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ACCC Inquiry into the Australian Dairy Industry
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UDV Submission – ACCC Interim Report into the Dairy Industry in Australia

United Dairyfarmers of Victoria (UDV) is the peak representative body for dairy farmers in Victoria. We advocate for our members on all matters affecting the dairy industry, for the benefit for all dairy farmers. UDV is a leading commodity group within the Victorian Farmers Federation, the peak representative body for all farmers in Victoria, and is an affiliate member of Australian Dairy Farmers (ADF), the peak national body for Australian dairy farmers.

UDV has been highly engaged in matters relating to trade between farmers and dairy processors, including milk price reporting, milk price structures, and contracting practices in the dairy industry.

UDV welcomes the opportunity to make comment on the ACCC's Dairy Inquiry Interim Report.

As always, we welcome further engagement with the ACCC to clarify and consult on these and any other issues of competition in our industry.

Yours Sincerely,

Adam Jenkins
President
United Dairyfarmers of Victoria

Executive Summary

The events of 2016 in the Australian dairy industry have had a lasting impact across the dairy industry supply chain, causing damage that cannot be reversed.

UDV believe this inquiry is a rare opportunity to highlight and amend behaviours within our supply chain that degrade fairness in our industry. We believe the ACCC should take full advantage of its powers to address issues in the dairy industry.

UDV is disappointed with the Interim Report. The recommendations and findings show an apparent lack of long term analytical rigour across the whole supply chain.

- UDV agrees with interim recommendations 1,2,3,6 and 7.

- UDV agrees in principle with interim recommendations 4 and 5.

- Without full, long term analysis of the processes, liabilities and impacts that development and implementation of a mandatory code would represent for the dairy industry, UDV does not support Interim Recommendation 8.

- UDV agrees with the assessment that processors hold a substantial imbalance of bargaining power over suppliers.

- UDV also supports the assessment that retailers, specifically large supermarkets, hold a substantial imbalance of bargaining power over dairy processors.

- Considering the ACCC investigative powers in this inquiry, UDV considers this process to represent a unique opportunity to scrutinise trade behaviour in the retail sector

- UDV is greatly disappointed in the lack of depth ACCC appears to have gone into in scrutinising retail behaviour and the lack of focus on forming recommendations to address the imbalances in bargaining power held by retailers that have been recognised in this Interim Report.

- UDV recognises and agrees with the need to strengthen controls around terms presented in supply agreements, including implementation of strong repercussions for breach of standards set out in the voluntary code.

- UDV is disappointed in the lack of detail presented in this report examining the processes, liabilities and responsibilities relating to the implementation of a mandatory code in the dairy industry to accompany the recommendation for implementation of a mandatory code presented in this Interim Report.

Interim Recommendations

UDV acknowledge the eight recommendations put forward by ACCC in its Interim Report. However the issues discussed by ACCC have been clearly identified by industry and efforts are already being made to address them, either by inclusion in the voluntary code, or in other projects.

Considering the existing industry actions, UDV does not believe that vague recommendations are constructive for the industry or the Federal Government in decision making. Furthermore, this vagueness does not reflect the time and resources that have been committed in this inquiry thus far.

The following are UDV responses to each of the interim recommendations presented by ACCC.

1. Processors and farmers should enter into written contracts for milk supply that are signed by the farmer.

> Agreed: UDV agrees that farmers should be presented with the terms and conditions of their agreement prior to entering into that agreement in any formal sense; signing the document helps to ensure that this is the case.

2. All processors should simplify their contracts where possible, including by minimising the number of documents and clearly indicating which documents contain terms and conditions of milk supply.

> Agreed: UDV has advocated for transparent communication between processors and farmers regarding milk supply contracts. By making it easier for farmers to understand their contracts, farmers can better respond to problematic clauses.

3. Milk supply contracts should not include terms which unreasonably restrict farmers from switching between processors.

> Agreed: UDV agrees that loyalty payments and exclusivity clauses represent barriers to switching for farmers. UDV supports the phasing out of these clauses and looks forward to these issues being reviewed in the voluntary code.
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> UDV believes that restrictive practices extend to financial offers and loan schemes offered by processors to farmers. These practices result in the supplier being financially bound to their processor. Although these are not an inherent part of contracting practices in the dairy industry, UDV believes that they are a result of the imbalance of bargaining power and directly infringe on the rights of the farmer to switch processors, and therefore reduce competition.

4. The industry should establish a process whereby an independent body can administer mediation and act as a binding arbitrator or expert in relation to contractual disputes between farmers and processors.

> Agreed with caveats: UDV believes that independent review of contract disputes is of value and represents a good option for implementation of controls around the code. UDV is, however, wary that any such body should have significant dairy knowledge and experience.

5. Farmers should ensure they have properly considered the legal and financial implications of contracts with processors.

Agreed in principle: It is UDV's belief that each farmer should be aware of the content of their contract and be able to negotiate where necessary. However, UDV does recognise that to do so can carry tangible cost to the farmer in time and finances.

The ability to provide legal counsel is not within the operational scope or funding of farmer representative bodies at this time.

Additionally, due to the voluntary nature of state or national dairy farmer representative membership, any service providing tailored legal advice would be unavailable to a proportion of Australian farmers, resulting in an unfair balance.

We acknowledge the ability to refer farmers to experienced independent legal counsel.

6. Processors should publish information identifying how their pricing offers apply to individual farm production characteristics to enable better farm income forecasts.

Agreed: UDV wishes to see increased transparency in formulation of milk price structures. UDV currently has ongoing work dealing with milk price structure models to improve simplicity in price reporting, and to help make transparency easier and more palatable for the supply chain to adopt.

7. The Voluntary Dairy Code should be strengthened

Agreed: UDV sees the need to extend the requirement for setting out dispute resolution terms to the code itself. Dispute resolution is a matter that will be raised upon review of the code. UDV sees value in the appointment of a dairy commissioner or similar official to oversee relationships between farmers and processors.

UDV also supports the fact that early reporting by processors is important for appropriate business decision making and have advocated to the processing sector on this matter. UDV was pleased to see the recent early reporting of 2017-2018 opening prices. UDV will continue to call for further development of risk management strategies to minimise volatility and uncertainty for farmers.

8. A mandatory code of conduct within the Competition and Consumer Act 2010 should be considered for the dairy industry.

Acknowledged: UDV recognises that a mandatory code may present an attractive option for amending issues in contracting between dairy farmers and milk processors; however, UDV cannot support the adoption of a mandatory code until positive and negative consequences have been fully considered, and it can be assured that the Victorian dairy industry will not be penalised economically by an inability to adapt to changing markets.

As with a Voluntary code there are inherent risks associated with introduction of a mandatory code. This was not adequately acknowledged in the ACCC Interim Report. Innovation is essential if the Australian dairy industry is to remain profitable going forward,

and UDV is concerned that a mandatory code could reduce the ability of the market to react effectively to opportunities. UDV believes that a recommendation for a mandatory code should be accompanied by a full cost benefit analysis for the whole supply chain before being presented to the treasurer.

UDV recognises that upon review of the Code by involved stakeholders, change of the status of the Code may be the desired outcome. The voluntary code as it was released in July 2017 was an early step in the process to define and begin to address the issues present in milk supply contracts in Australia. In this form, it was not intended to be a final product and was always slated for review. The code was meant to evolve as industry saw fit, including the potential implementation of stronger repercussions for breach as well as potential to adopt a mandatory status code.

The voluntary code already captures 95% of milk supplied in Australia. UDV considers that the majority of processors not already signed would be exempt from a mandatory code to avoid unfair burden, as suggested in the ACCC Interim Report.

Interim Report

UDV agrees, in general, with many of the assessments made by ACCC in the Interim Report of their inquiry into the Australian dairy industry. Chiefly, the series of concerns outlined by ACCC regarding contracting practices between farmers and processors aligns closely with those identified by UDV, our members, and many Victorian farmers. However, UDV holds some key concerns regarding the Interim Report, including lack of scrutiny of the power imbalance between supermarkets and processors, and a lack of detail on implications of adopting a mandatory code.

In general, UDV agrees with the ACCC assessment that dairy farmers lack bargaining power when dealing with processors, and that pricing information is complex to the point of reducing transparency, further limiting farmer bargaining power. This is reflected in our input in the voluntary dairy code of practice, our ongoing work investigating simplified and transparent pricing structures, disparity in pricing offered to farmers, and ongoing discussions with farmers, processors and ACCC.

Mandatory Code

UDV calls for caution on implementation of a mandatory code which may not represent the best outcome for farmers in the long term.

The adoption of a mandatory code for contract terms between suppliers and processors has always been a possible outcome of ongoing review processes associated with the voluntary code. However aspects of a prescribed voluntary code may be a preferable for the industry.

The implementation of a prescribed voluntary code may or may not be possible in our industry. UDV see the industry led nature of such a code coupled with the controls of prescription as a best outcome for industry. Ideally, any controls that are put in place should be industry led and able to be altered rapidly, with elements agreed to by stakeholders rather than foisted upon them.

It is naïve to believe that corporations in any industry will not look for and exploit gaps in any code of practice, mandatory or not. This has been seen in the mandatory Horticulture Code where flexibility in the adoption of specific agreements has allowed wholesalers to implement their own clauses that, although legal under the mandatory code, present challenges to the bargaining power of primary producers. UDV still believes that the best chance for compliance is through mutual understanding and industry negotiation, coupled with stronger controls and oversight.

Alteration of a mandatory code may be required to amend an identified loophole or due to our rapidly developing market, technologies and industry structures. It is a concern that the need to petition a regulator to implement change and then potential lengthy review processes overseen by government may impact on the industry's ability to respond to change. A voluntary code which may be amended in relatively rapid fashion presents a more attractive option in this respect.

UDV does not believe enough time has passed to prove the value of the existing voluntary code, with the scheduled review period not yet reached. Upon review, UDV will argue for stronger repercussions for processors in breach of the code possibly extending to prescribing the code.

UDV questions whether the creation of a mandatory code can occur by simply changing the status of the existing work of the dairy industry. It is a concern of UDV that formulation of a new mandatory code must occur anew by the responsible regulator, with consultation with industry only as that regulator sees fit. This process would likely be a lengthy one, and burdened by bureaucratic process.

Additionally, at present ACCC have not outlined who would regulate a mandatory code and how it would be covered under legislation, nor the appetite of the Australian government for such a code. UDV understands that development of a framework for a mandatory code to sit within legislation would also be required, adding further time to the development process.

If mismanaged, this process may leave formulation and alteration of a mandatory code subject to political ideology and lengthy parliamentary process in place of practical industry discussion. If selection of parties to be consulted in the creation of a mandatory code would be at the discretion of the body selected to create the code, UDV would hope that under such a process all appropriate representative bodies would be fully involved in drawing up such a document.

Due to the potential for development of a mandatory code to take years, as demonstrated by the Horticulture Code, it is highly possible that although a mandatory code may be fit for purpose at the initiation of its development this may change. After lengthy development times and the potential for market conditions to change rapidly, such a code may no longer be required, need to address newly developed issues or no longer be fit for use in the dairy industry upon its implementation.

Calls for implementation of a mandatory code are understandable; however, it is important to note that these calls come primarily from a place of frustration, not only with regard to processor relationships, but the pricing situation in which we find the domestic and global markets. This frustration has prompted increasing calls for a mandatory code which we believe has fed the recommendation made by ACCC. UDV calls for a clear analysis of whether a mandatory code is fit for purpose before handing such a recommendation to the treasurer. Therefore, we would prefer to see any potential revision to the status of the code occur as part of the due process already set out with appropriate consultation between stakeholders and regulators.

It should be noted that much of the frustration evident among farmers at present is in response to the milk price downgrade that occurred in early 2016. While improved contracting practices would have enhanced various aspects of farmer-processor relations through the intervening period, the presence of a mandatory code such are the one that is being called for in these interim recommendations would not have acted to prevent the milk price downgrade itself.

Retail Sector Behaviour

In its report, the ACCC has asserted that they have identified an imbalance of power between the processor and retail sectors. Despite this, none of the recommendations presented deal with bargaining power within the retail sector.

While processor behaviour has been scrutinised in detail across a broad range of aspects, potentially assisted by a higher volume of input from stakeholders, the same is not true of retail sector behaviour where submitting parties either do not have evidence to present or do not wish to

endanger commercial relationships with the major supermarkets. This is disappointing, as this lack of detail presents the greatest opportunity for the application of an inquiry. Instead, the greater portion of the Interim Report and all of the interim recommendations deal only with processor behaviour, focused on information and issues already widely acknowledged within the industry.

In the Interim Report, ACCC makes reference to retailers requiring transparency around successful suppliers input costs. The concept that the major supermarkets are using their bargaining power to force their suppliers to report these costs, thus allowing any efficiency savings made by those processors to be usurped by the supermarkets during contract negotiations is concerning and we believe worthy of further scrutiny.

The argument that increased revenue at the point of retail in the absence of private label products would be captured by the processor and not passed on to farmers does indicate imbalance in bargaining power for farmers. However, the argument remains that the supermarkets are using their power in these loss-leading exercises to shift revenue from dairy product streams that would otherwise be entering the supply chain and contributing to the growth of Australian dairy to alternate, higher margin product streams of other industries. UDV is concerned that long term vision is lacking in the ACCC decision that this will not eventually impact on farmers and the dairy industry.

Additionally, the argument that ACCC puts forward for why increased revenue from drinking milk sales would not reach the farm gate is that of the power imbalance between farmer and processor; an imbalance that this inquiry itself has explicitly set out recommendations to address. It is reasonable to assume that if imbalance in the farmer-processor relationship can be improved, an increase in revenue passing from retailers to processor may indeed be relevant at the farm gate. UDV urges ACCC to take this rare opportunity to properly determine whether continuation of existing contracting practices at the retail level will have a long term impact on competition in the dairy industry and a long term impact on the profitability and sustainability of an economically important industry.

Similarly, UDV does not agree that the loss-leading practices that discounted private label dairy products contribute to represent a positive outcome for retail customers. The loss leading method is implemented only to promote sales of more expensive premium products at the expense of cheaper milk and other private label goods. Ultimately the retailer must recoup their expenses from either their suppliers or their customers. Supermarkets are not in the business of donating goods to their customers and to represent loss-leading practices in any altruistic light is again naïve.

UDV are pleased to see that ACCC are still considering the implications of discount private label cheese for the Australian market and intent to include this analysis in the final report. UDV urges that in carrying out this analysis the impact and legality of importing of bulk foreign products by retailers and processors is considered in depth.

Conclusion

UDV supports the recommendations presented in the Interim Report relating to strengthening aspects of the Voluntary Code of Practice, and addressing the imbalance of bargaining power between farmers and processors. These aspects will be considered when the slated review of the voluntary code occurs, and continue to be key areas of work for UDV.

UDV is disappointed by the lack of recommendations relating to imbalance of bargaining power between processors and retailers and the lack of consideration that the supermarkets exhibit the ability and willingness to use market power to influence contracts, supply and competition.

UDV recognises the strength of a mandatory code is desirable. However, UDV has reservations about the flexibility and therefore usefulness of such a code to the dairy industry. UDV believes that strengthening the existing voluntary code and implementing stronger repercussions for breaches can allow the industry to address imbalances in bargaining power, whilst also allowing the industry to react effectively to unforeseen changes.

UDV wants far greater investigation of how a mandatory code would sit within the Australian dairy industry, what possible repercussions could impact farmers and other stakeholders and what processes would exist to ensure such a code would not result in disadvantage to farmers in the long term. Ultimately, any controls that are put in place around contracting practices must also address the need for our industry to be flexible in capitalising on any and all opportunities in the market place going into the future.

UDV looks forward to meeting with the ACCC to further discuss issues of competition in the dairy industry.