possible, can existing competition and fair trading laws be improved to address these harms?
- If existing laws cannot be improved, is additional regulation required, and if so, should it be focused on a particular industry or have economy-wide effect?
- Finally, are there problems that fall outside the scope of competition and fair trading laws?

Through this framework, this chapter sets out:

- Some further actions that the ACCC will take under existing laws in response to harmful effects of bargaining power imbalances in PAG industries

- Two significant regulatory changes on the horizon that will provide important additional protection against harmful effects of bargaining power imbalances in PAG industries, and
- Two key regulatory interventions that the ACCC considers are needed to address unregulated harmful practices in PAG industries.

## 6.2 Addressing harmful practices

This inquiry has identified a number of different issues around the harmful effects of bargaining power imbalances in different PAG industries, and the ability of existing regulatory arrangements in the CCA to respond to those different harmful effects.

### 6.2.1 Different harmful practices in different PAG industries

This inquiry has established that practices are occurring in PAG industries that cause significant economic harm. These practices stem from bargaining power imbalances and market failures in PAG supply chains.

However, the particular types of practices that are occurring, the prevalence of those practices at different levels of the supply chain, and the level of economic harm caused by those practices, varies from industry to industry, as noted in chapter 3.

Further, different PAG industries have experienced, and are currently experiencing, different levels of change in market structure, as well as changes in contracting practices (in response to previous regulatory interventions, like the Dairy Code, and for other reasons). This means that there is likely to continue to be a variation in the type, prevalence, and economic harmfulness of practices across PAG industries in the future. In other words, this inquiry has not found any evidence that PAG industries are converging on the same set of economically harmful practices.

As a result, the ACCC considers that there is no one-size-fits-all solution that is appropriate for responding to all these practices across all the PAG industries reviewed in this inquiry. Responding to these issues will require a range of tools, including further investigation work and regulatory changes.

### 6.2.2 A regulatory response is justified

While the harmful practices identified in this inquiry are diverse, the ACCC considers that there are practices occurring that justify a regulatory response. These practices are damaging to markets because they reduce market confidence and can cause a misallocation of resources, leading to inefficient investments.

However, the ACCC considers that regulatory responses to these significantly harmful practices should not jeopardise the export competitiveness of PAG industries. As noted by the Productivity Commission in its 2017 report into the regulation of agriculture in Australia:

*Reducing regulatory burden, and improving the efficiency of the regulatory environment, is important for all sectors of the economy, but particularly for the agricultural sector given its high dependence on international markets—around two-thirds of Australia’s agricultural output is exported (with most producers being price takers in international markets).<sup>520</sup>*

The ACCC considers that its recommendations in this inquiry would not undermine the export competitiveness of PAG industries, and that a regulatory response is required, given the harmfulness of these practices.

### 6.2.3 Further ACCC investigations

This inquiry has reviewed multiple PAG industries in only twelve weeks. This has provided the ACCC with important insights into the operation of these industries, but further investigation is still required in some key areas.

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<sup>520</sup> Productivity Commission, *Regulation of Australian Agriculture*, no. 79, November 2016, p. 11.

Firstly, the ACCC will further investigate alleged unfair contract terms in the chicken meat industry. Chicken growers and their representatives have raised significant concerns with the ACCC during this inquiry, many of which relate to potential unfair contract terms in standard form contracts. However, further information is required for the ACCC to consider whether conduct in the chicken meat industry has contravened the B2B UCT framework, or other aspects of the CCA or ACL.

▶ **ACCC action 1:**

**The ACCC will investigate the potential UCTs identified in the chicken meat industry.**

Secondly, the ACCC will further investigate allegations that some horticulture wholesalers are trading without horticulture produce agreements. Under the Horticulture Code, growers and traders are required to have a Code-compliant, written horticulture produce agreement in place in order to trade in horticultural produce. Traders are prohibited from trading in horticultural produce on terms and conditions other than the terms and conditions specified in the horticultural produce agreements. Penalties apply for non-compliance.

▶ **ACCC action 2:**

**The ACCC will investigate reports that horticulture wholesalers are trading without Horticulture Produce Agreements. The ACCC will conduct further Horticulture Code audits in 2021 to examine these concerns.**

## 6.2.4 Upcoming changes to regulatory arrangements

There are some key regulatory improvements on the horizon. These include the Government's commitment to strengthen the B2B UCT framework, and the ACCC's introduction of a small business collective bargaining class exemption.

These improvements will assist the ACCC and market participants to respond to some of the harmful effects of bargaining power imbalances and market failures in PAG industries that have been identified in this inquiry. These improvements and their likely effects are discussed in greater detail below.

However, even with the key regulatory improvements on the horizon, important regulatory gaps will remain in the ACL.

## 6.2.5 Shortcomings or gaps in regulation

This inquiry has received allegations of practices occurring in PAG industries which, if proven, would indicate that significant economic harm is currently being caused.

The ACCC is particularly interested in two categories of alleged practices. Firstly, this inquiry has received allegations of supermarket practices that, at face value, should constitute a contravention of the Food and Grocery Code. As noted in chapter 3, this includes:

- agreeing to provide a supplier with a price increase on the condition that the supplier offsets part of that price increase back to the supermarket, such as through contributing more funding for promotional activities
- de-listing, or threatening to de-list, a supplier's goods as retribution for seeking a price increase, or making a complaint about Code non-compliance
- controlling fresh produce inventory through the unreasonable or inconsistent application of quality specifications.

While practices such as these may, at face value, constitute a contravention of the Food and Grocery Code, there are several reasons why the Code may not be deterring or punishing those alleged practices. These reasons are explored in chapter 5, but they include:

- *The ability to opt out of certain Code protections, such as supplier payments for promotional activities*

The ACCC acknowledges the importance of freedom of contracting, particularly in situations where suppliers are large, sophisticated, and able to bargain with supermarkets on terms of relative equality.

However, the ability to opt out of the Code's protections remains a fundamental weakness, as it means the Code's ability to protect smaller suppliers is undermined by the very bargaining power imbalances that are the reason for the Code.

- *The lack of an effective Code dispute resolution process or sufficient penalties for non-compliance*

The dispute resolution process available under the Code is not sufficiently independent to prevent retribution or biased decision-making by the supermarkets, and the ACCC cannot effectively enforce the Food and Grocery Code because of the lack of sufficient penalties or other remedies available for non-compliance.

As a result, even practices that, at face value, constitute a contravention of the Food and Grocery Code cannot be adequately deterred or punished.

- *The voluntary nature of the Food and Grocery Code*

Even if changes were made to respond to the above weaknesses, there remains the risk that signatories to the Code would withdraw, since the Code is voluntary. This remains a fundamental problem with the Code.

The ACCC considers that these weaknesses in the Food and Grocery Code constitute an important under-regulation of practices that have significantly economically harmful effects.

Secondly, through this inquiry and past analysis of agriculture markets, the ACCC has received allegations of practices that are not currently regulated under the CCA, but which the ACCC considers should be regulated under the CCA, as they cause significant economic harm. The primary focus of these practices is to dissuade a party with inferior bargaining power from exercising its legal rights by threatening it with some kind of commercial retaliation. The ACCC has identified two related categories of this kind of commercial retaliation:

- *Dissuading parties from seeking their full entitlements under contracts*

As part of this inquiry, the ACCC received allegations about parties with superior bargaining power seeking to dissuade parties with weaker bargaining power from receiving the full benefit to which they were entitled under a contract.

For example, the ACCC received an allegation that, in a particular geographic region, one chicken meat processor withdrew from the market, leaving only one processor remaining. The remaining processor told its existing growers, mid-contract, that it wished to decrease the prices paid to them for the rest of the contract period.

The growers were not obliged by their contract to accept any price decreases during their contract term, nor did the processor seek to unilaterally vary the existing contract. However, the discussions took place in the context of the growers knowing that there was now excess growing capacity in the region.

The ACCC considers that exerting pressure on parties with inferior bargaining power to dissuade them from seeking their full benefit from a contract is harmful behaviour that ought to be prohibited.

In this example, some growers agreed to the price decrease. Growers that did not accept the price decrease allegedly did not have their contract renewed when it next expired.

The ACCC does not necessarily consider that the processor in this example ought to have been compelled to renew the contracts of the growers who did not accept the price decrease. However,

the ACCC is concerned by the unfair and harmful pressure allegedly exerted by the processor during the contract term, in relation to contractual rights that the growers already had.

- *Dissuading parties from seeking to enforce their legal rights*

As noted above, a key allegation made by some suppliers about retailers who are signatories to the Food and Grocery Code, is that suppliers have been, or are threatened with being de-listed in retaliation for seeking price increases (to which they may have been contractually entitled), or for making complaints about a retailer's alleged non-compliance with the Code and other legal obligations.

The ACCC also considers that this problem arises in other industries. For example, the 2010 report on the wine grapes market by the NSW Legislative Council Standing Committee on State Development noted concerns raised by wine grape growers about the threat of commercial retaliation by buyers if the growers sought to negotiate prices, or complained about prices or the buyer's business practices.<sup>521</sup>

Similar concerns were raised in the ACCC's Wine Grapes Market Study regarding the wine grape grower – buyer relationship. As part of the market study, wine grape growers were asked whether they agreed or disagreed with the statement that “engaging in a dispute resolution process would not harm my business' future dealings with wine grape buyers”. Over 50% of growers in warm climate and cool climate regions disagreed or strongly disagreed with that statement.<sup>522</sup> In some growing regions, that figure was over 60% of growers.<sup>523</sup>

The ACCC considers that this likely indicates the existence of harmful practices that seek to, and often manage to, deter parties with less bargaining power from taking actions to defend or enforce their legal rights.

The ACCC considers that these unregulated alleged practices lead to significantly harmful outcomes that justify a regulatory response.

Some options that the ACCC considers will reduce these regulatory gaps (including the introduction of a prohibition on unfair trading practices, and strengthening the Food and Grocery Code) are discussed below.

## 6.2.6 Solutions outside competition and fair trading laws

The goals of competition and fair trading laws should be kept in mind when designing regulatory responses to harmful behaviour.

For example, the competition and fair trading laws cannot respond to concerns about whether low farmgate prices are resulting in farmers adopting environmentally unsustainable practices. Environmental sustainability is best addressed using regulations or policies specifically addressing those issues. Similarly, competition and fair trading laws cannot be qualified depending on whether primary producers have sufficient business knowledge and experience to take advantage of any risk mitigation options available to them. Such issues are best addressed using specifically developed policies.

Further, it is not the role of the competition and fair trading laws to regulate the distribution of value throughout a supply chain.

Participants in PAG industries are subject to substantial regulation at federal, state or territory, and local government levels, at each stage of the supply cycle. This regulation includes environmental protection legislation, agricultural and veterinary chemical standards, land use and building legislation, biosecurity legislation, animal welfare legislation, land transport and shipping legislation, and food safety legislation.<sup>524</sup>

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521 NSW Legislative Council on State Development, *Wine grapes market and prices*, report no. 35, December 2010, pp. 30–31.

522 ACCC, *Wine grapes survey results report*, September 2018, p. 32.

523 Riverina, North East Victoria (VIC), Mount Lofty Ranges (SA), Limestone Coast (SA), Central Ranges (NSW/ACT).

524 See, for example, Productivity Commission, *Regulation of Australian Agriculture*, no. 79, November 2016, p. 4.

Bearing this in mind, other tools will need to be used in conjunction with competition and fair trading laws to ensure that PAG industries are operating in the way that Australians desire.

## 6.3 Key regulatory changes on the horizon

As noted above, there are two key regulatory changes on the horizon that will provide important additional protection against some harmful effects of bargaining power imbalances: the strengthening of the B2B UCT framework, and the ACCC's introduction of a class exemption for small business collective bargaining.

### 6.3.1 Strengthening the small business unfair contract terms framework

The Government has committed to strengthening the B2B UCT framework<sup>525</sup>, and conducted a consultation process last year on various potential reforms.<sup>526</sup> The ACCC strongly supports strengthening the B2B UCT framework.

As discussed in chapter 5, the B2B UCT framework is a key component of protecting against the economic harms that can result from parties exercising their greater bargaining power in particular ways. The purpose of extending the UCT framework to cover small business standard form contracts was:

*To promote fairness in contractual dealings with small businesses with regard to standard form contracts. This will reduce small business detriment and have positive impacts on the broader economy by increasing small business certainty and confidence, and providing for a more efficient allocation of risk. Small businesses, in dealing with other businesses through standard form contracts, should have confidence that the contract they are offered is fair and reasonable and that the risks are allocated efficiently.<sup>527</sup>*

This inquiry has further underscored the importance of strengthening the B2B UCT framework, as contracting practices have been a major concern in PAG industries. The ACCC has conducted a number of investigations into potential B2B UCTs in PAG industries in recent years, and the current framework poses a number of challenges.

Firstly, the lack of penalties available for the inclusion of UCTs in standard form contracts reduces the incentives for the party offering the contract to ensure that it does not include UCTs.

Secondly, the inclusion of UCTs in standard form contracts is not prohibited under the ACL. Instead, if a term is declared to be a UCT, it automatically becomes void. This means that more flexible enforcement options are not available to remedy the situation. This risks undermining confidence in, and the effectiveness of, the B2B UCT framework. Further, the ACCC considers that harmful behaviour, like UCTs in standard form contracts, ought to be prohibited as a matter of principle.

Thirdly, the current contract value and small business definition thresholds risk excluding a significant number of contracts or small businesses in PAG industries. This may be the case even where a significant imbalance in bargaining power exists, and the UCT causes significant economic harm. This undermines the stated intention of the B2B UCT framework.

A number of submissions to this inquiry supported strengthening the B2B UCT framework, including the National Farmers Federation and the NSW Farmers' Association, who supported a number of changes, including the introduction of pecuniary penalties.<sup>528</sup>

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525 The Hon Stuart Robert MP, 'Further strengthening the unfair contract term protections for small businesses', media release, 28 March 2019.

526 Treasury, *Enhancements to Unfair Contract Term Protections*, consultation regulation impact statement, December 2019.

527 Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015 (Cth), explanatory memorandum, paragraph 3.65.

528 National Farmers Federation, public submission, p. 23.; NSW Farmers' Association, public submission, p. 20.

Following the Government's consultation process last year, the consumer affairs ministers and agencies of the different Australian government jurisdictions have recently decided that they will seek to strengthen the B2B UCT framework, including through<sup>529</sup>:

- Making UCTs unlawful and giving courts the power to impose a civil penalty.
- Providing more flexible remedies to a court when it declares a contract term unfair, by giving courts the power to determine an appropriate remedy, rather than the term being automatically void.
- Clarifying that the remedies for 'non-party consumers' also apply to 'non-party small businesses'.
- Creating a rebuttable presumption that a term is unfair where it is the same or substantially similar to a declared UCT, and is used by the same entity in another contract.
- Increasing the eligibility threshold for the protections from less than 20 employees to less than 100 employees, and introducing an annual turnover threshold of less than \$10 million as an alternative threshold for determining eligibility.
- Removing the requirement for the upfront price payable under a contract to be below a certain threshold in order for the contract to be covered by the UCT protections.
- Improving clarity around the definition of a standard form contract, by providing further certainty on factors such as repeat usage of a contract template, and whether the small business had an effective opportunity to negotiate the contract.

► **Recommendation 1:**

**The ACCC recommends that the B2B UCT framework be strengthened in the ways agreed to by the Legislative and Governance Forum on Consumer Affairs.**

The ACCC strongly supports the proposed improvements to the B2B UCT framework. These improvements would be an important step forward in seeking to protect against the economic harms that can stem from bargaining power imbalances in PAG industries. The impact of these improvements is set out in the Government's decision regulation impact statement.<sup>530</sup>

### 6.3.2 A class exemption for small business collective bargaining

As discussed in chapter 5, it can be advantageous for small businesses in PAG industries to use collective bargaining as a means of negotiating better terms and conditions with larger businesses than they would otherwise achieve on their own.

The ACCC is currently introducing a 'class exemption' that will provide immediate legal protection for small businesses to engage in collective bargaining. This class exemption will come into effect in early 2021, following the expiry of the Parliamentary disallowance period, and will apply to three categories of eligible businesses:

- A business with an aggregated turnover of less than \$10 million in the financial year preceding when it joins a collective bargaining group
- Franchisees negotiating with their franchisors (regardless of turnover)
- Fuel retailers negotiating with their fuel wholesalers (regardless of turnover).

The class exemption will allow these eligible businesses to form or join a collective bargaining group to negotiate with suppliers or customers about the supply or acquisition of goods or services.

This class exemption will remove the need for these businesses to seek authorisation or lodge a notification, meaning that they could access the exemption without delay or additional cost and realise the benefits of collective bargaining. In particular, it will reduce the administrative and financial cost of collective bargaining for businesses that have an existing authorisation or notification in place, as

529 Treasury, *Enhancements to Unfair Contract Term Protections*, regulation impact statement for decision, November 2020; The Hon Michael Sukkar MP, 'Penalties to be introduced for unfair contract terms', media release, 10 November 2020; Legislative and Governance Forum on Consumer Affairs, joint communique, 6 November 2020, p. 2.

530 Treasury, *Enhancements to Unfair Contract Term Protections*, regulation impact statement for decision, November 2020.

they would not have to seek renewal. This quicker and simpler process for gaining an exemption from competition laws to collectively bargain will also encourage more businesses to take advantage of collective bargaining. Bargaining groups will only have to fill out a simple, one page form, and provide it to the ACCC. There will be no fee for lodging the form. Legal protection from competition laws will then commence automatically.

The class exemption does not oblige target businesses to negotiate with a bargaining group. Nor does it override any existing legal or contractual obligations between the parties, such as confidentiality clauses. The class exemption simply removes the risk that collective bargaining by eligible businesses will contravene competition laws.

Importantly, the class exemption would not provide protection for collective boycotts. Businesses will, however, be able to seek legal protection to engage in collective boycotts using the authorisation and notification processes, as discussed in chapter 5.

The ACCC considers that this class exemption provides efficiencies for producers and suppliers that are seeking to collectively bargain.

The ACCC will release further information about the class exemption, including the form businesses need to lodge with the ACCC and a guide to using the class exemption, in early 2021 when the class exemption becomes available for use, and will engage with agricultural industry associations about the potential benefits of the class exemption.

▶ **ACCC action 3:**

**The ACCC will engage directly with agricultural industry associations in 2021 to explain how the class exemption for collective bargaining may be beneficial and how businesses can access the regime.**

## 6.4 Addressing gaps in the fair trading regulatory framework

There are important regulatory gaps in the ACL, as noted above and in chapter 5. While existing ACL provisions, like the B2B UCT framework and the prohibitions on unconscionable conduct, are important protections against some of the harmful effects of bargaining power imbalances, they are not sufficient.

There are two general ways in which the ACL can respond to harmful behaviour:

- Sector-specific regulation, including industry codes, or
- Performance-based, economy-wide prohibitions, such as the prohibition on misleading or deceptive conduct.

As noted in chapter 5 in relation to ‘good faith’ requirements in industry codes, the ACCC considers that a balance between specificity and performance-based regulation leads to the best regulatory outcomes. These two general approaches have different advantages and disadvantages, making them appropriate to respond to different situations.

### 6.4.1 A PAG-wide industry code

Industry codes are an important part of Australia’s competition and fair trading regime. They can be effective in resolving sector-specific problems, and, where they are mandatory and contain penalties sufficient to deter non-compliance, they can also be a key part of the ACCC’s enforcement toolkit in promoting and ensuring competition and fair trading.

Submissions to this inquiry have raised the idea of introducing an industry code that covers all PAG industries, in order to address the variety of different harmful behaviours occurring across those industries.<sup>531</sup>

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531 National Farmers Federation, public submission, pp. 20–21.

The European Union's recent *Directive on unfair trading practices in B2B relationships in the agricultural and food supply chain*<sup>532</sup> provides an example of how an industry code might operate across PAG supply chains to prohibit harmful behaviour that is not currently caught by existing ACL or industry code provisions.

The Directive, which is due to come into full effect in Europe next year, is intended to address bargaining power imbalances between suppliers (including farmers, processors, wholesalers and cooperatives) and the buyers of their goods (including retailers, processors and wholesalers) in the entire 'agri-food' supply chain.

The Directive is split into two key categories (table 6.1): 'black practices', which are prohibited in all circumstances, and 'grey practices', which are prohibited unless the supplier and buyer agree on them beforehand in a clear and unambiguous manner.

**Table 6.1: Practices prohibited under EU Directive 2019/633**

'Black practices'	'Grey practices'
<p>The following buyer trading practices are prohibited in all circumstances:</p> <ul style="list-style-type: none"> <li>▪ the buyer paying the supplier later than 30 days after the delivery of perishable products</li> <li>▪ the buyer paying the supplier later than 60 days after the delivery of other agricultural products</li> <li>▪ short-notice cancellations of perishable agri-food products</li> <li>▪ unilateral contract changes by the buyer</li> <li>▪ payments not related to a specific transaction</li> <li>▪ risk of loss and deterioration transferred to the supplier</li> <li>▪ refusal of a written confirmation of a supply agreement by the buyer, despite request of the supplier</li> <li>▪ misuse of trade secrets by the buyer</li> <li>▪ commercial retaliation by the buyer, and</li> <li>▪ transferring the costs of examining customer complaints to the supplier.</li> </ul>	<p>The following buyer trading practices are prohibited unless the supplier and buyer agree on them beforehand in a clear and unambiguous manner:</p> <ul style="list-style-type: none"> <li>▪ returning unsold goods to the supplier without paying for them or for their disposal</li> <li>▪ charging the supplier for stocking, displaying, or listing the supplier's products</li> <li>▪ requiring the supplier to bear part or all of the cost of the buyer's promotion of the supplier's goods</li> <li>▪ requiring the supplier to pay for the buyer's advertising or marketing, and</li> <li>▪ requiring the supplier to provide or pay for staff for fitting out the buyer's premises.</li> </ul>

Source: EU Directive 2019/633.

However, the ACCC considers that such a code is likely to face three key challenges in being flexible enough to adequately respond to the harmful behaviour identified in this inquiry.

Firstly, it would be difficult to construct an industry code that responded appropriately through process-based regulations (as is most common in industry codes) to the variety of different instances, prevalence, and harmfulness of behaviour in different PAG industries. To take an example from the EU Directive discussed above, it would be extremely challenging to:

- identify the different payment times used in different parts of the supply chains in different PAG industries, and the varying level of harmfulness that those payment times caused, depending on all the circumstances
- prohibit in a clear and targeted way only the behaviour that was sufficiently harmful to justify regulation.

Designing an appropriate sector-specific industry code is possible after a thorough investigation of a particular sector, such as the ACCC's recommendation that a Dairy Code be introduced following an 18-month inquiry into the dairy industry. However, the more sectors that are included in such regulation, the higher the risk that the regulation will not be well targeted nor effective. Since the

<sup>532</sup> EU Directive 2019/633.

EU Directive is not yet in full effect, there is no evidence yet available about how this regulation can respond to this challenge.

Secondly, as discussed in chapter 5, process-based regulation in industry codes is less successful at responding to evolutions in behaviour over time, and requires significant resources to ensure it remains up-to-date. This challenge is exacerbated when the industry code would cover multiple PAG industries, each evolving in different ways. As with the first challenge, this challenge is more manageable when an industry code only covers one sector, like the Dairy Code. However, this issue increases the risk that a PAG-wide industry code would inappropriately regulate behaviour, through prohibiting behaviour that may not be harmful, and through not prohibiting behaviour that is harmful.

Thirdly, an industry code-based response to the harmful effects of bargaining power imbalances would be limited by the larger industry codes framework in relation to the penalties that could be imposed for non-compliance. The maximum penalty currently available for a contravention of an industry code is 300 penalty units (currently, \$66,600).<sup>533</sup> This is significantly lower than the maximum penalties available for a corporate contravention of the ACL, which, for the provisions discussed in this inquiry, is the greater of \$10 million, three times the value of the benefit obtained (if the court can determine the value of the benefit obtained), or 10% of the corporation's annual turnover in the preceding 12 months (if the court cannot determine the benefit obtained).<sup>534</sup>

## 6.4.2 A prohibition on unfair trading practices

An alternative to a PAG-wide industry code is performance-based regulation in the form of an economy-wide ACL prohibition on 'unfair trading practices'.

Discussions are currently underway between the consumer affairs ministers and agencies of the Australian federal, state, and territory governments about what form an ACL prohibition on unfair trading practices could take.<sup>535</sup>

Key international jurisdictions already prohibit unfair trading practices in various forms.

For example, the United States prohibits "unfair ... acts or practices in or affecting commerce".<sup>536</sup> The test for whether an act or practice will be considered unfair is whether:

- it causes or is likely to cause substantial injury to consumers
- the substantial injury is not outweighed by countervailing benefits to consumers or to competition, and
- the substantial injury cannot reasonably be avoided by consumers.<sup>537</sup>

Similarly, the European Union prohibits "unfair commercial practices" between businesses and consumers, in addition to the black and grey lists of specific unfair practices in agricultural and food supply chains discussed above.<sup>538</sup> This more general prohibition on unfair commercial practices provides that a commercial practice will be unfair if it meets the following two criteria<sup>539</sup>:

- *It is contrary to the requirements of professional diligence.*

'Professional diligence' is defined as "the standard of special skill and care which a trader may reasonably be expected to exercise towards consumers, commensurate with honest market practice and/or the general principle of good faith in the trader's field of activity".<sup>540</sup>

533 Section 51AE(2) of the CCA, although the Government has recently introduced the *Treasury Laws Amendment (2020 Measures No. 4) Bill 2020*, Schedule 3 of which would increase this maximum penalty to 600 penalty units.

534 Section 224 of the ACL. The maximum penalty for an individual who has contravened these sections is \$500,000.

535 Legislative and Governance Forum on Consumer Affairs, joint communique, 6 November 2020, p. 3.

536 *Federal Trade Commission Act*, 15 USC § 45(a).

537 15 USC § 45(n).

538 Directive 2005/29/EC, concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, article 5(1); this directive is also known as the Unfair Commercial Practices Directive (UCPD).

539 Directive 2005/29/EC, article 5(2). Article 5(4) also states that a commercial practice will be unfair if it is "misleading" (a defined term) or "aggressive" (another defined term). However, the definition of 'unfair' in article 5(2) is more relevant to the issues considered in this inquiry.

540 Directive 2005/29/EC, article 2(h).

- *It materially distorts or is likely to materially distort the economic behaviour with regard to the product of the average consumer whom it reaches or to whom it is addressed, or of the average member of the group when a commercial practice is directed to a particular group of consumers.*

The phrase ‘to materially distort the economic behaviour of consumers’ is defined to mean “using a commercial practice to appreciably impair the consumer’s ability to make an informed decision, thereby causing the consumer to make a transactional decision that he [sic] would not have taken otherwise”.<sup>541</sup>

The ACCC strongly supports the introduction of an unfair trading practices prohibition in Australia. This inquiry has identified that significant bargaining power imbalances can lead to conduct that causes substantial detriment to supply chain participants, and which causes resources to not be allocated efficiently. While this report is not the forum to propose a particular legal formulation, an unfair trading practices prohibition in Australia aimed at reducing these problems is appropriate.

The ACCC considers that an unfair trading practices prohibition would have a number of advantages over a PAG-wide industry code, including:

- It would establish a norm of behaviour that would be better able to apply across different sets of circumstances. This would allow it to focus its prohibition on behaviour that was causing significant harm, instead of prohibiting particular practices that may or may not cause harm, depending on the circumstances.
- This norm of behaviour would be able to keep up with evolving commercial practices in a way that more rigid regulation, like a PAG-wide industry code, would not.
- The current regulatory gaps in the ACL are a problem that extends beyond PAG supply chains. For example, the ACCC’s 2019 final report in its Digital Platforms Inquiry identified harmful behaviour occurring in that sector, and recommended an unfair trading practices prohibition in response.<sup>542</sup> While PAG industries are the focus of this inquiry, the ACCC considers that regulatory responses should be considered from a broader perspective as well.
- An ACL-based prohibition would potentially be subject to the greater penalties available under the ACL in comparison to industry code penalties. These penalties are crucial in ensuring that a new prohibition would function effectively to secure meaningful behavioural change.

More specific guidance on particular types of potentially harmful behaviour, such as those practices identified in the EU black and grey lists discussed above, could be provided in a variety of ways, including through the explanatory memorandum or a second reading speech that accompanies the amending bill.

### ► Recommendation 2:

**The ACCC recommends that an economy-wide prohibition on unfair trading practices be introduced into the ACL.**

The impact of such a prohibition will be explored further as part of the regulation impact assessment process agreed to at the Legislative and Governance Forum on Consumer Affairs.<sup>543</sup>

Despite the challenges associated with introducing a PAG-wide industry code, the ACCC considers that many of the sector-specific industry codes that currently apply to PAG industries are key tools for responding to the harmful effects of bargaining power imbalances. It is important that these industry codes are able to effectively respond to the harmful effects to which they are directed.

However, one of these industry codes, the Food and Grocery Code, is not currently able to respond as effectively as it should to harmful behaviour within its intended scope. Although the Food and Grocery Code has recently been amended, the ACCC considers that further strengthening is necessary.

541 Directive 2005/29/EC, article 2(e).

542 ACCC, *Digital Platforms Inquiry*, final report, July 2019, p. 498.

543 Legislative and Governance Forum on Consumer Affairs, joint communique, 6 November 2020, p. 3.

### 6.4.3 Recent amendments to the Food and Grocery Code

In 2018, the Government commissioned an independent review of the Food and Grocery Code, which made 14 recommendations in its final report.<sup>544</sup> These included:

- the Code remaining voluntary
- amending the definition of good faith to provide greater clarity, and introducing a new requirement to consider fair dealings in dispute resolution
- improving the internal dispute resolution requirements, by replacing Code Compliance Managers with Code Arbiters for each signatory (Code Arbiters would be empowered by the Code to make binding determinations on the signatory, including awarding compensation)
- the Government appointing an Independent Reviewer to oversee the dispute resolution process to ensure it is conducted independently and without bias
- ensuring that price rise negotiations are not conditional on suppliers providing commercially sensitive information to a signatory or third party
- requiring that a future review be conducted in three to five years' time to test the effectiveness of the review's recommendations.

In March 2019, the Government accepted the abovementioned recommendations, and the accepted recommendations took effect in the Food and Grocery Code from 3 October 2020 (except for provisions on conduct relating to price increase processes, which will commence on 2 January 2021).

### 6.4.4 Strengthening the Food and Grocery Code

Despite the recent amendments, the ACCC considers that the effectiveness of the Food and Grocery Code continues to be undermined by a range of shortcomings. Further changes are necessary to address the harmful effects of bargaining power imbalances in the relationships between retailers and wholesalers, and their suppliers.

Firstly, to provide meaningful protection for suppliers, the Food and Grocery Code should be made mandatory, applying to all relevant retailers and wholesalers in the sector. Without being mandatory, the risk of signatories withdrawing from its coverage undermines the force of the Code and the extent to which businesses can rely on its protections. This risk could be triggered by a number of factors, such as the introduction of civil pecuniary penalties.

Secondly, the ability of retailers or wholesalers to contract out of important protections in the Food and Grocery Code should be removed. The Code is intended to address the fact that retailers and wholesalers hold the bargaining power in negotiations with suppliers. Allowing them to contract out of Code obligations fatally undermines this purpose. Throughout this inquiry, the ACCC has heard concerns that many suppliers are unlikely to oppose requests from retailers owing to a fear of losing a significant component of their business.

Thirdly, the Food and Grocery Code should be updated to make significant civil pecuniary penalties and infringement notices available for contraventions. As it currently stands, the Code does not provide the ACCC with the necessary enforcement tools to protect suppliers against signatories that fail to comply with its requirements. Submissions to this inquiry have indicated that they are unwilling to raise complaints because of the risk to their business, and the fact that there will be no genuine consequences for the retailers under the Code.

Fourthly, the Food and Grocery Code needs to provide a genuinely independent dispute resolution, so that suppliers are not deterred from using it because of concerns over confidentiality, bias, or commercial retaliation by retailers or wholesalers. The ACCC considers the employment relationship between the Code Arbiter and the retailer or wholesaler erodes the actual and perceived independence of the Arbiter, and that the Independent Reviewer will not resolve the Arbiters' lack of independence.

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<sup>544</sup> Professor Graeme Samuel AC, *Independent Review of the Food and Grocery Code*, final report, September 2018.

This inquiry highlights that supplier relationships with retailers continue to be a major issue across a number of industries.

► **Recommendation 3:**

**The ACCC recommends that the Food and Grocery Code be strengthened, including by making it mandatory for retailers and wholesalers, and by introducing significant penalties for contraventions.**

The explanatory statement accompanying the introduction of the Food and Grocery Code noted the compliance costs likely to be incurred by grocery retailers and wholesalers, but said:

*Over the longer term, it is considered that the estimated cost would be outweighed by the broader benefits deriving to the grocery sector from the improvement in standards of conduct if the Code achieves its purposes.<sup>545</sup>*

The ACCC considers that the Code has not fully achieved its purposes. In order for the full benefits of the Code to accrue to the grocery sector and Australian consumers, the Food and Grocery Code should be strengthened as set out above.

## 6.5 Assessing the Dairy Code's effectiveness

The Dairy Code was implemented to address the market power imbalances and market transparency issues identified in the ACCC's Dairy Inquiry.

It has been in operation for less than 12 months, having commenced operation on 1 January 2020. Further, obligations related to contract publication commenced on 1 June 2020, meaning there has been an even shorter period to consider their effectiveness.

### 6.5.1 Initial observations

As noted above, the Dairy Code has only been in operation for a short time, and this time has only included one period in which dairy contracts are typically renewed (typically the third quarter of the calendar year).

Through its initial operation, the ACCC identified a number of positive developments in terms of the operation of the Dairy Code, including:

- evidence of competition among processors on raw milk prices after prices were announced on 1 June 2020
- increased transparency as farmers were able to access price information a sufficient period ahead of needing to make a decision about which processor to supply
- written agreements were in operation across the vast majority of processors.

While these signs are positive, there is currently not enough information, given the Code's very recent introduction, to conclusively show whether the Code has achieved its goals in terms of mitigating the effects of bargaining power imbalances in the dairy industry.

Furthermore, the introduction of the Dairy Code has required adjustment by processors and dairy farmers to a new regulatory framework. As such, the ACCC expects it will take a number of years for the effectiveness of the Dairy Code to be fully understood.

Enforcement and compliance activities in relation to the Dairy Code are a priority for the ACCC, and the ACCC continues to consider a number of matters. The ACCC will publish a report setting out its observations on compliance with the Dairy Code, and intends to do so by the end of 2020.

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<sup>545</sup> *Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015*, explanatory statement, p. 4.

The first mandated review of the Dairy Code, as required by clause 6 of the Dairy Code, will occur in 2021. This review will enable a more detailed consideration of the Dairy Code.

## 6.5.2 Proposed amendments in submissions

Submissions to this inquiry have proposed a number of amendments to the Dairy Code.

Firstly, there have been calls for the Dairy Code to apply to retailers.<sup>546</sup> The Dairy Code does apply to retailers in situations where they are direct acquirers of raw milk from farmers, but it does not govern the interactions between processors and retailers. The ACCC considers that this relationship should be governed through the Food and Grocery Code.

Secondly, there have been calls for the Dairy Code to have a role in regulating retail prices for dairy products.<sup>547</sup> This inquiry's terms of reference specifically exclude ACCC consideration of the Government's policy that there is to be no regulation of prices in PAG industries. Further, while the ACCC acknowledges the pressure that lower retail pricing imposes on margins across the dairy industry, the ACCC has found that the farmgate prices received by farmers are mainly driven by commodity prices and competition between processors, rather than by retail pricing. This is discussed in more detail in chapter 4.

Thirdly, significant concerns have been raised about the Code requirement for a processor to offer a non-exclusive supply agreement for every set of circumstances in which they offer an exclusive supply agreement. These concerns included that this requirement for every agreement is unnecessary, and creates duplication, complexity and potential for error. Other submissions argued that non-exclusive supply agreements under the Code have been the subject of lower prices, and that therefore the Code has not achieved its objective of encouraging non-exclusive supply agreements.<sup>548</sup>

Fourthly, significant concerns were also raised about the 14 day cooling off period set by the Dairy Code. It was argued that this is unfairly weighted in favour of farmers and reduces certainty around milk supply for processors. It was argued that this period should be reduced to 7 days.

Finally, concerns about the effectiveness and clarity of the minimum price requirements in the Dairy Code have also been raised by submissions to this inquiry and to the ACCC more generally.<sup>549</sup> While these minimum price requirements provide greater price transparency for dairy farmers than previously existed, the ACCC received feedback that it is still difficult to interpret and compare offers made by processors.

Overall, the ACCC considers that it is important that the industry is able to adjust to the regulatory arrangements without further major changes to the Dairy Code. However, the ACCC's observations on the early period of the Dairy Code's operation indicates the code review should give particular attention to the certain provisions, such as minimum price requirements, exclusivity and cooling off periods.

## 6.6 Overcoming information asymmetries appropriately

The further ACCC actions, the upcoming regulatory changes, and the recommended regulatory changes outlined above will significantly improve the ability of the ACCC and market participants to protect against some of the harmful effects of bargaining power imbalances in PAG industries.

However, they will not completely protect against these harmful effects, nor fully prevent the market failures discussed in chapter 1. In particular, one of the key ways in which bargaining power imbalances can lead to market failures—information asymmetry—will require continuing consideration into the future to ensure that any regulatory response is appropriately targeted.

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546 Australian Dairy Farmers, public submission, p. 38.; National Farmers Federation, public submission, p. 12.; NSW Farmers' Association, public submission, p. 26.

547 Australian Dairy Farmers, public submission, p. 40.

548 Australian Dairy Farmers, public submission, p. 37; NSW Farmers Association, public submission, p. 27.

549 NSW Farmers' Association, public submission, p. 27.

Information asymmetries between different levels of the supply chain persist throughout PAG industries, but there is no simple response to increase market efficiency and protect against harmful effects of bargaining power imbalances.

### 6.6.1 Information asymmetries and market efficiency

As noted in chapter 1, information asymmetries can undermine market efficiency where they weaken market participants' ability to make decisions about their best interests.

For example, the ACCC's 2017 final report of the Cattle and Beef Market Study noted that some cattle producers reported difficulties accessing buyers' price grids in a timely manner. This could affect the producer's future investment decisions:

*For example, if a small-scale producer finds that higher returns could be achieved by increasing turn-off to supply cattle OTH [over-the-hooks], then they may purchase additional restocker cattle for finishing or invest in feedlot infrastructure to intensify their operation. If producers cannot access this information, then it is difficult to make these decisions.<sup>550</sup>*

As a result of this market study, the ACCC recommended that all processors and other major purchasers of prime cattle should make their price grids publicly available in a timely manner, reasoning that this will increase price discovery and the ability of producers to negotiate and make informed and timely decisions about who to sell their cattle to.<sup>551</sup>

Similarly, the ACCC's 2019 final report of the Wine Grapes Market Study noted that winemakers benefit from information asymmetries regarding competitive market pricing:

*Winemakers are better able to estimate the price growers are likely to accept, in contrast to growers who are frequently unable to determine what constitutes a fair market price. This results from winemakers having better access to market information than growers. In addition to having better access to information about market prices and likely demand, winemakers have information about how the season is proceeding for a large number of growers. In contrast, as winemakers generally do not make public price announcements and usually require growers to keep prices confidential, growers have a limited understanding of potential competing offers.<sup>552</sup>*

As a result of this market study, the ACCC recommended that warm climate grape grower organisations should provide market analysis to growers, and that wine grape buyers should provide retrospective but identified pricing information to Wine Australia for publication.<sup>553</sup>

### 6.6.2 Price transparency measures

One common regulatory response to information asymmetries is to focus on increasing price transparency. Examples include the cattle and wine grapes recommendations discussed above, as well as aspects of the Dairy Code, such as the requirement to publish milk supply agreements which include pricing information by a particular time.

However, the ACCC is not in a position to recommend additional price transparency measures following this inquiry. Further consideration would be needed about the likelihood of price transparency measures succeeding in specific PAG industries.

Increases in price transparency can improve the functioning of markets by enabling market participants to better identify the prices or offers best suited to their individual preferences. This can also enable market participants to make more efficient investment decisions. Measures to improve price transparency may include:

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550 ACCC, *Cattle and Beef Market Study*, final report, March 2017, p. 62.

551 ACCC, *Cattle and Beef Market Study*, final report, March 2017, p. 11.

552 ACCC, *Wine Grapes Market Study*, final report, September 2019, p. 96.

553 ACCC, *Wine Grapes Market Study*, final report, September 2019, p. 11.

- Compelling market participants to publish prices offered or paid.
- Requiring prices to be communicated in a standardised form across a sector.
- Tasking industry bodies or an independent organisation with collecting, analysing, and publishing market data in a timely and usable fashion to help inform market participants.

However, poorly designed price transparency measures, or measures applied to markets that are ill-suited to them, can have detrimental impacts. These impacts can include:

- reducing the incentives for market participants to offer lower prices to particular suppliers or customers. If those lower prices become public knowledge, they may be demanded by other suppliers or customers of those participants. In this position, the participants may decide not to offer those lower prices at all.
- making a market more conducive to collusive outcomes. Price transparency can facilitate market participants monitoring each other's prices. This can lead to prices coalescing around a particular point, which may result in a reduction of price competition. Increased transparency can also increase the ability of participants to quickly punish those who 'cheat' by offering different prices to win customers or suppliers from their rivals. This also facilitates collusive outcomes.

PAG industries can also face additional complications when considering price transparency measures. For example, commitment to production decisions in PAG industries may often need to be made well in advance of price information being discoverable. For example, wine grape growers must commit to pruning and watering vines well before export prices and domestic harvest conditions can possibly be known. If pricing information can only be made available after producers have made their production decisions and committed to supply, then it may not be of as much, or any, benefit.

In addition, some PAG industries feature lengthy supply contracts and as such, at any given time there may only be a limited number of producers who are able to switch between processors. If producers cannot act upon price information, then it may have little benefit to competition and potentially more benefit to processors seeking to coordinate. However, in the absence of any other information, having historical price information available to producers may assist them in comparing prices and making supply decisions at the time of contract renewal.

All these factors mean that deciding whether a regulatory response is appropriate, and if so, designing that regulatory response, is a complicated process. It must attempt to guard against unintended consequences that can prejudice the interests of the very parties that the regulatory response is designed to protect.

In the longer term, the ACCC considers that governments and PAG industries should consider means to improve market transparency. However, this needs to occur on an industry by industry basis, and care needs to be taken to ensure that unintended consequences do not emerge.

#### ► Recommendation 4:

**The ACCC recommends that Australian governments and PAG market participants should explore measures to increase price transparency in PAG industries, in order to increase competition in those industries.**

## 6.7 Conclusion

The existing competition and fair trading regulatory arrangements do not adequately respond to the harmful effects of bargaining power imbalances and market failures in PAG industries identified in this inquiry.

The ACCC considers that a general economy-wide prohibition on unfair trading practices in the ACL would be a major step forward in benefitting the operation of PAG industries, and the Australian economy in general. It would address a key regulatory gap that currently exists in ACL provisions, and would offer a more effective and flexible model for compliance across multiple industries compared with a PAG-wide industry code.

The ACCC also supports further strengthening the Food and Grocery Code, to remove the ability of retailers and wholesalers to contract out of their Code obligations, to make significant penalties and infringement notices available for contraventions, and to provide a more independent dispute resolution process.

The ACCC notes stakeholder calls for strengthening the Dairy Code but, given it was introduced less than 12 months ago, considers that it is appropriate to give the industry time to adjust to these new regulatory arrangements without further major changes, and for the Code's operation and effectiveness to be revealed. However, the ACCC supports further consideration of minor changes, such as exclusivity, cooling off periods and minimum price requirements, during the scheduled review of the Code next year.

There are also some significant regulatory changes on the horizon. When these are implemented, they will provide important additional protections against the harmful effects of bargaining power imbalances. This includes:

- strengthening the B2B UCT framework, including an effective deterrent like significant pecuniary penalties, expanding and amending the range of available remedies, a rebuttable presumption that a term is unfair, a new threshold for determining a small business, and greater clarity on what constitutes a small business having an ability to effectively negotiate a contract
- introducing a class exemption for small business collective bargaining, which will reduce administrative costs and barriers for small businesses and assist them to overcome some of the harmful effects of bargaining power imbalances.

Bargaining power imbalances are not a new challenge for PAG supply chain participants or regulators, and their harmful effects will not be overcome overnight. Therefore, this chapter has also noted some longer-term policy considerations, like overcoming information asymmetries in PAG supply chains, and discusses key principles that should inform future regulatory responses in the future.

The lessons learnt and information gathered as part of this inquiry will continue to inform the ACCC's work in agriculture markets.

# Appendix A: Public submissions to the inquiry

The ACCC sought submissions from all interested parties in response to the terms of reference of the inquiry. It received over 80 submissions from stakeholders (written and oral), of which 35 stakeholders indicated that their written submissions could be made public. These public submissions are summarised below, and are available on the [ACCC's website](#).

## Beef

The ACCC received seven public submissions regarding the beef industry.

Submissions raised concerns that were similar to those addressed in the ACCC's 2017 cattle and beef market study final report.<sup>554</sup> These concerns included that the beef processing sector had become highly concentrated in certain regions, and that this had reduced producers' bargaining power and increased their transportation costs.<sup>555</sup>

In particular, submissions raised concerns that processors now have significant influence over cattle prices as a result of unclear meat grading practices in fewer abattoirs.<sup>556</sup> NSW Farmers, for example, considered the current grading system to be inherently subjective and often inaccurate, with grading undertaken by individuals (generally employed by processors) by way of visual assessments.<sup>557</sup> It also noted that processors' lack of price transparency had made it difficult for producers to make informed sales decisions.<sup>558</sup> While processors were increasingly making their price grids available to producers,<sup>559</sup> the Red Meat Advisory Council noted that this could be improved through standardised feedback.<sup>560</sup>

Stakeholders expressed support for objective carcass measurement (OCM) technologies,<sup>561</sup> although NSW Farmers noted that the current uptake of OCM technologies amongst processors remains low.<sup>562</sup> The Australian Beef Association claimed that beef processors may take more 'trim' than is legally allowed during processing, and despite regular audits, this conduct is difficult to identify.<sup>563</sup> The Cattle Council of Australia claimed that OCM technologies would increase transparent carcass measurement, overcome carcass grading and pricing frustrations, potentially improve breeding strategies, and identify inefficient livestock.<sup>564</sup>

Woolworths' submission highlighted the ACCC's 2017 market study, which found that margins and profitability in the beef industry were driven by the export market, and not supermarket pricing.<sup>565</sup> Monaro Farming Systems' submission also stated that export prices determine the price of beef at the retail level and emphasised the importance of access to export markets to assist producers.<sup>566</sup> Stakeholders recommended expanding free trade agreements and maintaining export competitiveness.<sup>567</sup> This included addressing costs such as energy, labour, regulatory burdens and the impacts of COVID-19.<sup>568</sup>

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554 ACCC, *Cattle and beef market study*, final report, March 2017.

555 NSW Farmers, submission, p. 17, and South Coast Beef Producers Association, submission, p. 3.

556 NSW Farmers, submission, p. 17, and South Coast Beef Producers Association, submission, p. 3.

557 NSW Farmers, submission, p. 17.

558 NSW Farmers, submission, p. 17.

559 Cattle Council of Australia, submission, p. 2.

560 Red Meat Advisory Council, submission, p. 3.

561 Cattle Council of Australia, submission, p. 2, and Red Meat Advisory Council, submission, p. 3.

562 NSW Farmers, submission, p. 17.

563 Australian Beef Association, submission, p. 2.

564 Cattle Council of Australia, submission, p. 2.

565 Woolworths Group, submission, p. 6.

566 Monaro Farming Systems, submission, p. 1.

567 Monaro Farming Systems, submission, p. 1.

568 Red Meat Advisory Council, submission attachment (from the Australian Meat Industry Council), p. 7.

South Coast Beef Producers Association Inc. submitted that the current grading system that applies to export beef cattle meat (i.e., AUS-MEAT accreditation standards) should also apply to domestically supplied goods.<sup>569</sup> Similarly, the Australian Beef Association proposed using AUS-MEAT to conduct audits of processing practices.<sup>570</sup>

## Chicken meat

The ACCC received six public submissions regarding the chicken meat industry.

Stakeholders expressed concern about the structure of the industry and particularly a high level of market concentration in the processing sector.<sup>571</sup> NSW Farmers contended that the contracting practices of processors were directly related to their inability to recover costs from their customers, including the major supermarket chains.<sup>572</sup>

Various parties submitted that producers are unable to switch processors, even at the end of a contract, because of their fixed geographic location and absence of competing processors.<sup>573</sup> They also stated that producers face difficulty in leaving the sector as farm infrastructure is costly and highly specialised,<sup>574</sup> and that the resulting bargaining power imbalance has led to contracting practices which unfairly burden producers.<sup>575</sup> For example, the Australian Chicken Growers' Council indicated contracts transfer profits to the processor and risk to the producer.<sup>576</sup> The National Farmers' Federation also highlighted an emerging trend of processors obtaining and controlling production data. The NFF submitted that this often enables processors to set prices, and creates disincentives for producers to invest in productivity-enhancing improvements.<sup>577</sup>

Some submissions recommended the introduction of a mandatory code of conduct for the chicken meat industry.<sup>578</sup> The Victorian Farmers' Federation (VFF), submitted that an effective code should be accompanied by an accessible and affordable dispute resolution process.<sup>579</sup> It also indicated that while collective bargaining had worked in the past for chicken growers, it is now largely ineffective because of a lack of viable alternative processors.<sup>580</sup> The VFF argued that an appropriately drafted mandatory industry code would be the best means of addressing the systematic issues that leave growers with no effective bargaining power with processors.<sup>581</sup>

## Dairy products

The ACCC received six public submissions from the dairy industry.

### Views on the dairy industry

Some submissions asserted that the bargaining power of major retailers and processors has negatively affected the competitiveness of their industry and adversely affected producers.<sup>582</sup> This included processors taking lower milk prices from retailers, which submissions argued ultimately results in

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569 South Coast Beef Producers Association, submission, p. 4.

570 Australian Beef Association, submission, p. 2.

571 Australian Chicken Growers' Council, submission, pp. 1-5, National Farmers' Federation, submission, p. 8, NSW Farmers, submission, p. 12, Queensland Farmers' Federation, submission, p. 5.

572 NSW Farmers, submission, p. 12.

573 Australian Chicken Growers' Council, submission, p. 4, NSW Farmers, submission, p. 13.

574 NSW Farmers, submission, p. 13.

575 National Farmers' Federation, submission, pp. 8-9.

576 Australian Chicken Growers' Council, submission, p. 4.

577 National Farmers' Federation, submission, p. 9.

578 Australian Chicken Growers' Council, submission, p. 5.

579 Victorian Farmers' Federation, submission, p. 13.

580 Victorian Farmers' Federation, submission, pp. 3-4.

581 Victorian Farmers' Federation, submission, p. 12.

582 Queensland Farmers' Federation, submission, pp. 3-4, noted a severe imbalance of power between processors and retailers, in addition to between dairy farmers and processors.

producers receiving lower milk prices at the farmgate, affecting their profitability.<sup>583</sup> The ACCC heard that these issues are exacerbated in regions with fewer processors (notably Queensland).<sup>584</sup> Submissions also pointed out that while export channels are available to processors, producers do not have this option, further limiting their bargaining power.<sup>585</sup>

Both Coles and Woolworths submitted that the introduction of \$1 per litre milk or reductions in other dairy retail prices has not had an observable direct impact on farm numbers, output, or profitability.<sup>586</sup> Coles noted that movements in farmgate prices can be attributed to changing demand conditions within the export or domestic markets (and not directly influenced by prevailing retail or domestic wholesale process).<sup>587</sup> Coles additionally stated that while supermarkets have a strong bargaining position relative to dairy processors, the contracting model for the supply of private label milk ensures farmgate prices are paid to producers.<sup>588</sup> Both major retailers raised their efforts to assist dairy farmers, for example, Coles noted its new sourcing model as a direct acquirer of raw milk from farmers in certain regions.<sup>589</sup>

## Amendments to the Dairy Code

There appears to be broad support for the Dairy Code across the supply chain. However, a number of submissions recommended changes to the Code, including to extend it to cover all milk supply agreements involving retailers.<sup>590</sup> The Dairy Code currently only applies to retailers where they purchase milk directly from producers.

Stakeholders also recommended ways to improve pricing outcomes at the producer level. Niche Agribusiness submitted that the pricing actions by supermarkets needs to be addressed by more competition at the retail level.<sup>591</sup> Australian Dairy Farmers recommended establishing fair pricing principles in the Dairy Code to address the discounted price of milk at the retail level.<sup>592</sup> It also recommended setting the minimum farmgate price above the market clearing rate.<sup>593</sup> NSW Farmers submitted that processors should be required to post their full pricing structure online on 1 June of each year, to allow producers to accurately compare the price terms of milk supply agreements offered by different processors.<sup>594</sup>

Similarly, stakeholders recommended clarifying the terms of a milk supply agreement for parties that may lack experience or resources to fully understand them. For example, Australian Dairy Farmers submitted that producers should be required to provide written confirmation to the processor to acknowledge receipt of agreed terms, in unwritten milk supply agreements.<sup>595</sup> ADF also submitted that the ACCC should explore ways to incentivise longer term milk supply agreements through the requirements of the Dairy Code.<sup>596</sup> The South Australian Dairyfarmers Association suggested spot checks with farmers to determine that the intent of the Dairy Code is working.<sup>597</sup>

The Dairy Code requires processors to post a non-exclusive contract option for every milk supply agreement offered on an exclusive basis. Some parties submitted that non-exclusive supply agreements are penalised since if a producer does not give exclusive supply to a processor then they receive a lower

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583 NSW Farmers, submission, p. 26.

584 Queensland Farmers' Federation, submission, p. 3.

585 Farmer Power, submission, p. 1.

586 Coles Supermarkets Australia, submission, p. 5, and Woolworths Group, submission, p. 6.

587 Coles Supermarkets Australia, submission, p. 5.

588 Coles Supermarkets Australia, submission, p. 5.

589 Coles Supermarkets Australia, submission, p. 6.

590 Australian Dairy Farmers, submission, p. 38.

591 Niche Agribusiness, submission, pp. 0-1.

592 Australian Dairy Farmers, submission, p. 40.

593 Australian Dairy Farmers, submission, p. 41.

594 NSW Farmers, submission, p. 27.

595 Australian Dairy Farmers, submission, p. 37.

596 Australian Dairy Farmers, submission, p. 37.

597 South Australian Dairyfarmers Association, submission, p. 4.

price.<sup>598</sup> NSW Farmers claimed that the Code has not achieved what it submits is one of the Code's intended outcomes of encouraging non-exclusive contracts.<sup>599</sup>

Some provisions of the Dairy Code are subject to penalties for contraventions. Stakeholders supported increased pecuniary penalties for contraventions of the Code. The South Australian Dairyfarmers Association requested that the ACCC take a more proactive role in policing compliance in the dairy market.<sup>600</sup> NSW Farmers supported adequate resourcing for the ACCC to carry out the administration and enforcement activities under the Dairy Code.<sup>601</sup> It noted that third-party legal action is unfeasible for producers that may be reluctant to take action against larger businesses for fear of being locked out of the supply chain.<sup>602</sup> Australian Dairy Farmers recommended, as a minimum, that the ACCC should monitor prices, costs and profits of the dairy supply chain including major retailers engaging in discounted milk prices.<sup>603</sup>

Dairy Connect proposed enhancing existing dispute resolution clauses in the Dairy Code.<sup>604</sup> It also recommended providing safeguards for suppliers in milk testing, sampling, and calibration, including that the Code should indicate that national standards must be implemented before the next round of milk supply agreement negotiations.<sup>605</sup>

Stakeholders also recommended further support for collective bargaining by dairy farmers.<sup>606</sup> Australian Dairy Farmers supported a prohibition on companies undermining collective bargaining groups.<sup>607</sup> It recommended that section 93 of the CCA be updated to include a prohibition against companies undermining a collective bargaining group by individual negotiation or other activity.<sup>608</sup>

## Eggs

The ACCC received one public submission on the egg industry from Egg Farmers Australia. The submission raised concerns with the bargaining power of major retailers, in particular that the burden of compliance with ethical and animal welfare standards had fallen largely on producers.<sup>609</sup> It asserted that demands to phase out caged eggs were not consumer-led but had been imposed unilaterally by major retailers, and were likely to lead to negative outcomes for suppliers and consumers.<sup>610</sup>

## Fish and shellfish

The ACCC received three public submissions regarding the fish and shellfish industry.

Stakeholders highlighted that the experiences of producers in the fishing and aquaculture industries differed.<sup>611</sup> Seafood Industry Australia submitted that the aquaculture sector generally had better experiences dealing with the major retailers, but impediments included lengthy purchase contracts and the tough trading environment during COVID-19.<sup>612</sup> The ACCC heard that the aquaculture sector benefited from being able to generate higher volumes of produce, as well as predictable harvesting patterns.<sup>613</sup> However, Seafood Industry Australia stated that producers in the wild-catch sector face a

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598 Australian Dairy Farmers, submission, p. 37.

599 NSW Farmers, submission, p. 27.

600 South Australian Dairyfarmers Association, submission, p. 1.

601 NSW Farmers, submission, p. 22.

602 NSW Farmers, submission, p. 22.

603 Australian Dairy Farmers, submission, p. 42.

604 Dairy Connect, submission, p. 6.

605 Dairy Connect, submission, p. 6.

606 For example, Niche Agribusiness, submission, p. 10, and South Australian Dairyfarmers' Association, submission, pp. 4-5.

607 Australian Dairy Farmers, submission, p. 34.

608 Australian Dairy Farmers, submission, p. 34.

609 Egg Farmers of Australia, submission, pp. 2-3.

610 Egg Farmers of Australia, submission, pp. 2-3.

611 Seafood Industry Australia, submission, p. 3.

612 Seafood Industry Australia, submission, pp. 3-4.

613 Seafood Industry Australia, submission, p. 6.

number of challenges owing to their smaller size, certification requirements and the greater uncertainty in commercial fishing.<sup>614</sup>

Submissions affirmed the benefits to producers of independent wholesalers and retailers (new and established), and access to export channels.<sup>615</sup> Submissions also emphasised the relevance of perishability and the importance of bringing product to market promptly, which provide major supermarkets with substantial bargaining power.<sup>616</sup>

## Horticultural products

The ACCC received twelve public submissions regarding the horticulture industry.

Stakeholders submitted that market concentration at the retail level and the bargaining power of the major supermarkets has resulted in declining producer margins.<sup>617</sup> In particular, the perishability of horticultural products puts producers at a significant disadvantage to sellers in the negotiation process.<sup>618</sup>

Producers submitted that their increasing input costs, coupled with declining profit margins, have prevented them from investing further to remain competitive, which has in turn limited innovation and productivity growth.<sup>619</sup> Parties also submitted that retailers' bargaining power has allowed them to impose produce specifications which reduce suppliers' margins and resulted in food waste.<sup>620</sup> Stakeholders considered that poor market information and price transparency to be problematic for producers, as they prevented them from making informed production decisions.<sup>621</sup> They also considered the effectiveness of the Food and Grocery Code to be limited by it being voluntary.<sup>622</sup>

Fruit Growers Victoria, a representative body for fruit growers, considered its members to have a strong relationship with supermarkets.<sup>623</sup> However, to address concerns about retail prices, it proposed that retailers and suppliers work more closely together, for example, by working collectively in seasons of oversupply with increased promotion without dumping prices.<sup>624</sup> It also proposed a watchdog to monitor prices.<sup>625</sup>

Coles and Woolworths noted the importance of the Food and Grocery Code.<sup>626</sup> Both parties also noted their own internal complaints handling and supplier service mechanisms, which extend beyond horticultural products. For example, Coles noted that, in addition to the Food and Grocery Code, it has a Supplier Charter, which outlines the principles it commits to in its relationships with suppliers (including an Independent Arbiter).<sup>627</sup> Woolworths submitted that its Code of Conduct drives positive behaviours and values in supplier relationships, and that its independent and confidential complaints process, 'Woolworths Speak Up', provides an appropriate avenue for suppliers to raise concerns.<sup>628</sup>

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614 Seafood Industry Australia, submission, pp. 4–5.

615 Huon Aquaculture Group, submission, p.1, and Seafood Industry Australia, submission, p. 6.

616 Huon Aquaculture Group, submission, p.1, and Seafood Industry Australia, submission, p. 4.

617 NSW Farmers, submission, p. 14.

618 National Farmers' Federation, submission, p. 13.

619 Queensland Farmers' Federation, submission, pp. 2–3.

620 NSW Farmers, submission, p. 14.

621 National Farmers Federation, submission, p. 14.

622 NSW Farmers, submission, p. 14.

623 Fruit Growers Victoria, submission, p. 2.

624 Fruit Growers Victoria, submission, p. 3.

625 Fruit Growers Victoria, submission, p. 3.

626 Coles Supermarkets Australia, submission, p. 3, and Woolworths Group, submission, p. 7.

627 Coles Supermarkets Australia, submission, pp. 3–4.

628 Woolworths Group, submission, pp. 3–4.

## Pork

The ACCC received two public submissions that covered the pork industry.

Australian Pork Limited submitted that the industry is characterised by the presence of large vertically-integrated operators that both produce and process meat, and are able to negotiate large mutually beneficial agreements with purchasers.<sup>629</sup>

Australian Pork Limited also observed that, generally, angst in supply relationships only arises when there are significant increases or decreases in prices, and the wholesalers and producers do not have long term agreements in place.<sup>630</sup> When this occurs, imperfect information about wholesale market prices can disadvantage producers, who are unaware of such price movements.<sup>631</sup> It recommended exploring ways to support greater market information and feedback across the perishable agricultural goods supply chain.<sup>632</sup>

NSW Farmers expressed concerns about the market shares of both pork processors and the major supermarkets, and the problems facing smaller producers attempting to negotiate with processors, wholesalers and retailers.<sup>633</sup> It also emphasised that pork producers are largely dependent on the domestic market and that domestic producers must compete with imported processed products.<sup>634</sup>

## Sheep meat (lamb and mutton)

The ACCC received three public submissions that covered the sheep meat industry.

Sheep Producers Australia raised concerns about the decreasing number of processors in some regions, which it argued has reduced the bargaining power of producers (especially in Western Australia and Tasmania).<sup>635</sup> It highlighted the importance of price transparency and the availability of market information, emphasising that access to information such as auction results would help improve producers' decision making.<sup>636</sup> It also expressed support for OCM technologies in the sheep meat industry as a means of increasing producers' bargaining power.<sup>637</sup>

NSW Farmers' submission suggested that supply chain issues identified in the beef cattle industry (such as collusion among buyers at saleyard auctions and visual inspections) are generally found in the sheep meat industry as well.<sup>638</sup>

Similarly, as with the beef industry, Monaro Farming Systems highlighted that the strong export markets create competitive tension with domestic retailers, and that competitive export markets should be fostered.<sup>639</sup> It supported Woolworths' claim that it is export prices that determine domestic retail prices.<sup>640</sup>

## Sugar

While the sugar industry is outside the terms of reference for this inquiry, Pioneer Cane Growers Organisation made a brief submission noting its experience of bargaining power imbalance between

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629 Australian Pork Limited, submission, p. 4.

630 Australian Pork Limited, submission, p. 5.

631 Australian Pork Limited, submission, p. 5.

632 Australian Pork Limited, submission, p. 3.

633 NSW Farmers, submission, pp. 15–16.

634 NSW Farmers, submission, pp. 15–16.

635 Sheep Producers Australia, submission, p. 2.

636 Sheep Producers Australia, submission, p. 3.

637 Sheep Producers Australia, submission, p. 2.

638 NSW Farmers, submission, p. 18.

639 Monaro Farming Systems, submission, p. 1.

640 Monaro Farming Systems, submission, p. 1.

growers and monopolistic processors.<sup>641</sup> This included its view that collective bargaining, by itself, will not solve bargaining power imbalances; that producers have made substantial capital investment to produce a commodity, and negotiating a contract with a processor is an expensive process.<sup>642</sup>

## Reform recommendations across multiple industries

### Unfair practices

Unfair business practices were a common theme in submissions to this inquiry.

Stakeholders proposed introducing principles of fairness in the ACL for contractual agreements between producers and processors.<sup>643</sup> Stakeholders also noted that other jurisdictions, in particular the European Union, have specific fairness provisions that address bargaining power and viable supply chains.<sup>644</sup>

### Strengthening business-to-business unfair contract terms provisions

Stakeholders submitted that the current ACL provisions have been insufficient in protecting small businesses from B2B UCTs in standard form contracts.<sup>645</sup> Recommendations included an effective deterrent against companies using UCTs, such as significant pecuniary penalties for their inclusion in a standard form contract.<sup>646</sup> Secondly, submissions recommended lowering thresholds (by expanding the current headcount and turnover thresholds, and removing the contract value requirement) to recognise the impact of UCTs on small businesses.<sup>647</sup> Thirdly, submissions recommended greater clarity on what constitutes a standard form contract and the ability to effectively negotiate.<sup>648</sup>

The National Farmers' Federation submitted that UCT protections should be available to all standard form contracts regardless of the business's size, and that the definition of a standard form contract should be expanded to capture repeat usage, and cases where a contract cannot feasibly be negotiated by the small business because of a fear of retribution should it seek changes.<sup>649</sup> Furthermore, it suggested the ACL be amended to specify a standard negotiation/agreement process that includes a fair and reasonable timeframe to consider the provisions and a more transparent fee structure.<sup>650</sup>

NSW Farmers submitted that the ACL should consider contracts containing 'repeat usage' clauses and further clarify the types of actions that do not constitute 'an effective opportunity to negotiate'.<sup>651</sup>

### Strengthening unconscionable conduct requirements

Stakeholders supported strengthening the unconscionable conduct provisions in sections 20 to 22 of the ACL that apply to supply agreements for perishable agricultural goods.

The National Farmers' Federation considered reforming the unconscionable conduct provisions in the ACL to be the most appropriate action to address problems arising from bargaining power imbalances.<sup>652</sup> It recommended amending section 21 of the ACL to specify characteristics which

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641 Pioneer Cane Growers Organisation, submission, pp. 1-2.

642 Pioneer Cane Growers Organisation, submission, pp. 1-2.

643 NSW Farmers' Association, submission, p. 21.

644 NSW Farmers' Association, submission, p. 21, Australian Farm Institute, submission, pp. 2-3; National Farmers Federation, submissions, p. 20.

645 NSW Farmers, submission, p. 20, National Farmers' Federation, submission, p. 23 and Australian Dairy Farmers, submission, p. 32.

646 NSW Farmers, submission, p. 20.

647 NSW Farmers, submission, p. 20.

648 NSW Farmers, submission, p. 20.

649 National Farmers' Federation, submission, p. 23.

650 National Farmers' Federation, submission, p. 23.

651 NSW Farmers, submission, p. 20.

652 National Farmers' Federation, submission, p. 17.

determine whether a behaviour is unconscionable.<sup>653</sup> It also noted that UCT provisions in the ACL do not capture behaviours that fall outside the contract, including behaviour during contractual negotiations and behaviour once the contract is in force.<sup>654</sup>

Australian Dairy Farmers considered unconscionable conduct to be vaguely defined.<sup>655</sup> It supported including a stronger definition to provide greater clarity for courts on its scope, and to require pecuniary penalties for a contravention.<sup>656</sup>

Similarly, NSW Farmers supported a review of the unconscionable conduct provisions to understand how they can be more accessible to producers in challenging supermarkets and intermediaries.<sup>657</sup> It submitted there should be stronger unconscionable conduct provisions under the ACL to hold dominant players in the supply chain to account, noting that the current provisions are difficult and resource-intensive to prove (a successful claim requires evidence of harm).<sup>658</sup> It also submitted that the ACCC should be adequately funded to pursue cases of unconscionable conduct.<sup>659</sup>

## Perishable agricultural goods code of conduct

A number of public submissions made policy recommendations that would apply across multiple industries. These included the introduction of a mandatory code for perishable agricultural goods. The National Farmers' Federation submitted that a mandatory code should have the same legal status as the Dairy Code and apply to all commodities within the scope of this inquiry.<sup>660</sup> While the National Farmers' Federation supported different provisions for different commodities where necessary, it submitted that minimum requirements should apply to all supply contracts, such as an obligation on all parties to act in good faith, minimum disclosure requirements, that all supply contracts specify minimum prices and quantities, and access to dispute resolution processes.<sup>661</sup>

## Other recommendations

Stakeholders, such as the Queensland Farmers' Federation, raised concerns about producers bearing the financial burden of complying with animal welfare and ethical sourcing standards.<sup>662</sup>

Some submissions proposed broad economy-wide reforms. Monaro Farming Group advocated continued access to export markets by expanding free trade agreements.<sup>663</sup> The Australian Food Sovereignty Alliance submitted that policy should support smaller scale and environmentally friendly farming practices.<sup>664</sup> NSW Farmers proposed forced divestiture under the ACL to address bargaining power imbalances, in particular managing the power of major retailers.<sup>665</sup> It submitted that there was a lack of prosecutions and inadequate fines despite numerous complaints against supermarkets.<sup>666</sup> NSW Farmers also submitted there should be limitations on the market share of a single business in any one market.<sup>667</sup>

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653 National Farmers' Federation, submission, pp. 5 and 7.

654 National Farmers' Federation, submission, p. 17.

655 Australian Dairy Farmers, submission, p. 32.

656 Australian Dairy Farmers, submission, pp. 32-33.

657 NSW Farmers, submission, p. 19.

658 NSW Farmers, submission, p. 19.

659 NSW Farmers, submission, p. 19.

660 National Farmers' Federation, submission, pp. 20-21.

661 National Farmers' Federation, submission, p. 21.

662 Queensland Farmers' Federation, submission, p. 5.

663 Monaro Farming Group, submission, p. 1.

664 Australian Food Sovereignty Alliance, submission, pp. 5-7.

665 NSW Farmers' Association, submission, p. 21.

666 NSW Farmers' Association, submission, p. 21.

667 NSW Farmers' Association, submission, p. 21.

# Appendix B

**Figure B.1: 2016-17 to 2018-19 average return on total assets —Dairy farms**



Note: DFMP participants are selected to represent a distribution of farm size, herd size and geographical location within each region. Participant farms may not be fully representative of the industry.

Source: ACCC analysis of Dairy Farm Monitor Program and Queensland Dairy Accounting Survey data.

**Table B.1: 2018-19 Average dairy farm costs, income and financial performance**

Farm income and cost category	Victoria			NSW		South Australia	Tasmania	Western Australia	Queensland	
	North	South West	Gippsland	North	South				South	North
	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS				\$kg/MS	\$kg/MS
<b>INCOME</b>										
Milk income (net)	6.28	6.15	5.97	8.07	7.37	6.46	6.16	7.07	8.40	8.45
Other*	0.53	0.84	0.50	1.09	0.77	0.86	0.74	1.18	0.98	0.82
Gross farm income	6.81	6.99	6.47	9.16	8.14	7.32	6.90	8.25	9.36	9.22
<b>VARIABLE COSTS</b>										
Total feed costs**	4.40	3.20	3.27	4.45	4.54	3.30	2.78	3.85	5.11	4.55
Other costs***	0.55	0.54	0.54	0.68	0.56	0.53	0.48	0.55	0.63	1.08
Total variable costs	4.95	3.74	3.81	5.13	5.10	3.83	3.27	4.40	5.70	5.64
<b>GROSS MARGIN</b>	1.85	3.26	2.66	4.03	3.05	3.49	3.63	3.85	3.66	3.58
<b>OVERHEAD COSTS</b>										
Employed labour	0.60	0.55	0.57	1.20	0.83	0.89	0.73	0.98	0.93	1.49
Imputed labour	0.87	0.97	0.85	1.03	0.84	0.55	0.55	0.62	0.99	0.96
All other overheads****	0.84	1.04	0.74	1.36	1.07	0.96	0.91	1.09	0.90	1.04
Total overhead costs	2.31	2.55	2.15	3.59	2.74	2.40	2.19	2.69	3.26	2.53
<b>EARNINGS BEFORE INTEREST AND TAX (EBIT)</b>										
EBIT (Average)	-0.45	0.71	0.51	0.43	0.31	1.09	1.44	1.16	0.40	-0.23
EBIT (Range)	-4.28 to 2.68	-0.64 to 2.60	-1.00 to 1.96	-0.83 to 1.87	-2.41 to 2.17	0.13 to 2.50	-1.15 to 3.50	-0.24 to 3.30	-3.48 to 1.66	-2.91 to 1.86
<b>RETURN ON TOTAL ASSETS (RoTA) (%)</b>										
RoTa (Average)	-1.7%	2.3%	1.7%	1.1%	0.3%	3.5%	5.0%	3.2%	1.0%	-0.5%
RoTa (Range)	-12.6% to 6.6%	-2.2% to 9.1%	-3.3% to 6.4%	-2.9% to 5%	-8.6% to 5.9%	0.4% to 8.3%	-1.9% to 15.5%	-0.5% to 10.6%	-4.2% to 6.2%	-6.2% to 6.4%

Note: DFMP participants are selected to represent a distribution of farm size, herd size and geographical location within each region. Participant farms may not be fully representative of the industry. \*Includes livestock trading profit and other farm income. \*\*Includes home grown feed, purchased feed and agistment, and feed and water inventory change. \*\*\*Includes herd costs and shed costs. \*\*\*\*Includes repairs/maintenance, depreciation, and all other overheads.

Source: ACCC summary of Dairy Farm Monitor Program and Queensland Dairy Accounting Survey data.

**Table B.2: 2017-18 Average dairy farm costs, income and financial performance**

Farm income and cost category	Victoria			NSW		South Australia	Tasmania	Western Australia	Queensland	
	North	South West	Gippsland	North	South				South	North
	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS
<b>INCOME</b>										
Milk income (net)	5.87	5.80	5.74	7.62	6.81	6.24	5.95	7.00	7.89	7.99
Other*	0.68	0.62	0.52	0.77	0.68	0.84	0.75	1.16	0.93	0.75
Gross farm income	6.55	6.42	6.26	8.39	7.49	7.08	6.70	8.16	8.77	8.77
<b>VARIABLE COSTS</b>										
Total feed costs**	3.21	2.90	2.69	4.09	3.63	2.80	2.47	3.52	4.15	3.55
Other costs***	0.54	0.53	0.52	0.71	0.57	0.6	0.48	0.53	0.62	0.91
Total variable costs	3.75	3.43	3.21	4.79	4.20	3.40	2.95	4.05	4.74	4.46
<b>GROSS MARGIN</b>	2.79	2.99	3.05	3.60	3.29	3.68	3.75	4.11	3.97	4.31
<b>OVERHEAD COSTS</b>										
Employed labour	0.53	0.57	0.57	0.94	0.76	0.92	0.73	0.81	0.96	1.03
Imputed labour	0.79	0.93	0.90	1.22	0.84	0.54	0.44	0.67	0.97	1.39
All other overheads****	0.82	1.01	0.74	1.31	1.11	1.04	0.92	1.09	0.80	0.91
Total overhead costs	2.14	2.51	2.21	3.46	2.71	2.50	2.09	2.57	3.07	3.58
<b>EARNINGS BEFORE INTEREST AND TAX (EBIT)</b>										
EBIT (Average)	0.65	0.48	0.84	0.13	0.58	1.18	1.68	1.54	0.91	0.72
EBIT (Range)	-1.43 to 2.27	-2.72 to 2.72	-1.60 to 2.08	-1.71 to 1.53	-0.62 to 1.80	-0.9 to 2.34	0.50 to 3.40	-0.32 to 4.27	-1.51 to 2.72	-1.64 to 1.80
<b>RETURN ON TOTAL ASSETS (RoTA) (%)</b>										
RoTa (Average)	2.5%	1.9%	3.0%	0.5%	2.1%	4.3%	6.3%	4.3%	2.4%	1.7%
RoTa (Range)	-3.6% to 8.6%	-5.3% to 10.6%	-4.3% to 8.7%	-5.5% to 4.4%	-1.3% to 7.1%	-1.3% to 10.1%	1.7% to 15.2%	-0.8% to 11.4%	-2.9% to 8.0%	-2.6% to 6.8%

Note: DFMP participants are selected to represent a distribution of farm size, herd size and geographical location within each region. Participant farms may not be fully representative of the industry. \*Includes livestock trading profit and other farm income. \*\*Includes home grown feed, purchased feed and agistment, and feed and water inventory change. \*\*\*Includes herd costs and shed costs. \*\*\*\*Includes repairs/maintenance, depreciation, and all other overheads.

Source: ACCC summary of Dairy Farm Monitor Program and Queensland Dairy Accounting Survey data.

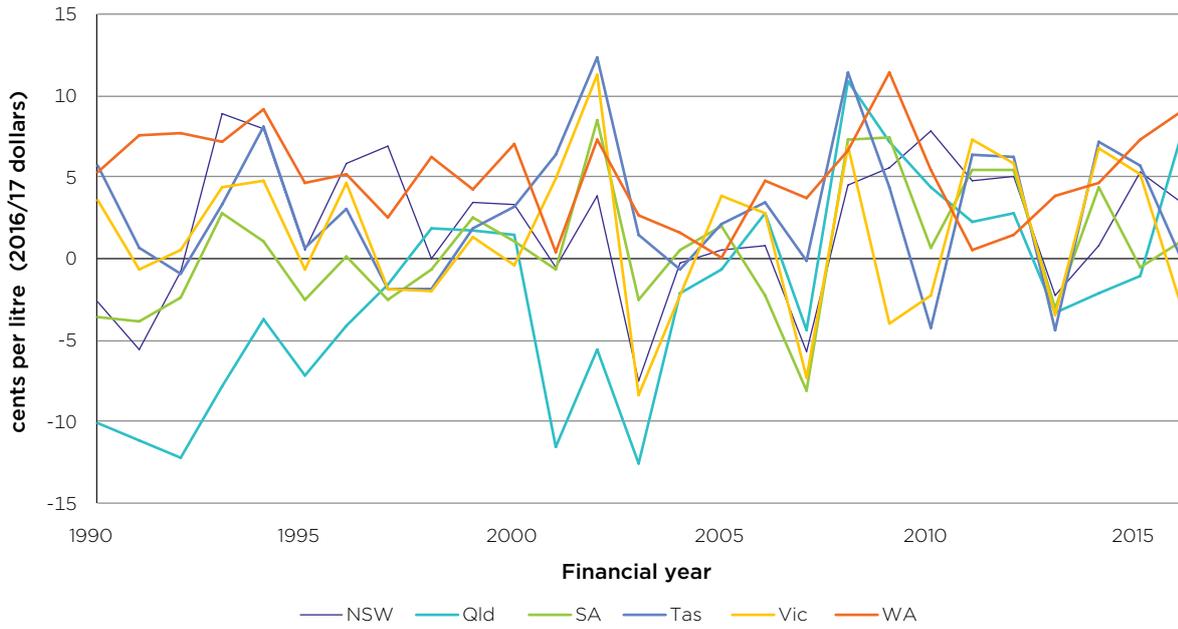
**Table B.3. 2016-17 Average dairy farm costs, income and financial performance**

Farm income and cost category	Victoria			NSW		South Australia	Tasmania	Western Australia	Queensland	
	North	South West	Gippsland	North	South				South	North
	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	\$kg/MS	
<b>INCOME</b>										
Milk income (net)	5.13	5.25	4.84	7.28	6.48	5.78	5.03	7.05	7.96	8.18
Other*	0.79	0.73	0.66	0.97	1.14	0.97	0.81	1.07	0.95	0.98
Gross farm income	5.92	5.98	5.50	8.25	7.62	6.75	5.84	8.12	8.90	9.28
<b>VARIABLE COSTS</b>										
Total feed costs**	2.86	2.14	2.21	3.47	3.06	2.63	2.40	3.25	3.69	3.95
Other costs***	0.54	0.45	0.47	0.66	0.62	0.67	0.48	0.52	0.62	1.08
Total variable costs	3.41	2.59	2.68	4.12	3.68	3.30	2.88	3.77	4.26	5.03
<b>GROSS MARGIN</b>	2.51	3.39	2.83	4.13	3.93	3.45	2.96	4.35	4.64	4.24
<b>OVERHEAD COSTS</b>										
Employed labour	0.53	0.51	0.52	0.95	0.85	0.89	0.71	0.78	1.01	0.88
Imputed labour	0.78	0.83	0.86	1.08	0.81	0.72	0.55	0.57	0.79	1.02
All other overheads****	0.83	0.89	0.71	1.35	1.18	1.09	1.41	1.87	0.80	1.19
Total overhead costs	2.14	2.23	2.10	3.38	2.83	2.70	2.67	3.22	2.87	3.33
<b>EARNINGS BEFORE INTEREST AND TAX (EBIT)</b>										
EBIT (Average)	0.37	1.16	0.73	0.75	1.10	0.88	0.92	1.98	1.78	0.91
EBIT (Range)	-1.43 to 2.27	0.14 to 2.72	-2.13 to 1.97	-0.80 to 2.48	-0.77 to 3.61	-1.18 to 1.95	-0.59 to 2.78	-0.15 to 4.48	-0.49 to 3.48	-0.38 to 3.09
<b>RETURN ON TOTAL ASSETS (RoTA) (%)</b>										
RoTa (Average)	1.0%	4.2%	2.3%	1.8%	2.7%	3.1%	3.7%	6.7%	4.8%	2.2%
RoTa (Range)	-8.9% to 8.3%	0.2% to 11.2%	-6.1% to 6.6%	-1.4% to 6.9%	-2.2% to 13.6%	-5% to 10%	-1.3% to 10.4%	-0.3% to 15.2%	-1.0% to 10.0%	-1.1% to 12.0%

Note: DFMP participants are selected to represent a distribution of farm size, herd size and geographical location within each region. Participant farms may not be fully representative of the industry. \*Includes livestock trading profit and other farm income. \*\*Includes home grown feed, purchased feed and agistment, and feed and water inventory change. \*\*\*Includes herd costs and shed costs. \*\*\*\*Includes repairs/maintenance, depreciation, and all other overheads.

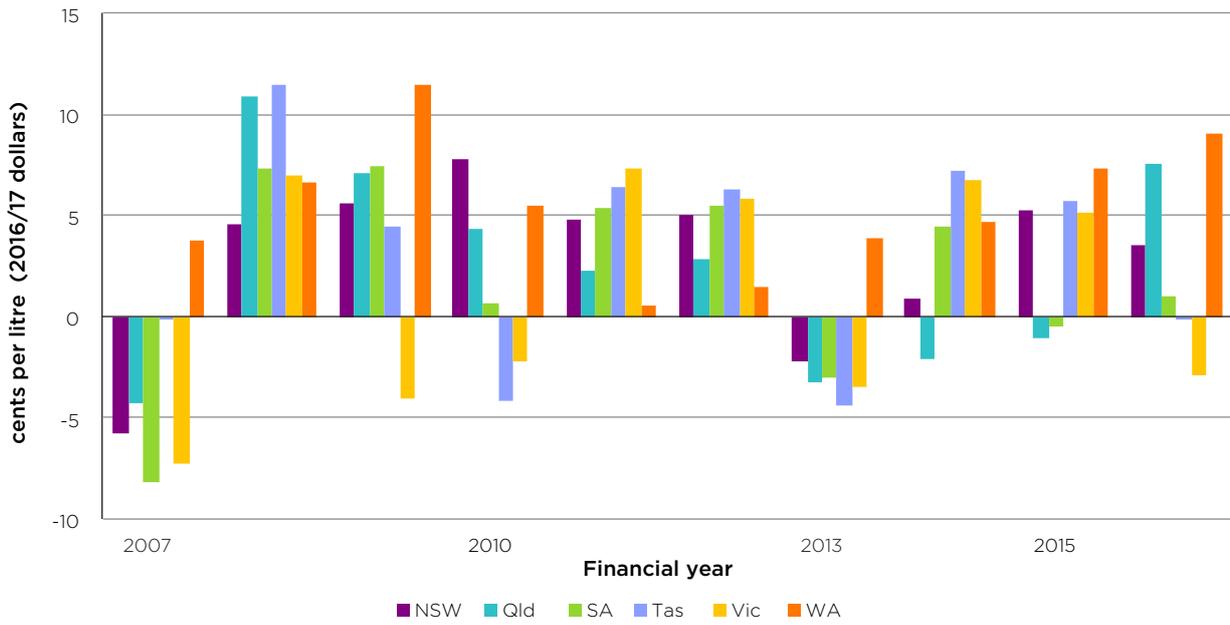
Source: ACCC summary of Dairy Farm Monitor Program and Queensland Dairy Accounting Survey data.

Figure B.2: Farm business profit, by state, real terms (2017 dollars)



Source: ACCC, Dairy inquiry final report, p. 185 (ABARES, ACCC analysis).

Figure B.3: Farm business profit, by state, real terms (2017 dollars)



Source: ACCC, Dairy inquiry final report, p. 185 (ABARES, ACCC analysis).



AUSTRALIAN COMPETITION  
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