

Notifications lodged by

Dairy Vale Cooperative Ltd

in relation to

**Exclusive dealing agreements for the
distribution of dairy products in
South Australia**

Registration Nos: **N60014**
 N60015

Commissioners: **Fels**
 Broome
 Asher

File Nos: **CN93/4, CN93/2**

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CN92/11

Summary

On 24 November 1992 and 9 February 1993, Dairy Vale Cooperative Ltd (Dairy Vale) lodged notifications with the Trade Practices Commission in relation to an exclusive dealing agreement between Dairy Vale and 23 milk vendors in the South East of South Australia and for the same agreement with six milk vendors in the Riverland region. The term of the agreement was 18 months.

The agreement gave vendors the exclusive right to distribute all Dairy Vale products in these areas and specifies 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.

Excluding UHT milk, Dairy Vale has 30 per cent of the white milk market in South Australia and 15 per cent of the flavoured milk market. There is one other South Australian milk processing company — National Dairies S.A. Ltd (National Dairies). National Dairies also lodged a notification of exclusive dealing in relation to an agreement with milk vendors in some country regions of South Australia (see notification N60016).

The exclusive dealing agreements between Dairy Vale and vendors in the Riverland and the South East would make little difference in the short term. However, whether the agreements would substantially lessen competition in the market for white milk after deregulation is unclear.

There is little public benefit in the agreements themselves. Any longer term benefits would be, more likely, the result of deregulation than exclusive dealing.

Subject to the outcome of any predecision conference, the Commission proposes not to give notice to the applicant under ss 93(3) of the Trade Practices Act at this stage. However, it would consider giving notice following deregulation if it considered that the agreements were, by substantially lessening competition, hindering the benefits of deregulation flowing to consumers.

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Attachment: proposed agreement

1. The notifications

On 24 November 1992 and 9 February 1993, Dairy Vale Cooperative Ltd (Dairy Vale) lodged notifications with the Trade Practices Commission in relation to an exclusive dealing agreement for the distribution of dairy products. The notifications were lodged under sub-section 93(3) of the *Trade Practices Act 1974* (the Act). Copies of the notifications and of the supporting submissions are on the public register.

The notifications related to exclusive dealing agreements between Dairy Vale and milk vendors in the country areas of South Australia. Notification N60014 was for an agreement with 23 vendors in the South East, and notification N60015 covered the same agreement with six milk vendors in the Riverland region.

Dairy Vale is a cooperative with no formal interstate linkages.

Before this agreement was proposed, the milk vendors in South Australia were independent self-employed operators. They delivered dairy products manufactured by Dairy Vale and by the only other South Australian processor, National Dairies S.A. Ltd (National Dairies). They also carried a range of other food products.

The Dairy Vale agreement gave vendors the exclusive right to deliver all Dairy Vale products and specified the territory in which the vendor would operate. Dairy Vale retained the right to sell its products direct to the retailer, and the agreement provided for vendors to carry competing products provided that Dairy Vale agreed in writing.

The term of the agreement was 18 months.

2. Background

Deregulation

The South Australian government has announced measures to deregulate the dairy industry in the State. The main exception is that the farm gate price for market milk (white whole milk, reduced fat milk, low fat milk, ultra filtered milk and modified milks, excluding Skim Choice, Calcium Choice and Pro Active) will continue to be set administratively. Processor prices, wholesale prices and retail prices for market milk will be deregulated by 1 January 1995. A new dairy authority will administer prices in the interim and control licensing in the industry. All other aspects of the industry will be subject to self-regulation or be administered through other existing legislation on health and food standards.

Until recently, the dairy industry in South Australia was regulated under two Acts. The *Metropolitan Milk Supply Act 1946* applied to the production of milk in the metropolitan milk supply area (as defined in the Act) and the consumption of milk in the Adelaide metropolitan area. The Act was administered by the Metropolitan Milk Board, which had the following main functions.

- To license dairy farms, milk depots, milk processing plants and vendors.
- To control and zone retail delivery vendors.
- To determine farm gate prices, processor prices, wholesale prices, and maximum and minimum retail prices for market milk.¹ (The gap between the maximum and minimum retail prices from July 1992 was 11c a litre, compared with at most 4c a litre in other states.) Prices for other dairy products, including flavoured milk, were not set.
- To set quality standards.
- To regulate all other aspects of the industry in the metropolitan milk supply area from the dairy farm to the consumer.

Dairy activity outside the metropolitan milk supply area was the responsibility of the South Australian Department of Agriculture under the *Dairy Industry Act 1928*. The role of the department was restricted mainly to licensing premises and conducting quality analysis.

- Vendors in the country areas were licensed by local councils.

¹ The farm gate price for market milk in the metropolitan milk supply area was set by the South Australian government at the recommendation of the board. The farm gate price for manufacturing milk (made into flavoured milk, cheese, butter and other dairy products) was set by the Milk Equalisation Committee. The prices paid to farmers for manufacturing milk were about two-thirds of the price paid for market milk.

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Maximum wholesale and retail prices outside the metropolitan milk supply area were determined by the Prices Commissioner under the *Prices Act 1948*, though in practice the Commissioner generally passed on the prices set by the Metropolitan Milk Board.² Processor prices were not set, but the wholesale price effectively acted as a processor price if retailers or vendors bought direct from the processing plant.

The *Dairy Industry Act 1992* was passed on 3 December 1992. The Act has not yet been proclaimed because the regulations have not been finalised. The new legislation repealed the *Metropolitan Milk Supply Act 1946* and the *Dairy Industry Act 1928*, and established the Dairy Authority of South Australia. The authority commenced operations on 1 July 1993.

The main function of the authority is to issue licences to dairy farmers, processors and vendors throughout South Australia. It recommends to the Minister for Agriculture a statewide farm gate price, processor and distribution margins, and recommended retail prices for market milk. The Minister may also set a farm gate price for manufacturing milk on the recommendation of the authority.

The administratively set retail price for market milk was removed on 1 January 1993 and replaced by a recommended retail price that will be set until 1 January 1995. All pricing controls except the farm gate price will be removed by 1 January 1995.

The Act provides for the authority to monitor compliance with appropriate standards and codes of practice, and to provide training in their implementation. Quality and food safety standards will be determined by the processors or under other legislation relating to health and food standards. Codes of practice for dairy farmers and milk vendors are being developed by the Department of Primary Industry.

The dairy industry in South Australia

The Australian Dairy Corporation estimates that South Australia produced 411 million litres of milk in 1991-92, 6.1 per cent of Australian output. More than 80 per cent was produced in the Adelaide Hills and the remainder was produced in the South East. About 38 per cent was used for market milk and 62 per cent was manufactured into other dairy products.

Some South Australian dairy products are sold to border towns in NSW, Victoria and the Northern Territory. Dairy Vale also sells dairy products, including fresh white milk, to Singapore. Dairy products from Victoria (mainly UHT white and flavoured milk) are sold in South Australia, particularly in Adelaide, and across the border in the South East.

² The farm gate prices for market milk and manufacturing milk in the country areas were determined by negotiation between the dairy farmers and the processors in each region. Farmers in the metropolitan milk board area received farm gate prices significantly higher than the prices that applied in a number of country regions. However, under an authorisation granted in November 1985 (A6057, equalisation schemes in the metropolitan region and in the South East region operate to ensure that dairy farmers in the South East region do not supply the metropolitan region.

South Australia has two milk processing companies — Dairy Vale Cooperative Ltd and National Dairies S.A. Ltd.³ The two processors manufacture basically the same dairy products. The main difference is that National Dairies has a larger range of flavoured milk. There are also some differences in pack sizes.

Milk and other dairy products are transported from the processing plant to cool rooms or depots by a contractor. Each of the two processors has 22 depots in the Adelaide metropolitan area. The large number of depots is a result of a regulation under the Metropolitan Milk Supply Act that prevents vendors from delivering milk outside an eight kilometre radius of a depot.

Vendors in South Australia are independent self-employed operators. Almost all are dual vendors, carrying products manufactured by both processors. There are two types of vendor — wholesale and retail (home delivery); most retail vendors also deliver to small retail outlets. Retail vendors in Adelaide were zoned under the Metropolitan Milk Supply Act, but the *Dairy Industry Act 1992* has no provision for zoning. Country vendors and wholesale vendors in Adelaide are not zoned. The latter deliver to the outlets specified in their round titles and to others established as new business.⁴

Regional distribution arrangements and market shares

Dairy Vale provided the following estimates for market shares in South Australia, excluding UHT milk.⁵ UHT white and flavoured milk accounts for about 5 per cent of the respective markets.

| White milk | | Flavoured milk | |
|------------------|-----|------------------|-----|
| Dairy Vale | 30% | Dairy Vale | 15% |
| National Dairies | 70% | National Dairies | 85% |

South Australia is divided into seven regions mainly on the basis of the location of white milk processing plants. The regions, the location of the processing plants, the owner of the plant and the main brand of white milk sold in each region are shown below.

Both National Dairies and Dairy Vale have processing plants in **Adelaide**, where almost 80 per cent of the State's population live. Dairy Vale has provided the following estimates for market shares in Adelaide excluding UHT milk.

³ A haulage firm (South Australian Milk Haulage Ltd) that is jointly owned by the two companies transports raw milk from the farm to the processing plant.

⁴ There are round titles for wholesale and retail business. These are bought and sold through the Vendors Business Agency of the Milk Vendors Association of SA. The agency operates under the management of a licensed land broker. The sales value of a round (goodwill) is calculated by taking the average weekly gross profit of a round for the past 12 months and multiplying it by an adjustment factor.

⁵ National Dairies estimates that Dairy Vale's share of the white milk market in South Australia is 45 per cent and its share of the flavoured milk market is 20 per cent. In Adelaide, it estimates that Dairy Vale has a share of the flavoured milk market of 25 per cent.

White milk

| | |
|------------------|-----|
| Dairy Vale | 50% |
| National Dairies | 50% |

Flavoured milk

| | |
|------------------|-----|
| Dairy Vale | 30% |
| National Dairies | 70% |

Most milk in Adelaide is delivered through the vendor system; there was an average of 245 retail vendors and 57 wholesale vendors in the metropolitan milk supply area in 1991-92. Dairy Vale also has its own fleet of six vans that account for the equivalent of 3-5 per cent of the Adelaide market, and they are planning to add another two vans. This is to ensure that customers are serviced adequately and that they have an alternative source of supply if they are not satisfied with services provided by the vendor. National Dairies does not operate any company vans in Adelaide.

| Region | Processing plant | Owner | White milk brand |
|-------------------|------------------|------------------|---------------------------------|
| Metropolitan | Adelaide | National Dairies | National Dairies (Pura) |
| | Adelaide | Dairy Vale | Dairy Vale |
| South East | Mt Gambier | Dairy Vale | Dairy Vale (Lakeland) |
| Riverland | Renmark | Dairy Vale | Dairy Vale (Fallands) |
| Barossa Mid-North | Port Pirie | National Dairies | National Dairies (Golden North) |
| Far North | Port Pirie | National Dairies | National Dairies (Golden North) |
| Murray Districts | Adelaide | National Dairies | National Dairies (Pura) |
| Kangaroo Island | Kangaroo Island | Local | Island |

Dairy Vale supplies most of the **South East's** white milk, which is processed in Mt Gambier. It also supplies Big M flavoured milk (packaged for Dairy Vale in Victoria under an agreement with the Victorian Dairy Industry Authority). When the exclusive dealing agreements were introduced, Dairy Vale withdrew its locally produced Lakeland Light flavoured milk and brought in its full range of flavoured milk from Adelaide. (Before the agreements were introduced, Lakeland Light had a market share in flavoured milk of about five per cent, Big M had a share of 20 per cent, the UHT share was 5 per cent and National Dairies' share was 70 per cent.) The complete range of National Dairies flavoured milk, processed in Adelaide, is distributed in the region.

Dairy Vale estimated market shares in the South East after the introduction of the agreements as follows:

White milk

| | |
|------------------|-----|
| Dairy Vale | 80% |
| National Dairies | 5% |
| Interstate UHT | 15% |

Flavoured milk

| | |
|------------------|-----|
| Dairy Vale | 40% |
| National Dairies | |
| Big M and UHT | 60% |

Dairy Vale operates one van in the region that delivers dairy products, including white milk, to 30 outlets. In addition, Golden North, a division of National Dairies, operates two vans in the South East that carry flavoured milk, dairy products and a range of other items, such as frozen peas and beans. The vans do not carry white milk. Golden North also distributes across the border into Victoria. National Dairies has cold storage facilities in the region and is considering investing in a more serviceable depot in response to Dairy Vale's exclusive dealing agreements.

Dairy Vale owns a small factory at Renmark in the **Riverland** that produces white milk, some flavoured milk, custard and cream. According to Dairy Vale's estimates, it provides about 80 per cent of the white milk and 70 per cent of the flavoured milk in the region, excluding UHT. Dairy Vale has a van operating in the Riverland area, and National Dairies has a vendor in Renmark who delivers flavoured milk supplied by Golden North vans.

National Dairies is the main supplier of white and flavoured milk throughout the rest of South Australia.

- The **Far North** and **Barossa Mid-North** are supplied from its plant at Port Pirie. (Milk from the Port Pirie plant is also sold in Ceduna, Streaky Bay, which are in the far west of the State, Alice Springs and Broken Hill.) Golden North vans operate in the north.
- The **Murray Districts** are supplied from Adelaide. According to vendors in Murray Bridge, some 50-60 per cent of the white milk sold in Murray Bridge is unpasteurised.⁶
- **Kangaroo Island** has a small local dairy that supplies one-third of the island's needs and dairy products are obtained from both processors from Adelaide.

Dairy Vale estimated that its market share for white and flavoured milk is at most 20 per cent in these country areas (excluding Kangaroo Island). A Dairy Vale van delivers dairy products to Murray Bridge from Adelaide. Dairy Vale also sends some dairy products to the north and Kangaroo Island by other forms of transport and through general grocery distributors. All but two vendors in the Far North and Barossa Mid-North areas sell only National Dairies products.

⁶ South Australia is the only State in Australia where unpasteurised cows milk can be sold, and only in the country areas. Unpasteurised milk is usually home delivered and it is cheaper than pasteurised milk. The two processing companies are not involved in the sale of this product, though it is stored in the National Dairies cool room in Murray Bridge.

3. The agreement

Dairy Vale has offered an exclusive dealing agreement to 23 vendors in the South East to distribute dairy products. It has stated to the Commission that the agreement has been signed by all 23 vendors to distribute dairy products. According to Dairy Vale, vendors in the South East have been granted an exemption to carry National Dairies flavoured milk, and in theory they can carry any non-dairy product.

The same agreement has been offered to and signed by six vendors in the Riverland. One of the vendors in the Riverland (in Waikerie) was granted an exemption to carry National Dairies flavoured milk; the others did not request exemptions.

According to the Milk Vendors Association, Dairy Vale also approached a vendor in Port Pirie with the offer of an agreement. The vendor was not interested because National Dairies has such a large share of the market in the north.

National Dairies has offered exclusive dealing agreements to 11 vendors in the Murray Districts, 13 vendors in the Far North, 23 vendors in the Barossa Mid-North, one vendor in the Riverland, one vendor on Kangaroo Island, and one in Broken Hill. These agreements are the subject of a separate notification (N60016).

The provisions

The Commission was interested in provisions 2, 3.3 and 3.14 of the Dairy Vale agreement.

Provision 2 states that Dairy Vale appoints the vendor as an exclusive reseller of its products. Dairy Vale retains the right to use its own vans to sell its products, except white and flavoured milk, to retailers. It also retains the right to sell white and flavoured milk and other dairy products when the vendor breaches the agreement.

- The products are specified in the schedule attached to the standard agreement.
- The store locations and streets allocated to each vendor are also specified in the agreement.

Provision 3.3 states that the vendor will not advertise, sell or promote the products outside the specified territory or to any person who would be likely to do so.

Provision 3.14 covers competitive products. It states that the vendor will not sell or distribute any products that are in competition with Dairy Vale's products unless Dairy Vale agrees in writing.

4. Dairy Vale submissions

The submissions by Dairy Vale in relation to notifications N60014 and N60015 are on the public register. These submissions provide background on the dairy industry in South Australia, address the effects of the exclusive dealing agreements on competition and outline the public benefits expected to arise from this conduct.

Dairy Vale stated that it offered exclusive dealing agreements to country vendors in preparation for increased competition when white milk prices are fully deregulated. The move would allow Dairy Vale to have a commercial arrangement with its vendors and to provide them with the training needed to promote Dairy Vale products. Dairy Vale argued that it would also be better prepared for the possibility of competition from across the border and better able to handle existing competition from manufacturers of other beverages, such as Coca Cola and fruit juice, whose products compete with Dairy Vale's flavoured milk.

Dairy Vale was also motivated by the resistance shown by milk vendors in the South East towards distributing and selling an additional brand of flavoured milk, ie Dairy Vale. They hoped that the introduction of exclusive dealing agreements would give them the opportunity to introduce their flavoured milk into the South East where it was not previously sold.

They also commented that Dairy Vale was losing market share in the Riverland, partly as a result of the downturn in the economy, but also because of a sales promotion drive by National Dairies.

Effects on competition

Dairy Vale argued that the agreements will not detract from competition for the following reasons.

- A large number of vendors will operate in a relatively small market.
 - Dairy Vale argued that a reduction in the number of vendors now might result in further rationalisation in future. Distribution costs would rise as vendors maximise profit, and services to outlying areas would decrease.
- Dairy Vale has allocated vendors to retailers to enable a professional relationship to develop and to facilitate product promotion.
- More than one vendor can distribute products to the same retailer.
 - Before the agreements were signed, only one vendor served each retailer. The vendor stocked the retailer's fridge, determining the brands and quantity of milk that were delivered. With more than one vendor calling, there is significant competition between Dairy Vale and National Dairies.
- Retailers can change vendors if they wish.

- The Dairy Vale van in the area provides additional competition for vendors.
- Dairy Vale has agreed to vendors' requests to allow them to distribute National Dairies flavoured milk, so the agreements are not restrictive in this regard.
- Dairy Vale has also agreed to allow vendors to distribute non-dairy products as before.
- After deregulation, competition will increase because the processors will be able to compete in terms of white milk prices.

Dairy Vale noted that National Dairies is an aggressive competitor with the potential to introduce more of their white milk into the South East region.

They are able to supply products from either Adelaide or Horsham in sufficient quantities to satisfy the market. They own or have access to depot facilities in Mt Gambier and seven regional centres in the South East. Their sister company, Golden North, already operates in the region with two trucks.⁷

Dairy Vale also considered that there are almost no barriers to entry into distribution.

Vendors do not have to be licensed, while technical expertise is low. They need to meet relevant council by laws regarding hygiene and have access to a small van.

Public benefits

Dairy Vale submitted that a number of public benefits arise from exclusive dealing. These arguments were advanced in relation to the South East, though Dairy Vale contended that most of them also apply to the Riverland and more generally.

- 'The promotion of competition in the market place, with retailers having an additional flavoured milk to choose from. Consequently price-off specials, advertising and sales promotions will increase between the companies in the market place.'
- Dairy Vale indicated that their share of the flavoured milk market in the South East had increased from 5 per cent to 40 per cent as a result of the agreements. (They also commented that the prices of flavoured milk had been dropped for a short period to promote their products.) The increase in market share allowed:
 - additional monies to be spent with the retail trade.
 - another part-time merchandiser to be appointed in the South East. Therefore Dairy Vale now has two merchandisers in the region, plus regular visits by city based sales representatives.
 - a retail promotion to be run on our "Max" iced coffee, which included consumer prizes as an incentive to consumers.

⁷ The Horsham plant is now owned by Queensland United Foods Ltd.

- 'Vendors will be professionally trained to compete in the area of sales and service with National Dairies, Coca Cola and Schweppes. This will improve the viability of the 23 milk vendors in a region of high unemployment.'
- For example, Dairy Vale has held two trade nights in Mt Gambier where vendors have been involved with the local TAFE College in identifying new ways of using Dairy Vale products.
- 'The by-passing of the Vendors Area Agreement, thus allowing more than one vendor to call on any particular retailer.'⁸
- Dairy Vale notes that vendors with competitive milk products are operating into the same outlets, for example, into Millicent and near Port McDonnell in the South East.
- 'The economic development of the region, including the continued operation of our local dairy and the resultant benefits for employees and local dairy farmers.'
- 'The introduction of a new range of flavoured milks, which means increased consumer choice. This would not have occurred had the "status quo" remained, due to entrenched attitudes of milk vendors.'
- 'A more equitable market share between ourselves and National Dairies. This in turn will support further investment in each region.'

⁸ This refers to a code of conduct signed on 6 September 1983 between the vendors and Lakeland Dairies that restricted vendors to particular retail areas. It should be noted that the Commission advised Dairy Vale on 5 February 1993 that it considered the Vendors Area Agreement as a likely breach of the Act. This was based on a decision in May 1990 to deny authorisation to a similar agreement in the metropolitan region.

5. Interested parties

Submissions were received from National Dairies Ltd and from the Milk Vendors Association of SA Inc. on the Dairy Vale notification of the agreement in the South East. These submissions are on the public register. The Commission also contacted a number of other interested parties in its inquiries. These inquiries covered the effects of the introduction of exclusive dealing agreements in the South East and Riverland, their possible introduction in Adelaide and the potential effects of deregulation.

Effects on competition

The National Dairies submission covered the general issue of exclusive distribution by each of the processors throughout South Australia. They believed that the adoption of such a system would not result in a 'significant lessening of competition'.

At the consumer level distributors representing both major processors will visit each outlet and compete to maximise the sales of their particular brand. This should increase competition between the brands.

At the vendor level distributors of the same brand will be licensed in relation to specified outlets and will be prohibited from selling to another distributor's outlets. Obviously, this arrangement reduces competition between vendors selling the same brand. That reduction would not be significant if:

- the retailer is free to change vendors at any time; and
- each vendor is free to compete with the other vendors for any new outlets.

In addition, National Dairies stated that it would not be efficient for National Dairies to buy more vans and deliver all their own milk. Vendors have low overheads, they are self employed and prepared to work all hours. They are also prepared to make several deliveries a day to supermarkets to top up their milk supplies. National Dairies indicated, however, that some rationalisation of the existing vendor system would be necessary, particularly in Adelaide, to adjust for the effects of deregulation.

They suggested that the effect on competition would depend on the circumstances of each case and the terms of the relevant distribution agreement. For example, the combined effect of long distances between retail outlets and low volumes for retail outlets in the South East might result in less frequent visits by vendors to particular outlets.

National Dairies also noted that Dairy Vale had granted exclusions to allow vendors in the South East to carry National Dairies flavoured milk. National Dairies' view was that:

In the short term the exclusion given in relation to National Dairies flavoured milk means that there is very little difference between the new distribution system in the South East and the old distribution system. However, it is important in such areas as the South East to ensure that any arrangement is sufficiently flexible and can be adjusted to ensure that all retail outlets receive a full range of products. Regardless of

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the distribution system adopted, National Dairies will always ensure that a full range of its products are available to consumers throughout South Australia.

National Dairies said they would need to build a more serviceable depot in the South East to ensure that their products continue to be distributed, but it would not be attractive to transport white milk from Adelaide to the South East at current prices. The South East is a small market, so they did not consider offering their own agreements in the area. They preferred to concentrate on the Far North, Barossa Mid-North and Murray Districts that can be supplied from Adelaide or from their plant in Port Pirie.

Other points raised by interested parties were as follows.

- Consumers in the South East would not be disadvantaged by the Dairy Vale agreements because National Dairies can deliver its own products using its Golden North vans.
- Exclusive dealing agreements in the country areas are unlikely to be anti-competitive mainly because of brand loyalties.
- It would be inefficient to have two white milks in country areas because one is produced in the area and the other would have to be transported from Adelaide. The long distances in the country also need to be considered.
- There is no guarantee that exemptions would be allowed to continue.
- Exclusive dealing agreements without exemptions would be restrictive. Vendors that carry only National Dairies products would not be disadvantaged because they would be able to deliver the more popular National Dairies flavoured milk. Exclusive Dairy Vale vendors would be less well off because the public would go to the supermarkets to obtain the brand of flavoured milk they prefer. Small retail outlets would also be squeezed.
- Dairy Vale might be forced out of business if they tried to introduce exclusive dealing agreements in the city.
- Most of the large vendors in Adelaide are companies, so they could take out an agreement with one processor and set up a shelf company to sign an agreement with the other if both processors introduced exclusive dealing agreements in the city.
- Exclusive dealing agreements would be hard to enforce in Adelaide because vendors would be able to buy supplies of the other processor's products at a 'cash and carry' to supply what the market wants.
- In the city, exclusive dealing arrangements could be pro-competitive because of the associated advertising and promotional activities.
 - With exclusive dealing, each processor would have control over the vendor's vehicle. It would be painted in company colours and act as an advertising

billboard. The vendors could also wear uniforms. All this would help to sell more milk.

- The market would be competitive with exclusive dealing agreements because stores would still have freedom of choice. They would seek new products if they were advertised and promoted, and buy the range of products the consumer wants. The retail market would determine the outcome.

Public benefits

National Dairies stated that the following benefits would arise if a system of exclusive distributors is adopted by each processor throughout the State.

The promotion of competition as one processor's vendor competes against the other processor's vendor to maximise sales of their brand to retail outlets.

The efficiency of vendors' businesses will be increased as a result of the vendors participation in training programs, and the increased involvement of processors in the day to day business operations of vendors.

The anti-competitive effect of giving to vendors a right to service particular outlets will be far less than that which arose under the area agreement system. This will enable vendors to retain a significant portion of the value of their businesses.

Rationalisation of the distribution system resulting in the efficient allocation of resources and lower costs.

A high level of assistance being given to vendors by processors in relation to the conduct of their businesses.

Enhancement of the quality of products and expansion of the range of goods available to consumers arising as a result of retailers increased access to competing brands via each processor's distributors.

Increased availability of competing brands in areas where one brand was principally sold as each processor's vendors compete to sell their brand throughout the whole market.

Deregulation

Some interested parties suggested that the net result of deregulation of the dairy industry would be that the vending system — and home delivery — would be rationalised. Small retailers would also be squeezed because the processors would be expected to offer special deals to the supermarket chains. The consumer would be disadvantaged because they would not be able to obtain their preferred product from small retailers or through home delivery.

Independent Holdings Ltd commented that they will distribute white milk themselves after deregulation. They cannot obtain white milk directly from the processor now because they were not permitted to hold a licence as a milk vendor under the Metropolitan Milk Supply Act. Under the new legislation, they will be able to obtain a licence and distribution would be easier because a number of anachronistic regulations on the handling of milk will be repealed.

Independent Holdings also commented that it would not be in their interest — nor in the interest of the other supermarket chains — if Dairy Vale went out of business as a result of deregulation. Competition between the processors is necessary to keep prices to supermarkets down and to provide choice. They suggested that they would bring milk into Adelaide from Victoria to avoid a monopoly in processing. They indicated that if the other supermarkets started a price war that threatened to drive Dairy Vale out of business, Independent Holdings would use its countervailing power to buy Dairy Vale milk and keep them in business.

Other interested parties considered that Dairy Vale does not have the capital base and is not diversified enough to survive a milk price war after deregulation and that Independent Holdings would be unlikely to support them. A takeover by an interstate company would be a more likely outcome.

National Dairies and Dairy Vale suggested that the supermarkets may wish to introduce their own house brands of milk after deregulation. National Dairies said this milk might have to be brought in from interstate because it would be costly to introduce the different packaging; there is 20 minutes down time for each new pack run.

Woolworths indicated that they saw advantages in retaining the vendor system after deregulation. Some stores have 2-3 deliveries a day because the holding capacity of stores is limited. It is easier to use a vendor to do this than to pay extra costs to use the supermarket's own trucks. If they picked up milk from the processor, they would need significant volumes of extra cold space in their warehouse and more refrigerated delivery trucks. They would also have to do the merchandising themselves. These costs would have to be weighed against the vendor's margin that would accrue to the supermarket if they picked up milk themselves.

Woolworths also pointed out that they now negotiate their milk deliveries separately with each processor rather than with the vendor. The processors pay the vendor a fee to deliver the milk. The introduction of exclusive dealing contracts would not change this arrangement.

Interested parties suggested that there could be significant changes in costs resulting from deregulation as in the following examples.

- Before deregulation, advertising for white milk was generic and conducted by the Metropolitan Milk Board. After deregulation, advertising would be conducted separately by the two processors.
- The distribution system would be streamlined when the regulation that vendors must deliver only in a radius of eight kilometres of a depot is abolished. National Dairies estimated that it needs about six depots in the metropolitan area rather than 22. Both processors would need to invest to amalgamate depot facilities, but funds should be available from the sale of redundant depots, some of which are on prime residential or commercial land.

Milk prices

The Commission obtained differing views on the effect of deregulation on white milk prices.

- The price of milk should rise with deregulation because margins are very narrow. Moreover, processors would have to pay line fees and cooperative advertising fees to the supermarkets after deregulation. Advertising costs would also increase.
- Milk prices are likely to go down because supermarkets would offer specials.
- The possibility of bringing fresh white milk in from interstate would limit any price increases.
- In the longer term, UHT milk will taste better and be brought into South Australia in larger volumes. (UHT milk sells for about two-thirds the price of white milk.) It would cost 8-9c a litre to transport fresh milk from Melbourne to Adelaide. So, fresh milk deliveries from interstate would unlikely to be major. The lower price of UHT milk would allow transport costs to be covered, so it may become more competitive. This would also limit price increases.

6. The statutory test

Corporations engaged in exclusive dealing (other than forcing a third person's goods or services) may notify the Commission in accordance with s. 93 of the *Trade Practices Act 1974*. On proper notification being made, the parties to the conduct receive automatic protection from the operation of s. 47 (other than sub-sections 47(6), 47(7), 47(8)(c) and 47(9)(c)).

This immunity from court action remains in place unless the Commission issues a notice this protection if it is satisfied that:

- the conduct substantially lessens competition in the relevant market; and
- there is insufficient public benefit flowing from the conduct to outweigh the lessening of competition.

Functional market

The Commission considered that the relevant functional market was the wholesale market for the supply of flavoured and white milk from processors to vendors.

Temporal market

The Commission considered that, in assessing the effects of these agreements, it was necessary to look at their impact in both the present time frame as well as the period after deregulation.

Effects on competition

It was apparent that Dairy Vale, through these exclusive dealing agreements, is using its white milk 'monopoly' in the South East and in the Riverland to leverage its flavoured milk into these regions. It has to do this before deregulation because there is no guarantee that after deregulation it will maintain its white milk monopoly. It could also be seen as a way of protecting its white milk market after deregulation. While this may be the motivation for the agreements, the effect on competition in the markets defined above must be considered.

Beverage market

The Commission considered it unlikely that the agreements would substantially lessen competition in the beverage market in South Australia at the wholesale level. It further considered that this assessment holds for both the current time frame and for the period after deregulation. As stated above, flavoured milk competes with other beverages. Consequently, if Dairy Vale flavoured milks were to overtake Farmers Union flavoured milks, it would not have a great impact on the beverage market. The Commission also noted that National Dairies continues to deliver its flavoured milk in the South East using the vans of its subsidiary Golden North and that currently Dairy Vale is allowing its vendors an exemption to carry Farmers Union flavoured milk.

White milk market

It was the Commission's view that the agreements would be unlikely to substantially lessen competition in the wholesale market for white milk in the South East region or in the Riverland in the short term. The agreements preserve the status quo in the market for the delivery of white milk in these regions. While the Commission noted that the retail price for milk has been a recommended price since 1 July 1993, the processor and distribution margins have remained set. This would continue to discourage United Dairies sending milk to these regions. The Commission also noted that Dairy Vale has 23 exclusive vendor agreements in the South East when, on its own calculations, 8 vendors would be sufficient to cover the area. While this may be inefficient, it is not necessarily anti-competitive under the current arrangements which preclude National Dairies entering the region.

The Commission noted that some attempts have been made by both Dairy Vale and United Dairies to introduce exclusive dealing agreements into those regions traditionally supplied by the other processor. How successful, and what the effect would be, is unclear. It is unlikely, however, that an existing vendor supplying white

milk would move to an exclusive agreement with a processor that could not currently supply white milk. If new vendors were to sign an exclusive dealing agreement, they would only be supplying flavoured milk and therefore not affecting competition in the white milk market.

It was the possible effect of the agreements in the wholesale white milk market post deregulation that caused the Commission concern. As mentioned above, Dairy Vale has tied almost 200 per cent more vendors than it believes are necessary to distribute its products in the South East. Post deregulation this could amount to a barrier to entry if price movements in white milk were such that United Dairies wanted to supply into the South East.

The Commission was also concerned that when the Dairy Vale agreements were viewed in relation with the United Dairies agreements in other regions of the State (see notifications N60015 and N60016), they have a market sharing effect. One interpretation of these moves to exclusive agreements was that they are an attempt to 'bed down' the regions so that they can concentrate on the Adelaide market after deregulation. It is possible that the processors could inflate prices in their regional 'monopolies' to cross-subsidise price cuts in Adelaide.

Public benefits

Dairy Vale stated that the introduction of their flavoured milk into the South East increased consumer choice and was therefore a public benefit attributable to the advent of exclusive dealing. The Commission considered that they may have been overstated their case. The Commission noted that Dairy Vale reduced the price of its flavoured milk to promote the product, and that vendors were granted exemptions to carry the same range of products as before. The Commission suspected that Dairy Vale could have introduced its flavoured milk into the South East without the agreements if they had been prepared to cut its price and advertise it in the region.⁹

Dairy Vale also described the consequent increase in market share in flavoured milk in the South East and the associated promotional activities as public benefits. In the Commission's view, the increase in market share was probably the result of lower prices and better promotion, rather than an outcome of the introduction of the agreements. The Commission also considered that the increase in market share was a private benefit rather than a public benefit.

This should be qualified by noting that a large increase in Dairy Vale's market share in flavoured milk in the South East (and in the Riverland) would strengthen its position in areas where it has a near monopoly in the supply of white milk. The Commission suspects that after deregulation, Dairy Vale would be able to increase its market share in flavoured milk further by offering special prices for white milk to encourage consumers to buy its flavours. In these circumstances, further increases in market share could stifle competition, rather than provide public benefit.

⁹ The Milk Vendors Association considers that Dairy Vale's estimate of its market share in flavoured milk in the South East may be too high at 40 per cent. They said it is probably 10-20 per cent, the same as in Adelaide. When it introduced the agreements, Dairy Vale flooded the South East market with flavoured milk, but much of the milk had to be returned because it was past the use-by date.

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The Commission accepted that training for vendors in sales and service and other forms of assistance may yield public benefits attributable to the agreements. The Commission noted that Dairy Vale has not previously invested in training in the past because vendors carried products from both processors. Given that vendors in the South East and the Riverland are still carrying the same products, the Commission considered that Dairy Vale's incentive to invest in training would be diminished.

The Commission recognised the provision of employment opportunities and economic development as public benefits only if this occurs in efficient industries. Dairy Vale has estimated that it would need only eight vendors in the South East to maintain its market share and allow for some growth in sales in the region. This implies that the offer of vending agreements to all 23 vendors in the South East is inefficient.

Rationalisation of the distribution system is normally considered as a public benefit, but this has not occurred in the South East or in the Riverland.

Summary

In the Commission's view the exclusive dealing agreements between Dairy Vale and vendors in the Riverland and the South East would make little difference in the short term in either the beverage market or the white milk market. The Commission was also of the view that the agreements would be unlikely to distort the market for white milk during the period leading up to deregulation to a degree that they would substantially lessen competition, or that it would upset the aims of deregulation. However, the effects of the agreements in the deregulated market itself are unclear.

The Commission considered that there would be minimal public benefits only flowing from the agreements.

For the reasons stated above, the Commission does not propose to give notice to the applicant under s. 93(3) of the Act.

Having said that, the Commission's stated policy in relation to industries coming to terms with deregulation is to assist them as far as is possible. However, it does not support arrangements that are put in place in anticipation of deregulation, that seek to perpetuate the regulated régime or that put in place barriers which prevent the benefits of deregulation flowing to consumers. Examples of this policy are seen in the Commission's authorisation decisions in relation to the winegrape and tobacco industries and investigations it has made in the dairy industry.

The Commission will review this decision after deregulation on 1 January 1995. If the Commission concluded that the agreements were hindering the benefits of deregulation reaching consumers by substantially lessening competition in a deregulated market, be it a State market or a regional sub-market, it would consider issuing a notice under s. 93(3) of the Act.