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Notification lodged by

National Dairies S.A. Ltd

in relation to

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

Registration No:	***N60016***	***Commissioners:***	***Fels***
			Broome
			Asher

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Summary

On 13 April 1993, National Dairies S.A. Ltd lodged a notification of exclusive dealing with the Trade Practices Commission in relation to an agreement with milk vendors in some of the country regions of South Australia. The agreement was for an initial term of 12 months, and may be extended for two further terms of 24 months each.

The agreement gave vendors the exclusive right to distribute National Dairies' white milk, modified milk and flavoured milk. They also have non-exclusive rights to distribute other National Dairies products, and they can distribute competing products provided National Dairies grants them an exemption. Distributors are not zoned, and they can compete with National Dairies for the business of new customers.

National Dairies estimated that its share of the white milk market in South Australia is 55 per cent, and its share of the flavoured milk market is 80 per cent. There is one other milk processor in South Australia — Dairy Vale Cooperative Ltd. Dairy Vale has also lodged a notification of exclusive dealing in relation to an agreement with milk vendors in some of the country regions of South Australia (see notifications N60014 and N60015).

The exclusive dealing agreements between National Dairies and vendors in the country areas of South Australia would make little difference in the short term. However, whether the agreements would substantially lessen competition in the market for white milk following 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 hindering the benefits of deregulation flowing to consumers.

Contents

1. The notification

On 13 April 1993, National Dairies S.A. Ltd (National Dairies) lodged a notification of exclusive dealing with the Trade Practices Commission (the Commission) in relation to the distribution of dairy products. The notification (N60016) was lodged under sub-section 93(3) of the *Trade Practices Act 1974* (the Act). Copies of the notification and the supporting submission are on the public register.

The notification covered an exclusive dealing agreement between National Dairies and milk vendors in some of the country areas of South Australia. Agreements were offered to 11 vendors in the Murray Districts, 13 vendors in the Far North, 24 vendors in the Barossa Mid-North, one vendor in the Riverland, one vendor on Kangaroo Island and one vendor in Broken Hill NSW.

National Dairies S.A. Ltd is a wholly owned subsidiary of National Dairies Ltd, which is wholly owned by National Foods Ltd. Before 1 July 1993, National Dairies S.A. traded as Farmers Union Foods Ltd, and National Dairies Ltd traded as Allowrie Foods Australia Ltd.

Before the exclusive dealing arrangement was proposed, the milk vendors in South Australia were independent self-employed operators. They delivered dairy products produced by National Dairies and by the only other South Australian processor Dairy Vale Cooperative Ltd. They also carried a range of other food products.

The products covered by the exclusive dealing agreements are white milk, modified milk and flavoured milk. No exclusive rights were granted in relation to the remainder of National Dairies' product range (cheese, cream, etc.) because those products are also widely distributed by large warehousing organisations. Distributors can sell competing products provided National Dairies grants them an exemption. Exemptions are granted until National Dairies develops and markets an equivalent product.

The agreements were for an initial term of 12 months. They may be extended for two further terms of 24 months each.

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.

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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.

- 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 repeals the *Metropolitan Milk Supply Act 1946* and the *Dairy Industry Act 1928*, and establishes 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.

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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 the South East region operate to ensure that South East dairy farmers do not supply the metropolitan region.

South Australia has two milk processing companies — Dairy Vale Cooperative Ltd and National Dairies 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

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

White milk		**Flavoured milk**	
Dairy Vale	45%	Dairy Vale	20%
National Dairies	55%	National Dairies	80%

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. National Dairies provided the following estimates for market shares in Adelaide.

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 According to Dairy Vale's estimates, National Dairies has 70 per cent of the white milk market and 85 per cent of the flavoured milk market in South Australia. Dairy Vale estimates that its share of the flavoured milk market in Adelaide is 30 per cent.

White milk		**Flavoured milk**	
Dairy Vale	50%	Dairy Vale	25%
National Dairies	50%	National Dairies	75%

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. National Dairies does not operate any company vans in Adelaide. Dairy Vale, however, has a 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.

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

National Dairies is the main supplier of white and flavoured milk in the following regions 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 to Ceduna and Streaky Bay in the Far West and in Alice Springs and Broken Hill.) Vans owned by Golden North, a division of National Dairies, 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 about one-third of the island's needs and it obtains dairy products from both processors from Adelaide.

National Dairies estimated that its market share for white and flavoured milk is more than 80 per cent in the Far North and Barossa Mid-North. All but two vendors in these areas sell only National Dairies products. National Dairies is the main supplier of both pasteurised white and flavoured milk in the Murray Districts. A Dairy Vale van delivers some dairy products to Murray Bridge from Adelaide and some of its products are sold in the other regions.

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 complete range of National Dairies flavoured milk, processed in Adelaide, is distributed in the region, but the vans do not carry white milk. (National Dairies considers that it would not be attractive to transport white milk to the South East at current prices.) Golden North also distributes across the border into Victoria. National Dairies has cold storage facilities in the South East and is considering investing in a more serviceable depot in response to the introduction of exclusive dealing agreements by Dairy Vale late in 1992.

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) and Dairy Vale flavoured milk from Adelaide.[7] Dairy Vale operates one van in the region that delivers dairy products, including white milk, to 30 outlets.

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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.

7 Dairy Vale introduced exclusive dealing agreements into the South East late in 1992. At the same time, it withdrew its locally produced Lakeland Light flavoured milk and brought in its full range of flavoured milk from Adelaide. (Before the agreements were introduced, Dairy Vale estimated that Lakeland Light had a market share in flavoured milk of about 5 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.)

Dairy Vale estimated current market shares in the South East as follows:[8]

White milk		Flavoured milk	
Dairy Vale	80%	Dairy Vale	40%
National Dairies	5%	National Dairies, Big M and UHT	60%
Interstate UHT	15%		

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 also has a van operating in the Riverland area. National Dairies has a vendor in Renmark who delivers flavoured milk only; this vendor is supplied from Golden North vans.

8 The Milk Vendors Association considered that Dairy Vale's estimate of its market share in flavoured milk may be too high. They said it is probably 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.

3. The agreement

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 NSW.

Most of the vendors have signed the agreement, though some agreements have not yet been finalised in the outlying areas.

National Dairies hopes to implement similar agreements throughout the rest of South Australia by 1 January 1995, when white milk prices have been deregulated.

Exemptions were granted for products where National Dairies has no equivalent. The main exemptions granted were for unpasteurised milk, and Dairy Vale's low calorie, sugar-free white and flavoured milk (Take Care). National Dairies has only just introduced an equivalent to Take Care white milk and is planning to introduce an equivalent to Take Care flavoured milk. The duration of the exemptions depends on the specific agreement between National Dairies and the vendor. It usually depends on the availability and market acceptance of the competing National Dairies product. Eventually National Dairies expects its distributors to sell only its products.

Dairy Vale had earlier signed an exclusive dealing agreement to distribute dairy products with 23 vendors in the South East and six vendors in the Riverland. All the vendors in the South East and one of the vendors in the Riverland have been granted exemptions to carry National Dairies flavoured milk. These agreements are the subject of separate notifications N60014 and N60015.

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.

The provisions

The Commission was interested in the following provisions of the agreement.

Clause 1.1 of the agreement grants exclusive rights in respect of the distributor's current customers and for a limited range of products (white milk, modified milk and flavoured milk). Distributors are not zoned.

Distributors also have non-exclusive rights to distribute other National Dairies products to listed customers (clause 1.2).

A distributor is prohibited from selling competing products (clause 1.3.1) unless an exemption is granted (clause 1.4). The exemption specifies the products and the time period for which the exemption is granted.

The distributor cannot sell products to a customer of National Dairies or to another distributor. The distributor cannot sell products to another distributor or to a wholesaler for resale. (Clauses 1.3.2, 1.3.3 and 1.3.4)

Both National Dairies and the distributor are free to compete for the business of new customers (clauses 1.5 and 1.7.1). And National Dairies or a distributor can supply another distributor's listed customers if the listed customer asks them to do so (clauses 1.6, 1.7.2 and 1.7.3).

Procedures ensuring continued supply to customers are set out in clause 11.

4. National Dairies' submission

The National Dairies' submission recognised that changes to the distribution system must occur as a result of deregulation. They argue that:

> The creation by each of the processors of a system of exclusive distributors/franchisees having a right to service specified outlets will protect the value of distributors' businesses, promote competition between distributors selling competing brands and at the same time better serve the needs of consumers. Competition between brands is not vigorously promoted under the current system of dual (as compared to exclusive) distributors. Even though a distributor may carry more than one brand, in practice he or she will prefer one brand over another. Often a distributor will carry a competing brand to discourage the manufacturer of that brand "by-passing" the distributor and selling directly to the retail outlet. This practice discourages competition between brands at the distributor level which in turn, limits consumer access to competing brands.

National Dairies also commented that:

> Regardless of what system National Dairies and its distributors adopt, if large retailers require an alternative form of distribution (ie direct supply or warehousing) National Dairies will have no alternative but to meet this requirement. In the end the system of distribution adopted will be driven by National Dairies' desire to service retailers and consumers in the most efficient and productive manner.

They had been working on a revised distribution system for some time, but accelerated their plans when Dairy Vale introduced its exclusive dealing contracts into the South East and the Riverland. National Dairies were also concerned that Dairy Vale was trying to sign up vendors in the Mid-North.

Effects on competition

National Dairies considers that the adoption of a system of exclusive distributors in South Australia will increase competition.

> At the consumer level, distributors separately representing both major processors will visit each outlet and compete to maximise the sales of their particular brand.
>
> At the vendor level, distributors of the same brand ... will be prohibited from selling to other distributors' outlets. The effect on competition would not be significant because;
>
> - the retailer is free to change distributors at any time; and
> - each distributor is free to compete with other distributors for any new outlet.

They argued that the system in the Far North, Barossa Mid-North and Murray Districts would change little under the new arrangements because exemptions have been granted and because almost all distributors in those regions were already sole distributors of National Dairies products. So the frequency of services to retail outlets would be unlikely to decrease.

National Dairies noted two additional factors that affect competition between the processors.

> Despite increased market penetration in each of the country regions by both National Dairies and Dairy Vale white milk, there is still strong support for the locally produced and manufactured brands.
>
> Flavoured milk competes with soft drinks and fruit juices in the beverage market. So 'the market for flavoured milk is very different to the market for white milk. There is a much stronger brand identification in relation to flavoured milk. Consequently flavoured milks are promoted throughout the State in much the same manner as for example soft drinks, confectionery, snack foods etc.'

Public benefits

National Dairies believed that the following public benefits would arise from a system of exclusive distributors.

- Promotion of competition as one processor's distributors compete against the other processors' distributors to maximise sales of their brand to retail outlets.
- The efficiency of the distributors' businesses will be increased as a result of the distributors' participation in training programs, and the closer involvement between the parties.
- The anti-competitive effect of giving to distributors a right to service particular outlets will be far less than that which arose under the area agreement system. This should enable distributors to retain a significant proportion of the value of their businesses.
- Rationalisation of the distribution system resulting in the efficient allocation of resources and lower costs.
- High level of assistance being given to distributors 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 by each processor's distributors.
- Increased availability of competing brands in areas where one brand was principally sold as each processor's distributors compete to sell their brand of product throughout the whole market.

National Dairies also argued that:

> there are clear benefits to the public in encouraging increased efficiency and quality in the method by which basic food products are distributed to consumers.

They also contended that they have constructed a fair and comprehensive agreement that reduced uncertainty about the rights and obligations of both parties.

5. Interested parties

The Commission contacted a number of other interested parties in its inquiries on the National Dairies notification. Dairy Vale did not comment. These inquiries covered the effects of the introduction of exclusive dealing agreements in the country, their possible introduction in Adelaide, and the potential effects of deregulation.

Effects on competition

Interested parties made the following points about the effects of exclusive dealing on competition. They did not offer any views on the associated public benefits.

- Exclusive dealing agreements in the country areas would be 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.

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- 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.

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 — or 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 is 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. 169

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 estimates that it needs about six depots in the metropolitan area rather than 22. They 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 rise.

- 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 be 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

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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 until it is revoked by the Commission or until the applicant withdraws the notification.

The Commission may revoke 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.

7. Commission consideration

The market

In order to assess the effects on competition of the exclusive dealing agreements, the Commission defined the relevant market as follows.

Product market

The Commission considered that there were two product markets in which the effects of the agreements needed to be assessed.

Beverage market: It was the Commission's view that flavoured milk competes with soft drinks and fruit juices in the beverages market.

White milk market: This market consists of white milk and modified milks. In the Murray Districts it also includes unpasteurised milk. It is estimated that in Murray Bridge it has 50 per cent to 60 per cent share of the white milk sold.

Geographic market

Several interested parties indicated to the Commission that they thought the geographic market was South Australia. The Commission was not convinced that this was currently the case in relation to white milk. It was more inclined to the view that these regions are sub-markets within the broader market of South Australia because:

- white milk is produced at Port Pirie for the Barossa Mid North and Far North regions;
- at current prices, transport costs do not make it feasible for Dairy Vale to supply either region; and
- there is strong consumer support for locally produced brands;

The Murray district is supplied by National Dairies from Adelaide. This suggests that it is not as clearly a sub-market as the other two regions.

Following deregulation these sub-markets may break down. It was noted that the Dairy Industry Review White Paper recommended that in setting the farmgate price for milk due regard should be had to the Victorian farmgate price.

In relation to flavoured milk, the Commission accepted that the geographic market was likely to be South Australia. It is produced in fewer locations and transported around the State. Transport costs are less of a barrier because margins are higher for the production of flavoured milk than for the production of white milk. Flavoured milk is produced from manufacturing milk which is cheaper than the market milk from which white milk is produced. Further, the prices for flavoured milk are not controlled.

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 considers 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 National Dairies, through these exclusive dealing agreements, is using its white milk 'monopoly' in the Barossa Mid-North, Far North and the Murray Districts to consolidate its market share in flavoured milk in 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 been 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 National Dairies were to consolidate, or even increase, its market share as a result of these agreements, it would not have a great impact on the beverage market.

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 Barossa Mid-North, Far North or Murray Districts 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 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.

The Commission was also concerned that when the National Dairies agreements were viewed in relation with the Dairy Vale Dairies agreements in other regions of the State (see notifications N60015 and N60016), they may 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

National Dairies argued that public benefit would be derived from an increase in the efficiency of distributors' businesses as a result of their participation in training programs and other forms of assistance. The Commission accepted that there may be public benefit in this arrangement, particularly because most of the vendors who were offered contracts sell only National Dairies products. In these circumstances, the investment in training and other increases in efficiency attributable to the agreements would be unlikely to yield any returns to Dairy Vale.

The Commission did not consider that country consumers would have access to a wider range of better quality goods as a result of the agreements. The agreements effectively allow vendors to carry the same products as before, and in future the range could narrow as exempt Dairy Vale products are replaced by National Dairies equivalents.

The Commission recognised that rationalisation of the vending system could give rise to public benefit. The National Dairies agreements, however, are expected to be signed by all existing vendors in the country areas, so it is not clear to the Commission how the rationalisation will be effected.

Summary

In the Commission's view the exclusive dealing agreements between United Dairies and vendors in the Barossa Mid North, Far North and Murray Districts 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 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.

8 Commission decision

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 regime, 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 its decision in relation to these agreements following 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.