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Our Ref: 2451250

Dear Scott

**Interim authorisation application by Dairy Western Australia Limited (Dairy WA) – National Foods' submission**

**1. Background**

- 1.1 We act for National Foods Milk Limited (**National Foods**), and are writing in relation to the above matter, about which you sought National Foods' views by letter of 22 March 2005.
- 1.2 This letter contains National Foods' submissions on Dairy WA's application for interim authorisation. We are in the process of preparing a submission that sets out National Foods' views on Dairy WA's substantive authorisation application. As discussed with Susan Philp, we aim to lodge this submission with the ACCC by 26 April 2005.

**2. Executive summary**

- 2.1 National Foods submits that the ACCC should refuse Dairy WA's application for interim authorisation on the following grounds:
  - (1) in National Foods' view, no exceptional circumstances exist that would justify the ACCC granting interim authorisation to Dairy WA;
  - (2) Dairy WA's assertion that National Foods is insisting upon immediate execution of new contracts with dairy farmers is incorrect. Further, there is no basis for Dairy WA's statement on

page 3 of its submission that National Foods has stated that it aims to finalise its contracts with farmers so as to bypass the outcome of the ACCC's consideration of Dairy WA's authorisation application. Dairy WA cites this as its sole ground for seeking interim authorisation. In any case, Dairy WA contradicts itself on this issue, by stating on page 29 of its submission that this is merely an assumption that Dairy WA has made. There is no basis for Dairy WA's assumption in this regard;

- (3) in fact, National Foods is undertaking its annual contract renewal process in accordance with its standard practice of having contracts renegotiated by 30 June each year. National Foods' standard practice is to enter into annual contracts with farmers, unless individual farmers negotiate a longer term. National Foods is not seeking to lock dairy farmers into long term contracts. In any event, National Foods has currently postponed this process in the light of this authorisation application. Accordingly, there is no urgency that may warrant an interim authorisation of conduct the effect of which is potentially very anti-competitive;
- (4) it does not follow that because the current authorisation granted to the Australian Dairy Farmers' Federation (**ADFF**) is due to expire on 30 June 2005, Dairy WA requires interim authorisation now. Authorisation was granted to the ADFF in 2002 for the specific purpose of easing the transition of Australian dairy farmers to a deregulated market. Accordingly, any new authorisation should not be granted without a full reassessment by the ACCC of the likely anti-competitive detriments and public benefits. In any case, the conduct for which Dairy WA is seeking authorisation is much broader than the scope of the current authorisation granted to ADFF;
- (5) the conduct for which Dairy WA seeks authorisation would be likely to significantly impact upon competitive dynamics in the Western Australian raw milk and finished dairy product market. Accordingly, it is likely that conduct permitted by an interim authorisation would make it impossible for the market to return to its pre-interim state, if the ACCC was ultimately to refuse to grant Dairy WA final authorisation;
- (6) Dairy WA has not provided sufficient detail about the operation of the proposed arrangements of the Milk Negotiating Agency to enable National Foods, or any other interested party, to fully assess the likely competitive effect of the arrangements for which authorisation is sought. National Foods considers that interim authorisation should not be granted where there is uncertainty as to the scope of the relevant conduct; and
- (7) interim authorisation is not necessary for, and there is no indication that it would assist in, the ACCC's ability to give due consideration to Dairy WA's substantive authorisation application.

### 3. **Test for granting interim authorisation**

- 3.1 Section 91(2) of the *Trade Practices Act (TPA)* provides that the ACCC may grant an interim authorisation if it is appropriate to do so 'for the purpose of enabling due consideration to be given to ... an application for an authorisation'.
- 3.2 The ACCC's guidelines on notifications and authorisation relevantly provide that:
- (1) interim authorisations may be expected only in exceptional circumstances, where supported by persuasive submissions; and
  - (2) it is unlikely that an interim authorisation will be granted where the effect of allowing the proposed conduct to occur would prevent the market being able to return substantially to its pre-interim state if the ACCC later denied authorisation.

### 4. **National Foods' submissions**

#### 4.1 **No exceptional circumstances**

- (1) National Foods submits that there are no exceptional circumstances that justify the grant of interim authorisation in respect of Dairy WA's proposed conduct.
- (2) National Foods disagrees with the grounds upon which Dairy WA requests the ACCC to grant it interim authorisation. In particular, National Foods disagrees with the following arguments that have been raised by Dairy WA to explain its request for interim authorisation:
  - (a) urgency by National Foods to finalise and execute contracts with its farmer suppliers; and
  - (b) the impending expiry of the current authorisation granted to ADFP.

#### *National Foods' standard contract renegotiation practice*

- (3) There is no basis for Dairy WA's statement that National Foods is seeking to finalise contracts so as to bypass the outcome of the ACCC's consideration of Dairy WA's authorisation application. National Foods is not conducting its current contract renegotiation process with Western Australian dairy farmers in any way that is different from National Foods' usual practice. In any case, National Foods' Western Australian dairy farmer suppliers have welcomed the commencement of its contract renegotiation process, as these suppliers have in the recent past expressed an interest in renewing contracts with National Foods.
- (4) Dairy WA has indicated on page 3 of its submission in support of its authorisation application that National Foods has instructed its

suppliers to provide feedback on new contracts by the end of March. This is not accurate. In accordance with its standard procedure and as a precursor to starting the process of renegotiating new contracts, National Foods sought feedback from its Consultative Group as to terms and conditions of current contracts, and requested feedback by March. However, no new contracts have been issued by National Foods, and it has not commenced discussions directly with suppliers. In fact, National Foods has currently postponed its contract renegotiation process in Western Australia, in the light of this authorisation application. Accordingly, it is inaccurate for Dairy WA to assert that National Foods has sought feedback from suppliers as to the terms and conditions of new contracts.

- (5) National Foods' Western Australian standard farmgate milk supply contracts generally run for a term of one year from 1 July. Accordingly, all communications between National Foods and its Western Australian suppliers have been in accordance with National Foods' standard contract renegotiation procedures. National Foods has not imposed any unusual terms or timing upon its suppliers in seeking to renew contracts.
- (6) National Foods is not seeking to require that suppliers enter into longer term contracts than the standard one year duration. Further, there is provision in National Foods' Western Australian farmgate milk supply contracts for a 3 month transitional period to apply at the end of the term, in the event that the parties do not reach agreement as to the terms of a new contract. Even in the case of new contracts that are renegotiated and entered into over the next few months, these will come up for renegotiation in 2006 according to whatever method is appropriate following the ACCC's assessment of Dairy WA's substantive authorisation application.
- (7) National Foods submits that there are no grounds upon which the upcoming renegotiation of its Western Australian milk supply contracts should be undertaken in a way that is substantially different from its standard practice, particularly where the ACCC has not determined that the public benefits (if any) of the proposed new method outweigh the clear anti-competitive detriments.

*Expiry of current authorisation in June 2005*

- (8) National Foods disagrees with Dairy WA's argument that due to the impending expiry of the authorisation granted to the ADFF in 2002, it is necessary for the ACCC to grant Dairy WA an interim authorisation while it assesses the merits of Dairy WA's substantive authorisation application.
- (9) Rather than constituting re-regulation of the dairy industry, the ACCC's previous authorisation was provided for the specific purpose of enabling a smooth transition by Australian dairy farmers to the deregulated market. Given the transitional nature of

the ACCC's previous authorisation, National Foods considers that any proposal by dairy farmers to continue to act in a way that, in the absence of authorisation, would not be permitted in a deregulated environment, should only occur after the ACCC has comprehensively reassessed the likely competitive impact of the proposed arrangements in the context of the current state of the market.

- (10) In any case, the conduct being proposed by Dairy WA goes substantially beyond the terms of ADFF's current authorisation. It is not appropriate for such conduct to be permitted to occur without a comprehensive assessment of the public benefits and anti-competitive detriments likely to flow from it.

#### 4.2 Inability of market to return to pre-interim state

- (1) In the absence of an interim authorisation, none of the anti-competitive effects of having Dairy WA collectively negotiating on behalf of, potentially, all Western Australian dairy farmers would eventuate prior to the ACCC finding that there would be a net public benefit. However, an interim authorisation has the potential to entrench anti-competitive behaviour even if the ACCC declines to grant a final authorisation.
- (2) For example, by being able to threaten dairy processors and retailers with collective boycott (and thereby potentially impact upon the supply and price of milk to end consumers), Dairy WA would have a greater ability to secure long term contracts between itself (on behalf of dairy farmers) and dairy processors. Further, Dairy WA may seek to enter into long term contracts with dairy farmers to act on these dairy farmers' behalf, which, given the proposed power of Dairy WA to be able to prevent farmers represented by it from entering into contracts Dairy WA does not consent to, could potentially impact upon the long term position of dairy farmers. If such long term contracts were negotiated while Dairy WA had the benefit of interim authorisation, it would change the market structure significantly in a way that could not be quickly reversed if the ACCC did not grant final authorisation.
- (3) While National Foods does not now wish to make any submissions on the merits of Dairy WA's substantive authorisation application, National Foods notes that the proposed conduct, where a single agent might negotiate the supply of raw milk on behalf of all dairy farmers in Western Australia, has the potential to be highly anti-competitive.
- (4) It is also in direct contrast, in a number of ways, to the way in which milk supply contracts are negotiated in Western Australia now. For example:
  - (a) the first condition of authorisation granted to ADFF is that ADFF, or any other common agent, is not to be involved in price and supply negotiations between dairy farmers and

dairy processing companies. By contrast, Dairy WA has specifically indicated that it proposes to break the direct relationship that currently exists between processors and dairy farmers, with all milk supply contracts in Western Australia to be entered into between Dairy WA (through the Milk Negotiating Agency) and the processor;

- (b) the fifth condition upon which authorisation was granted to ADFP was that farmers retain their right to negotiate and enter into individual contracts with dairy processors. This is not the case under Dairy WA's proposed arrangements. By contrast, it is proposed that the contract that dairy farmers enter into with Dairy WA is binding and exclusive, and farmers that are represented by Dairy WA are unable to enter into individual contracts with dairy processors without Dairy WA's consent;
  - (c) no group in the dairy industry currently has the power to collectively boycott. However, through its proposals, Dairy WA is seeking to place itself in a position of total bargaining control as against dairy processors and retailers, and in a position to be able to significantly impact upon the price and supply of milk to consumers, which would allow it to act to the competitive detriment of all those parties; and
  - (d) currently, dairy farmers do not enter into direct contractual relationships with retailers. However Dairy WA proposes to be able to collectively negotiate with supermarkets on behalf of the dairy farmers it represents, and proposes to be able to prevent any or all of these dairy farmers from entering into or negotiating any contracts with retailers if Dairy WA has not consented to the dairy farmer(s) negotiating or entering into such contracts.
- (5) Many of the effects of the conduct that would be permitted during the term of any interim authorisation would be difficult to undo in the event that the ACCC did not ultimately grant Dairy WA final authorisation. National Foods asserts that for such conduct to be permitted during the period of interim authorisation, and then disallowed in the event that the ACCC does not ultimately grant authorisation, would be highly destabilising and disruptive to the market.
- (6) Further, National Foods considers that the proposed arrangements have the potential to reduce the volume of milk supplied by processors to retailers in Western Australia during the term of any interim authorisation, in the event that processors are forced to close their Western Australian businesses or limit the volume of milk they purchase from Dairy WA in response to prohibitively high milk prices. In addition, the arrangements may lead to increases in the price of milk supplied by processors to retailers (and ultimately to consumers), if processors are forced to pass on milk price

increases, either because of higher prices charged to them by Dairy WA or as a result of increased transport costs associated with bringing in lower cost milk from South Australia.

- (7) Accordingly, National Foods considers that if the ACCC grants interim authorisation to Dairy WA to allow it to engage in such conduct, this would fundamentally alter the competitive dynamics in the Western Australian market for the supply of milk in such a way as to prevent it from being able to later return to its pre-interim state.

#### 4.3 Insufficient detail of proposed arrangements

- (1) Dairy WA has not provided sufficient detail as to the operation of the proposed arrangements in order to allow National Foods, or any other interested party, to fully assess the likely competitive effect of the proposed arrangements.
- (2) The following is a list of some of the issues that National Foods has identified that require clarification before the impact of the proposed arrangements can be fully analysed:
  - (a) the way in which Dairy WA proposes to establish the Milk Negotiating Agency, and how it is proposed that the Milk Negotiating Agency will be constituted. For example, the lack of detail as to the identity of the Milk Negotiating Agency and the way in which it is proposed that it is set up raises potential concerns as to the creditworthiness of that entity;
  - (b) the respective parties' rights in relation to risk and title to milk;
  - (c) which party will assume responsibility for milk collection and freight;
  - (d) the nature and proposed duration of the contracts that Dairy WA will enter into with farmers whom Dairy WA will represent, and farmers' exit rights from this arrangement;
  - (e) the criteria upon which Dairy WA will base its decisions to consent to proposed contracts between dairy farmers and processors, or changes to terms, conditions or prices. It appears that Dairy WA is seeking total discretion to withhold consent in respect of a contract that a dairy farmer that it represents is able to enter into with a processor or retailer, even if the dairy farmer him/herself wishes to enter into it. Similarly, Dairy WA appears to be able to withhold its consent to changes in contract terms or conditions between a processor and a dairy farmer whom Dairy WA represents, even if both the processor and the dairy farmer consent to the changes; and

- (f) Dairy WA's rationale for seeking to enforce boycotts against retailers, given the lack of a direct contractual relationship between dairy farmers and supermarkets currently.
- (3) National Foods considers that the lack of detail provided by Dairy WA leads to confusion about the scope of the conduct for which Dairy WA is seeking authorisation. National Foods submits that it would be undesirable for an interim authorisation to be granted unless the conduct to be permitted is more clearly defined.

#### 4.4 **Due consideration: test in section 91(2) TPA**

- (1) There is nothing in Dairy WA's application that suggests that granting interim authorisation would assist the ACCC in giving due consideration to the substantive authorisation application.
- (2) Granting interim authorisation may in fact have the effect of changing the characteristics of and dynamics in the market, and therefore complicating the ACCC's assessment of the likely competitive impacts of the proposed conduct for which substantive authorisation is sought.

4.5 Accordingly, National Foods does not consider there to be any valid grounds upon which the ACCC should grant Dairy WA's request for interim authorisation in respect of either its proposed collective boycott or collective negotiation activity.

We would be happy to elaborate upon any issue in this submission that you would like to discuss. Please feel free to contact Anita George or me if you would like to do so.

Yours faithfully

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