



**Australian
Competition &
Consumer
Commission**

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Our Ref: C2004/1241

6 September 2004

Dear

Interested party consultation on arrangements for the distribution of dairy products in South Australia

1. Introduction

The Australian Competition and Consumer Commission (the ACCC) is currently conducting an interested party consultation process in relation to arrangements for the distribution of dairy products in South Australia. As a possible interested party you are invited to comment on the issues outlined in this letter.

The consultation process is in response to an application for authorisation lodged by the Milk Vendors Association (SA) Inc (the Association) for proposed collective bargaining arrangements in relation to the terms and conditions of distribution contracts between members and non-members of the Association and National Foods Milk Limited and Dairy Vale Foods Limited. For an explanation of the authorisation process and the conduct the subject of the application see sections 2 and 3 of this letter. A copy of the application for authorisation (without attachments) is also enclosed for your information and/or comment.

Consultation is also being conducted in relation to notifications for exclusive dealing agreements lodged by Dairy Vale Cooperative Ltd in November 1992 and February 1993 and by National Dairies SA Ltd in April 1993 and March 1994. For an explanation of the notification process and the conduct the subject of the notifications see sections 2 and 4 of this letter. Copies of the notified agreements and the 1993 decision of the Trade Practices Commission (now the ACCC) are available from the ACCC's website <http://www.accc.gov.au/content/index.phtml/itemId/278039>

2. Background

The ACCC is the Commonwealth agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business resulting in a greater choice for consumers in price, quality and service.

The Act, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way businesses may obtain immunity is to apply for what is known as an 'authorisation' from the ACCC. Broadly, the ACCC may 'authorise' businesses to engage in anti-



competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.

In assessing the public benefits and detriments of an authorisation application, the ACCC undertakes a public consultation process seeking comments on the application from interested parties.

Notification is another way businesses may obtain immunity from the Act. Notification is currently only available in respect of exclusive dealing conduct. Generally speaking, exclusive dealing involves a business imposing restrictions on another's freedom to choose with whom, or in what, it deals. Businesses wishing to engage in exclusive dealing conduct can 'notify' the ACCC of the conduct. Immunity is obtained automatically and will continue until the ACCC issues a notice revoking the immunity.

The ACCC may issue a notice revoking the notification immunity if it is satisfied that the conduct substantially lessens competition and does not result in any public benefit which outweighs the resulting public detriment.

3. Application for authorisation by the Milk Vendors' Association (SA) Inc (the Association)

On 3 September 2004 the ACCC received an application for authorisation lodged by the Association for the Association to collectively bargain on behalf of its present and future members with National Foods Milk Limited and Dairy Vale Foods Limited in relation to the terms and conditions of vendor distribution contracts. Authorisation has also been sought in relation to a dispute resolution process provided by the Association.

The Association has also sought 'interim' authorisation in respect of these proposed arrangements. If granted, interim authorisation will enable the parties to engage in the proposed arrangements while the ACCC considers the merits of the substantive application for authorisation. By its nature, the ACCC is required to consider a request for interim authorisation very quickly and so only a short consultation period is available. The ACCC is not required to make a decision on the merits of the application for authorisation in reaching its decision on a request for interim authorisation, but would look at factors such as the urgent need for exemption of the arrangement and harm likely to result to the applicant and interested parties should interim authorisation be granted/denied.

The Association has sought interim authorisation on the grounds that draft distributor contracts have recently been issued by both processors and are due to be finalised before the anticipated completion of the authorisation process.

The Association submits that the proposed collective bargaining arrangements would result in a benefit to the public of South Australia which would outweigh any detriment constituted by any lessening of competition that would be likely to result. For details on the public benefits and detriments that the Association claims are likely to result from the proposed collective bargaining arrangements please see the enclosed submission.

4. Exclusive dealing notifications

On 24 November 1992 and 9 February 1993, Dairy Vale Cooperative Ltd (Dairy Vale) lodged notifications in relation to an exclusive dealing agreement between Dairy Vale and selected milk vendors in South Australia. The agreement gave vendors the exclusive right to distribute all Dairy Vale products in particular areas and specified the territory in which the vendor would operate. Dairy Vale retained the right to sell products direct to the retailer. The agreement also provided for vendors to carry competing products provided Dairy Vale agreed in writing.

On 13 April 1993 National Dairies SA Ltd (National Dairies) lodged a notification of exclusive dealing in relation to an agreement with milk vendors in some country areas of South Australia. The agreement gave vendors the exclusive right to distribute National Dairies' white milk, modified milk and flavoured milk. Vendors were given non-exclusive rights to distribute other National Dairies products, and they could distribute non National Dairies products provided National Dairies granted an exemption. Distributors were not zoned and they could compete with National Dairies for the business of new customers.

On 29 March 1994 National Dairies lodged two further notifications of exclusive dealing in relation to agreements with milk vendors operating in Adelaide. The first gave wholesale vendors, who distributed products to retail outlets and other large buyers, the exclusive right to distribute National Dairies' white milk, modified milk and flavoured milk within a specified territory of metropolitan Adelaide. The second notification provided retail vendors with the exclusive right to distribute National Dairies' white milk, modified milk and flavoured milk to households and small retailers. Both agreements gave vendors non-exclusive rights to distribute other National Dairies products, and they could distribute non National Dairies products provided National Dairies granted an exemption.

At the time of assessing the notifications in 1993 and 1994, the Trade Practices Commission (now the ACCC) considered that the exclusive dealing arrangements were likely to have little impact on competition in the short term although it noted that the impact after deregulation was unclear. The Trade Practices Commission also considered there was little public benefit in the agreements themselves.

Given that the ACCC has received the application for authorisation of collective bargaining arrangements by milk vendors, the deregulation of the dairy industry and the considerable time that has passed since the exclusive dealing arrangements were notified, the ACCC proposes to review the notifications at the same time as considering the application for authorisation. The review will assess the effect the notified conduct may have on competition and whether the public benefit continues to outweigh the public detriment and therefore whether or not the immunity provided by the notifications should continue.

5. Request for submissions

To assist the ACCC in its consideration of the collective bargaining authorisation application and the review of the exclusive dealing notifications it would be helpful to obtain your comments on the following issues, where relevant:

- the likely public benefits from the proposed collective bargaining arrangements by milk vendors in South Australia with processors for the distribution of dairy products;
- the likely effect on competition, and any other public detriments, from the proposed collective bargaining arrangements by milk vendors in South Australia with processors for the distribution of dairy products;
- the effect of the ACCC granting/denying interim authorisation in respect of the proposed collective bargaining arrangements;
- the public benefits resulting from the notified exclusive dealing agreements for the distribution of dairy products in South Australia;
- the effect on competition from the notified exclusive dealing agreements for the distribution of dairy products in South Australia;
- the relevant market(s) affected by the notified exclusive dealing agreements and any changes since the notifications were lodged; and

- any other information that may be relevant to the ACCC's assessment of the public benefits and detriments of the proposed collective bargaining arrangements and/or the exclusive dealing agreements.

The ACCC asks for submissions to be in writing so they can be made publicly available. They are placed on a public register for this purpose.

Persons lodging a submission with the ACCC may request that information included in the submission be treated as confidential and not placed on the public register. If confidentiality is granted in respect of information the ACCC may take it into account, even though it is not publicly available. Guidelines for seeking confidentiality are attached.

If you wish to lodge a submission, please address your submission to:

The General Manager
Adjudication Branch
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Submissions can also be lodged by email to: adjudication@acc.gov.au

Initial submissions in relation to the request for interim authorisation by the Milk Vendors' Association (SA) Inc for the proposed collective bargaining arrangements in respect of current distribution contracts should reach the ACCC by **21 September 2004**. Submissions in relation to the substantive application for authorisation of proposed collective bargaining arrangements and the review of the exclusive dealing notifications should reach the ACCC by **5 October 2004**.

If you have any questions about the issues raised in this letter please contact Michael Green on 02 6243 1088.

A copy of this letter will be placed on the ACCC's public register.

Sincerely

Tim Grimwade
General Manager
Adjudication Branch

GUIDELINES FOR CONFIDENTIALITY CLAIMS

Authorisations/Notifications

The process whereby the Commission assesses applications for authorisation and notifications is very public, transparent and consultative. The *Trade Practices Act 1974* (the Act) requires the Commission to maintain a public register in respect of authorisation applications and notifications.

Applicants and interested parties can request that a submission, or a part of a submission, be excluded from the public register.

The Commission is required under the Act to exclude from the public register upon request details of:

- (i) secret formulae or processes;
- (ii) the cash consideration offered for the acquisition of shares in the capital of a body corporate or assets of a person; or
- (iii) the current manufacturing, producing or marketing costs of goods or services.

The Commission also has the discretion, under s 89 of the Act, to exclude material from the public register if it is satisfied that it is desirable to do so, either by reason of the confidential nature of the material or for any other reason. The Commission expects that a party claiming confidentiality on these grounds will present a case for its treatment in this manner.

Under Regulation 24 of the *Trade Practices Regulations*, when a request for confidentiality is made to the Commission:

- (a) where the request is that a whole document be excluded, the words **“Restriction of Publication Claimed”** should appear in red writing near the top of each page; and
- (b) where the request is that part of a document be excluded, the words **“Restriction of Publication of Part Claimed”** should appear in red near the top of the first page of each document, and the part for which confidentiality is claimed should also be marked in red. A submission of more than 5 pages should also include a description of the whereabouts of the parts for which confidentiality is claimed.

However, even if a document does not meet these technical requirements, the Commission may still grant confidentiality where, in the Commission's view, it is desirable to do so.

If the Commission denies a confidentiality request, the requesting party may ask that the material be returned. As a matter of practice, the Commission will specify a period (usually 14 days) in which they can request the return of such material. Upon response, the Commission will return the original material and destroy all associated copies. The Commission will not consider this material when reaching its decision.

If the Commission does not receive a response within the specified period, the original material will be placed on the public register.

Information or documents granted confidentiality may be used by the Commission pursuant to its powers generally under the *Trade Practices Act*.

Form B
Commonwealth of Australia
Trade Practices Act 1974 --- Sub-section 88(1)
AGREEMENTS AFFECTING COMPETITION:
APPLICATION FOR AUTHORISATION

To the Australian Competition and Consumer Commission:

Application is hereby made under sub-section 88(1) of the *Trade Practices Act 1974* for an authorisation under that sub-section

☐ to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of that Act.

☐ to give effect to a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of that Act.

1. (a) Name of Applicant

Milk Vendors Association (S.A) Inc. ("the Association")

(b) Short description of business carried on by applicant

The Association is a non-profit organisation which represents South Australian Milk Vendors who are responsible for the distribution of milk and milk products to retail customers and private residences

(c) Address in Australia for service of documents on the applicant

John Royle

Royle & Co Lawyers

98-100 Halifax Street, Adelaide SA 5000

Tel 8215 0008 Fax 8215 0472

2. (a) Brief description of contract, arrangement or understanding and, where already made, its date

Please see attachment.

(b) Names and addresses of other parties or proposed parties to contract, arrangement or understanding

(i) **National Foods Milk Limited**

167 Cross Keys Road, Salisbury SA 5018

(ii) **Dairy Vale Foods Limited**

154 Caulfield Avenue, Clarence Gardens SA 5039

(iii) **Such existing and future Milk Vendors (being members or non-members of the Association) who may elect to appoint the Association to negotiate on their behalf**

3. Names and addresses (where known) of parties and other persons on whose behalf application is made

Members of the Association

4. (a) Grounds for grant of authorisation
Please see attachment

(b) Facts and contentions relied upon in support of those grounds
Please see attachment

5. This application for authorisation may be expressed to be made also in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the above mentioned contract, arrangement or understanding.

(a) Is this application to be so expressed?
No

(b) If so, the following information is to be furnished:

(i) the names of the parties to each other contract, arrangement or understanding
Not Applicable

(ii) the names of the parties to each other proposed contract, arrangement or understanding which names are known at the date of this application .
Not Applicable

6. (a) Does this application deal with a matter relating to a joint venture (See section 4J of the *Trade Practices Act 1974*)
No

(b) If so, are any other applications being made simultaneously with this application in relation to that joint venture
Not applicable

(c) If so, by whom or on whose behalf are those other applications being made
Not applicable

7. Name and address of person authorised by the applicant to provide additional information in relation to this application

John Royle
Royle & Co Lawyers
98-100 Halifax Street, Adelaide SA 5000
Tel 8215 0008 Fax 8215 0472

Dated: 9th August, 2004

Signed by/on behalf of the applicant

.....
(Signature)

.....
(Full Name)

.....
(Description)

**ATTACHMENT TO
APPLICATION FOR AUTHORISATION BY
MILK VENDORS' ASSOCIATION (SA) INC**

The Milk Vendors' Association (SA) Inc ("the Association") seeks authorisation under Section 88 (1) of the Trade Practices Act 1974 (Cth):

- (a) to make a contract or arrangement or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of Section 45 of the Act; and
- (b) to give effect to a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of Section 45 of the Act.

Authorisation is sought for the purposes of engaging in the following proposed conduct:

- (a) *An arrangement between members and non-members (both present and future) of the Milk Vendors' Association (SA) Inc for the Association to collectively bargain on their behalf with National Foods Milk Limited ("National Foods") and Dairy Vale Foods Limited ("Dairy Farmers") in relation to the terms and conditions of distribution contracts between those parties and National Foods and Dairy Farmers.*
- (b) *An arrangement between members and non-members (both present and future) of the Milk Vendors' Association (SA) Inc to give effect to any contracts agreed by the Association with National Foods and / or Dairy Farmers.*
- (c) *An arrangement between:*
 - *Members and non members (both present and future) of the Milk Vendors Association (SA) Inc; and*
 - *National Foods Milk Limited; and*
 - *Dairy Vale Foods Limited*

For the Association exclusively to provide dispute resolution services in relation to disputes between vendors and/or between vendors and their suppliers and/or between vendors and any person or entity to which the vendor delivers product.

Further, the Association seeks interim authorisation for the same purposes.

Interim authorisation is sought on the grounds that draft distributor contracts have recently been issued by both South Australian processors and are due to be finalised before the anticipated completion of the Authorisation process proper.

1 Introduction

1.1 The Dairy Industry in South Australia

The dairy industry is a core industry in South Australia. Dairy farmers,

processors, distributors and retailers combine to produce and deliver to consumers such staple products as whole and modified white milk, flavoured milks, cheeses and yogurts.

Traditionally, the industry has been highly regulated from the farm gate to the point of retail sale. Since January 1995, the industry has been progressively deregulated, in line with general trends in the national economy towards open competition. This, together with deregulation in other sectors of the economy – such as retailing and service stations – has impacted significantly on the dairy industry and dairy distribution.

Deregulation has resulted in significant and ongoing restructuring as industry players have sought to optimise returns in the new regulatory and economic environment. Dairy farmers and, particularly, licensed milk vendors, have been forced to face significant adjustment costs. Milk processors and major retailers have, on the other hand, enjoyed increased profitability. These outcomes reflect the relative bargaining positions of the various industry players and the existence of certain exemptions from Trade Practices Act provisions enjoyed by the processors.

1.2 Products

Products in the industry include white milks, such as whole milk, and a range of reduced fat, low fat and specialty milks: see appendix “A”.

Further products include a wide range of flavoured milks, UHT (“long life”) milks, table spreads and regular and reduced fat cheeses and yoghurts: see Appendix “B”.

1.3 Turnover

Total milk production in South Australia in the financial year ending June 03 was 732.6 million litres per annum. Total retail milk sales during the same period was 181.4 million litres. The majority of the remaining product is exported overseas. Average household consumption is approximately seven litres per week: See appendices “C” and “D”.

2 The Suppliers in the Dairy Industry

2.1 Primary Producers

Farm gate prices were deregulated on 1 July 2000 and, over the ensuing period, farm gate prices have fallen from 28 cents per litre to 19/24 cents per litre. Prior to deregulation on 30 June 2000, there were 677 dairy farmers in South Australia. By December 03 that number had fallen to below 500.

The Federal Government recognized that, following deregulation of farm gate prices, primary producers would suffer significant losses and incur substantial adjustment costs. The Government therefore introduced nationally its DSAP package that set an 11c per litre levy on the retail price of all milk, to provide adjustment funding to the primary producers.

2.2 Processors

In South Australia, there are only two significant processing firms, namely

National Foods Milk Limited ("National Foods") and Dairy Vale Foods Limited ("Dairy Farmers"). These processors purchase bulk milk supplies from primary producers and process that milk into the various products identified in 1.2. Traditionally, processors then sold these products to licensed vendors who, in turn, would sell them to retailers or, via the home delivery network, directly to consumers.

In 2000, Paul's Parmalat, which processes in Bendigo Victoria, entered the S.A. market as a distributor. Paul's now has eight contracted vendors throughout metropolitan and country South Australia. The percentage of Paul's product in the South Australian market is minimal.

Both S.A. processors are multi million dollar corporations with substantial market influence and overwhelming bargaining power as against the suppliers (i.e. primary producers) and the distributors (the licensed vendors). The processors unilaterally prepared the current distributor contracts. Notifications made under Section 93 in 1993 have made them exempt from various provisions of the *Trade Practices Act*: see section 3.2 below.

Increasingly, the processors sell directly to the larger retailers – mainly supermarket chains and other buying groups – by the system known as "Direct Billing".

This system involves the processors assuming the role of supplier to the retailer "direct", with the licensed vendors providing an ordering, delivery, and merchandising service in return for a delivery fee. Delivery fees (set by the processor), are significantly less than the margin that the licensed vendors receive from their own customers.

No consideration was ever paid for the transfer of customers from vendors to the processors. The processors reserve the right to vary or terminate these delivery arrangements.

More recently, with the introduction of "Home Branding" by the large supermarket chains, the prospect has emerged that existing licensed vendors will be eliminated from the supply chain as the supermarket chains propose to purchase supplies directly from the processors and to introduce their own distribution arrangements.

The former Managing Director of National Foods, at a shareholders meeting in December 2001, stated that it is anticipated that approximately 75% of all milk distribution will henceforth be carried out outside the licensed vendor system. This clearly has implications for the availability of supplies to independent retailers, and for home deliveries.

2.3 Licensed Vendors

Licensed Vendors, widely known as "milkie", are responsible for the distribution of milk and milk products to retail customers and private residences. They are required to be licensed pursuant to the terms of the Dairy Industry Act 1992. There are 223 licensed vendors in South Australia – down by approximately 130 (over 37%) since the advent of deregulation in 1995, many having been bought out by existing vendors to consolidate into larger rounds.

Each licensed vendor is required to have an exclusive supply contract with either National Foods or Dairy Farmers. These contracts list retail customers that the vendor has the right to supply ("Listed" or "Designated" Customers) and/or territories in which the vendor has the right to supply to domestic residences ("Exclusive Territories"). They also list "Direct Billed" customers in respect of which the vendor is contracted to provide delivery services.

Designated customers, exclusive territories and listed "Direct Billed" customers are subject to variation under the contract at the processor's direction.

Vendors have, traditionally, purchased product from the processors and resold it to retailers and consumers. They are independent businesses and are, invariably, owner operated. As independent businesses, they are required to negotiate individually with processors.

Licensed Vendors who are members of the Milk Vendors Association (SA) Inc. ("the Association") provide in excess of 70% of the total amount of milk distributed in South Australia.

The role of Licensed Vendors is discussed in more detail in section 3 below.

2.4 Retailers

Retailers include the major supermarket chains, such as Woolworths and Coles-Myer; buying groups, such as Top Shop, the service station chains, and various State government agencies and instrumentalities; and independent corner stores, or "delis".

The major supermarkets and buying groups possess substantial bargaining power. This was recognised as long ago as 1980, when the South Australian Parliament enacted legislation to prevent supermarkets from obtaining their own milk vendors' licences. At the time, there were 420 home delivery vendors in South Australia, and it was felt that some would be forced out of business if supermarkets were to obtain their own licences: See appendix "E".

Since that time, the bargaining power of the large supermarkets has been significantly increased as a consequence of the partial deregulation of retail shopping hours and the introduction of Home Branding. Supermarkets now trade for longer hours. Service Stations now typically trade around the clock and provide convenience-store facilities. This has resulted in the closure of numerous independent delis and an increase in the volume of milk sold through supermarkets. In 1991, 8% of milk sales were through supermarkets; that figure is now 58%: See appendix "B". Significantly, supermarkets set the retail price for both Home Brand and processor-branded products, in effect having the power to manipulate the volumes and product sold.

3 Licensed Vendors

3.1 Licensing

The licensing requirements under the Dairy Industry Act stipulate that each vendor must have a credit contract with a processor and must comply with

certain health and hygiene standards.

3.2 Processor Contracts

Since 1993, all vendors have been required to have sole and exclusive supply contracts with one or other of the two processors. These contracts are, on their face, plainly anti-competitive and in breach of various provisions of the Trade Practices Act 1974 (Cth). However, the contracts were notified to the Trade Practices Commission (as it was then known) in 1993 and were approved, subject to review on the deregulation of post farm gate prices. This deregulation occurred in January 1995. No review has taken place, despite requests from the Association. See appendix "F".

Contracts introduced by the processors in the late 1990s clearly recognised the ongoing effects of deregulation and sought to maximise returns to the processors in the new environment. Dairy Farmers introduced a franchise system and National Foods introduced a contract featuring a provision which would allow National Foods to terminate the processor contracts for many reasons, including where:

"any other change occurs in, or affecting, the Industry or the Market."
(para. 34.2 contract)

Standard terms of the current processor contracts include the following provisions:

- Allowing the processor unilaterally to vary trading terms and conditions
- Requiring the vendor to be contactable 24 hours a day
- Requiring the provision of detailed business plans and marketing plans
- Entitling the processor to withdraw Listed Customers from the vendor without being liable for any loss, costs, expense or damage and without payment of transfer fees or duties
- Entitling the processor to nominate an alternative licensed vendor to deliver or supply to direct or listed customers
- Entitling the processor to vary the delivery fee paid to licensed vendors by giving a notice period and without cause or consultation
- The processor specifically does not guarantee the supply of product to the vendor
- Effectively prohibiting vendors from selling or supplying any products whatsoever other than those of the processor
- Requiring vendors to establish and maintain certain data bases, using specified computer programs, and to make those data bases available to the processor upon request
- Exempting the processor from legal obligations towards the vendors such as the payment of superannuation and workers compensation insurance where that may otherwise have been applicable.

Both processor contracts are clearly weighted in favour of the processors. Bearing in mind that licensed vendors operate independent businesses, the standard contracts are excessively intrusive. They are uncommercial in that they restrict unnecessarily the extent to which vendors may utilise capital assets whilst, at the same time, failing to guarantee product supplies.

Representations were made by the Association to the processors on behalf of the licensed vendors in an attempt to negotiate some alterations or additions to the contract making it more favourable to licensed vendors without satisfaction. Vendors had little option but to sign these contracts, given their financial vulnerability and lack of bargaining power.

The processor contracts represent the effective regulation of the distribution market by the processor duopoly.

Recently, both National Foods and Dairy Farmers have issued new draft processor contracts in standard form. These contracts continue to rely on the Notifications referred to above. The National Foods draft contains strict confidentiality provisions, including a provision that the vendor may not disclose the contents of the draft contract to any adviser until such time as that adviser has executed a confidentiality undertaking in a form specified, and that undertaking has been approved by National Foods.

3.3 Wholesale, Route and Home Delivery

Increasingly, the larger wholesale customers have been assumed by the processors as direct customers. Vendors receive a delivery fee for delivering products to these customers. Vendors have received no remuneration for any loss of customers, which traditionally, have been tradable. Entire rounds, Exclusive Territories of the Home Delivery vendor and specified Listed Customers of the Route/Wholesale vendor were traditionally sold in the same way that any business may buy or sell assets.

3.4 Direct Billing

Direct billing has become increasingly prevalent since the introduction of solus processor contracts in 1993. Under this system, the processors contract directly with major customers and pay delivery fees to licensed vendors, who deliver product on their behalf.

The major supermarkets and buying groups (which include various State Government agencies and instrumentalities) have sufficient bargaining power to negotiate on an even footing with the processors. They have exerted this power to negotiate favourable Direct Billing and Home Brand agreements. Consequently, vendors' delivery fees on white milk have been significantly reduced from 10c per litre in 1995 to an average of 8c per litre currently (a fall of 20%) and to 6c per litre for Home Brand. Flavoured milk fees have been reduced from 41.6c to 34c per litre. In the same period, the profit margins of the processors and of the supermarkets have increased.

3.5 Bargaining Power

As noted above, there are only two significant processors in South Australia and vendors must deal with one or other of these. Both are multi-million dollar corporations. Vendors, on the other hand, are typically self-employed small business persons. Given these relative economic strengths, the requirement for solus supply agreements and the existence of the Notifications, vendors have no real bargaining power vis-à-vis the processors. Contracts are offered on a "take it or leave it" basis. The nett effect of the processor duopoly, the solus supply arrangements and the Notifications is that the distribution of dairy products via the licensed vendor network is now regulated by the processors.

3.6 Entry and Exit

Vendors' processor contracts are tradable, subject to the consent of the relevant processor. Most sales have, traditionally, been brokered via the Milk Vendors Association (SA), which retains a substantial database. Sale values have declined substantially since the initial phase of deregulation in 1995, to the point where it is now widely accepted that rounds are virtually unsaleable. This means that vendors who have paid hundreds of thousands of dollars for their businesses have sustained major capital losses as a direct and foreseeable result of deregulation of the processor-dominated industry.

4 Role of the Milk Vendors' Association (SA)

The origin of the Milk Vendors' Association SA Inc can be traced back to the formation of the Adelaide and Suburban Milk Distributors and Dairymans' Association in 1931. The name being changed to The Master Retail Milk Vendors Association Inc in 1944 and to its present identity in August 1992. In 1932 there was also another Vendor Association formed, with both Associations working side by side until 1946/47 when they amalgamated.

The Association is controlled by a Committee of Management, elected by its members. Testament to the stability of its management is that since 1945 there have been only 9 Presidents and 8 Executive officers.

The Association concerns itself with all matters affecting the Dairy Industry in South Australia and the interest of Vendors in particular. Being a non-profit organization, the Association's assets are not large, but it has traded successfully in excess of sixty years for the benefit of its members.

Membership of the Association is entirely voluntary. However the Association represents and is financially supported by licensed vendors, within the State who distribute in excess of 70% of the volume of milk distributed in South Australia.

The Association has been the recognized Vendors' Association and has maintained strong communication with Government and all Industry bodies over the past six decades. It maintains records and data bases for all licensed vendors and provides a community service in answering daily enquiries and requests.

5 Disputes

The level of disputation involving vendors is not high. However, there is considerable discontent amongst vendors as to how disputes have been dealt with. No formal dispute resolution procedures have been followed, although they are nominally in existence. Many vendor grievances remain unaddressed because of lack of vendor confidence in the existing arrangements, in which outcomes are determined solely by the processors. Vendors are particularly concerned about the role of the processors (via their sales/marketing staff) in dealing directly with vendors' customers and imposing those customers wishes on vendors.

6 Grounds for Grant of Authorisation

Vendors in most states other than South Australia have received adjustment packages to assist in the process of structural change which has inevitably followed deregulation. The South Australian State Government has declined to provide such assistance, or to facilitate an industry self funded rationalisation package.

As has been indicated above, it is believed that the processors are looking toward a rationalisation of the distribution network which will have a significant effect upon the licensed vendor system and will impact on consumer prices and choices. When this occurs, unless the licensed vendors can participate in negotiations on a more equal footing with the processors, it is anticipated that further restrictions will be placed upon them and significant financial losses will flow. This will cause a reduction in the provision of distribution services and in consumer choices.

Collective negotiation will enable vendors to negotiate on a more equal basis with the processors. It is anticipated that this will lead to the public benefits set out below. The present range of distribution services would be maintained and the quality of those services would increase. There should be no adverse impact on consumer prices. There should be some redistribution of the monopoly profits currently enjoyed by the processors, major supermarkets and buyer groups.

In general terms, the authorisation sought would, or would be likely to, result in a benefit to the public of South Australia which would outweigh any detriment constituted by any lessening of competition that would be likely to result. Such authorisation would have the specific benefits enumerated below.

6.1 Fairness in the Negotiating Process

As indicated above, the relative bargaining strengths of the processors, retailers and vendors are such that the vendors are, in effect, obliged to accept whatever terms are offered to them. This is reflected in the steep decline in numbers and profitability of milk rounds since January 1995, as vendors have been forced to accept contractual terms which strongly favour the processors. Processors and major retailers (which enjoy a relative parity of bargaining power) have, on the other hand, enjoyed a significant increase in profitability over the same period.

Distribution contracts have been offered by the processor duopoly on a "take it or leave it" basis. The proposed arrangements would help to redress the disparity in relative bargaining positions and provide vendors with some competitive parity in contract negotiations with the processors. This will result in greater vendor input into the contract terms which will, in turn, lead to improved services and other public benefits.

6.2 Compliance with Statutory Requirements

The process of collective negotiation is likely to result in processor contracts which provide standards that ensure both processors and vendors comply with statutory requirements as to safety, roadworthiness, environmental protection, pollution control and cold chain compliance. The existing arrangements provide a clear incentive to vendors to "cut corners", which is likely to lead to serious consequences.

6.3 Efficiency of Operations

The structural changes which have occurred in the industry since the onset of solus processor contracts and deregulation (see above) have resulted in a sharp reduction in the number of licensed vendors. Many of the remaining vendor businesses are only marginally viable. The decline in home delivery and local "deli" sales has resulted in a sharp increase, in relative terms, of vendors' transport costs. The processor duopoly, strengthened by the Notifications, has enforced onerous contractual terms.

Collective negotiation will allow for the consolidation of rounds. This will increase the average size of rounds. This, in turn, will have the effect of reducing transport costs and total average costs of vendors. It will also ensure that those consumers who rely on home deliveries and/or local "deli" supplies will continue to benefit from the availability of such services at an affordable price. Any increase in vendors' margins or delivery fees is likely to be marginal and capable of being absorbed by the processors and/or major retailers.

6.4 Continued Viability of Independent Distribution Sector

As a result of the various factors referred to above, many of the remaining vendor businesses are only marginally viable. The continuing trend towards direct billing and home branding means that vendor's margins are likely to further decline, resulting in the closure of a significant number of those businesses. This, in turn, will result in the reduction of services available to consumers, loss of employment and other significant financial losses. Independent small business employs a large percentage of the workforce and should be supported to ensure competition in the market place and hence benefits to the consumer.

6.5 Reduction in Transaction Costs

Presently, the processors are required to negotiate individually with each vendor. This results in a substantial waste of resources. Processors are required to replicate the negotiation process with numerous vendors, whereas vendors must attempt to negotiate as individuals against the resources of multi million dollar corporations. This exercise invariably proves fruitless as few, if any, concessions are made by the processors.

Transaction costs vary among the vendors according to a range of factors, including:

- The processor with which they contract; and
- The extent to which they engage in negotiations.

All vendors are required to sign off on a declaration to the effect that they have had, or have had the opportunity to have, legal, accounting and business advice.

A vendor who obtains advice from appropriately qualified persons in each of those fields could reasonably expect to incur costs in excess of \$6,000. Allowing for the fact that not all vendors may take business (as opposed to accounting) advice, it is reasonable to estimate transaction costs at approximately \$5,000 per vendor per contract: a total cost of \$1.115 million.

Assuming processors' transaction costs of \$2,000 per contract gives a figure of \$446,000 in processors' transaction costs.

It is anticipated that total vendor transaction costs in relation to contracts negotiated under the proposed authorisation would be in the region of \$10,000-\$20,000 or \$45-\$90 per vendor.

6.6 Better Information

It is envisaged that vendors will be advised in the process of collective negotiation by the Milk Vendors Association, which will also provide secretarial services. The Milk Vendors Association maintains substantial records and databases in relation to the dairy industry, and it has access to further such material through its connections with vendor organisations interstate as well as organizations such as the Dairy Industry Council. The Association will be able to negotiate on the basis of more comprehensive and accurate market information.

Many vendors do not have the time or the skills to acquaint themselves with such information or to analyse such information adequately. The problem of asymmetrical information compounds the inherent disparity in bargaining positions as between individual vendors and the processors. The proposed arrangements would assist in redressing this disparity.

6.7 Improvement in Health and Safety

Vendors are required to meet all safety and delivery standards. The changing retail environment has resulted in vendors working longer hours, placing increasing demands on their own employees, or being no longer able to employ additional help. As a result, stress and fatigue levels have increased significantly.

Through the rationalisation process, consolidation of rounds will have the effect of reducing delivery distance and times, resulting in a safer environment for vendors, their employees, and those with whom they share the workplace and road.

6.8 Dispute Resolution

Disputes within the industry may be categorised and described as follows:

- 6.8.1 Vendor/Processor disputes. Typically, these disputes involve such matters as:
 - Failure to supply invoiced product.
 - The supply of damaged or out-of-date product.
 - The allocation of customers and/or territories by processors.
 - The transfer by the processors of vendors customers to direct billing.
- 6.8.2 Vendor/customer disputes. Typically, these disputes include such matters as:
 - Supply of damaged or out-of-date product.
 - Merchandising.
 - Frequency of supply.
- 6.8.3 Vendor/vendor disputes. These disputes occur very infrequently. They tend to relate to the allocation of customers or territories.

Both current processor contracts provide for dispute resolution procedures. However, these have rarely (if ever) been applied owing to the dominant

position of the processors vis-à-vis vendors, which results in the unilateral imposition of resolutions by the processors in all categories of disputes.

6.9 Opt Out Clause

It is proposed that all vendors (both members and non-members of the Association) will retain the right to negotiate individually with the relevant processor should they choose to do so. Participation by vendors in any collective negotiation structure will be entirely voluntary.

6.10 No Boycotts

For the avoidance of doubt, no authorisation is sought in respect of any collective boycott activity.

7 Market Assessment

The Association acknowledges that the statutory test requires that the Commission assess and weigh the likely public benefits and detriments flowing from the proposed collective bargaining arrangements. This process requires some elucidation of the markets which will be affected by those proposed arrangements. The Association submits that, in the circumstances described in Sections 2 and 3 above, it is not necessary for the Commission comprehensively to define the relevant markets. The Association submits that it is clear that there are two relevant areas of competition, namely:

- The supply of distribution services to the processor duopoly. In this area, vendors compete with each other to acquire distribution contracts from the processors; and
- The supply of milk and other dairy products to retailers and consumers. In this area, the vendors notionally compete with each other to supply retailers and with retailers to supply products to consumers.

All such competition occurs within the geographic area of the state of South Australia. Individual distributor contracts are highly localized and limited to listed customers and designated territories within a particular metropolitan or regional area.

7.1 Supply of Distribution Services to Processors

Theoretically, distributors compete for contracts to provide distribution services to one or other of the processors. Contracted vendors also compete amongst themselves in the actual provision of distribution services.

However, the level of actual competition is, at most, negligible. All existing contracted vendors have a right of renewal. Vendors numbers have declined substantially since 1995, as described above. As new retail outlets or residential territories are constructed, these are allocated to existing vendors. As vacancies occur in the distribution network (usually as a result of a particular round having become non-viable), customers tend to be reallocated to existing vendors by the relevant processor.

7.2 Supply of Dairy Products to Retailers and Consumers

Competition amongst vendors is similarly limited by the existence of listed customers and defined territories in the distributor contracts, which also prevent vendors from seeking to supply an existing customer of another vendor who is contracted to the same processor.

Thus the terms of the distribution contracts preclude any competition amongst vendors for the supply of product to retailers or consumers.

Vendors compete with retailers for the supply of dairy products to consumers. As indicated above in paragraphs 2.2 and 2.4 there has been a significant trend in recent years away from home delivery by vendors and towards supply to consumers via supermarkets.

Price competition between vendors is extremely limited, given that their margins have been forced downwards since deregulation as a result of the factors referred to in 3.5 above. It is anticipated that the proposed arrangements will result in an increase in non-price competition amongst vendors, particularly in the provision of home delivery services.

8 The Future With or Without

The Association acknowledges that, in determining this application, the Commission is required to make a reasonable forecast as to how the market will react in the event that the authorisation is, or is not, granted. The Association submits that, on any objective view, the public benefits which would be generated by the implementation of the proposed arrangements far outweigh any concomitant anti competitive detriment and would represent a significant improvement over the existing outcomes.

8.1 The Future Without the Proposed Arrangements

In the past, vendors have had no significant input into the processor distribution contracts. In the absence of the proposed collective bargaining and dispute resolution arrangements, it is most likely that South Australian milk vendors will continue to have no option but to accept the standard form processor contracts and to comply with processor requirements in relation to the operation of their businesses.

Although, currently, the Association may legitimately act to disseminate information and facilitate its exchange amongst vendors, vendors must, in the absence of authorisation, negotiate individually. Hence the role of the Association is extremely limited and its databases and expertise may not be effectively utilised by vendors.

It is most likely that, without the proposed arrangements, the decline of the independent distribution network will continue to the point of extinction. This will result in a decline in the range of available services, reduction in consumer choices, increases in the monopoly profits of the retail chains and processors, and increased retail prices.

8.2 The Future Situation With the Proposed Arrangements

Under the proposed arrangements, the Association would be able to play a far more extensive role in contract negotiations than that referred to above. This is likely to result in a greater degree of vendor influence in relation to

the terms and conditions of the distributor contracts and fairer and more consistent outcomes to disputes.

The Association would be in a position to collate vendor concerns and draw on its extensive databases of industry information in conducting negotiations and/or addressing disputes.

The range of services available to consumers would be maintained, efficiency would increase, the ability of the processors and of the major retail chains to extract monopoly profits would be restricted and competitive forces would influence retail prices.