

# PB Foods Limited

## Submission to the Australian Competition and Consumer Commission in response to requests for authorisation A90961 and A90962 by Dairy WA

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### 1 Introduction, purpose and structure of submission

#### 1.1 Background

##### *Introduction*

PB Foods Limited (“**Peters & Brownes**”) refers to the recent letter from the Australian Competition & Consumer Commission (“**Commission**”) requesting submissions and welcomes this opportunity to make a submission in response to requests for authorisation A90961 and A90962 by Dairy WA.

Peters & Brownes is a subsidiary of the New Zealand based farmer co-operative, Fonterra Co-Operative Group Limited (“**Fonterra**”), which is owned by more than 12,000 dairy farmers. [This submission is made by Peters & Brownes in relation to the position only in Western Australia.]

Peters & Brownes is also the largest Western Australian based dairy company, employing over 600 people in Western Australia and exporting milk and dairy products to other Australian States as well as overseas. Peters & Brownes contracts with and supports over 143 Western Australian milk producers who employ over 300 families on farms.

Peters & Brownes has a corporate philosophy of working closely with its dairy farmers, not just because of its dairy farmer co-operative background, but because Peters & Brownes’ business philosophy is to forge strong business relations with our key stakeholders. Dairy farmers are key to Peters & Brownes business. As such, Peters & Brownes believes that it is well placed to give a balanced view on Dairy WA’s authorisation application and the Western Australian dairy industry.

Peters & Brownes was not given an opportunity by Dairy WA to discuss the contents of Dairy WA’s submission, or the details of how it expects its proposals to operate in the dairy industry in Western Australia. Without the benefit of such a meeting or explanation, this submission by Peters & Brownes is based purely on Dairy WA’s submission as it has been presented to the Commission.

Peters & Brownes has given its dairy farmer Negotiation Committee Chairman an opportunity to comment on this submission, particularly in relation to the Peters & Brownes farmers, and he is satisfied that the content in this regard is accurate. We have also provided a copy of this submission in full to the Peters & Brownes Negotiating Committee. We have done our best to be completely accurate in this submission. However, should this submission contain any factual inaccuracies as to the Dairy WA proposal, we and not our farmers on the Negotiation Committee, take full responsibility for any inadvertent oversight.

***The dairy industry nationally - the applications must be considered in context and as against a balanced factual background***

Peters & Brownes acknowledges that there has been considerable discussion in the media concerning the “crisis facing the dairy industry”. There is no doubt that competition in the Australian dairy industry is robust for both suppliers and processors. However, the Economics and Industry Standing Committee’s report, *The Sustainability of the Dairy Industry in Western Australia*, noted at page xv that:

*“... None of these issues are unique to Western Australia. Difficult economic conditions and low morale can be found in the dairy industry of every Australian state”*

In this commercial environment, processors also face tough competitive constraints. Processors are also under financial pressure, due to returns from international markets being reduced by the strength of the Australian dollar, and more importantly due to the aggressive discounting of milk and dairy products in Western Australia and the very strong positions held by our major customers.

Having said that, our grocery customers have been very fair and contrary to some suggestions made by others, they have also been supportive of the positions of dairy farmers as small businesses. This is a tough business environment that we all have to operate in. The submission made by Dairy WA should therefore not be considered in isolation or, we respectfully submit, be approached as if other elements of the industry have not been co-operative and respectful of small businesses, as the Dairy WA submission appears to suggest. Indeed, this submission aims to be balanced, noting key facts such as the dairy adjustment payments continuing to be made via processors and therefore consumers to farmers, or the income received by farmers when they make an economic decision to sell cattle.

In these circumstances, we would request the Commission to consider the authorisation application in context. If the Commission was to focus upon the provision of raw milk alone by dairy farmers, such a consideration would not take into account the dairy industry’s structure on a State and national basis and the result it would have for other important stakeholders and customers in Western Australia or other States of Australia.

A review of Western Australia’s dairy industry in isolation would ignore the fact that products are transported from the East Coast to Western Australia and that if the industry is not viable in Western Australia, increased product will simply be imported into our State. As such, it is paramount that the Western Australian dairy industry remains efficient and competitive.

***Given the industry structure, the Dairy WA single desk proposal is structurally flawed***

As the Commission is aware, Fonterra has made a takeover offer in respect of National Foods Limited (“**National Foods**”). On 19 January 2005, the Commission announced that it would not oppose Fonterra’s proposed acquisition, subject to Fonterra providing undertakings relating to the divestiture of certain assets in Western Australia. On 11 April 2005, Fonterra announced that it would not increase its takeover offer above that of the competing takeover offer from the Philippines based beverage giant, San Miguel Corporation.

Peters & Brownes believes that the authorisation application needs to be considered carefully so that it does not create a single desk to sell a staple food item. The application is contrary to the Commission's preference to enhance, rather than restrict, competition in the supply of every day food items. The proposal is also inconsistent with the Commission's analysis and focus on retaining alternative suppliers and purchasers in the Commission's analysis of Fonterra's proposed takeover of National Foods. Indeed Fonterra acknowledged the benefits of ensuring competition for both dairy farmers and consumers in agreeing to the divestiture undertakings with the Commission as part of the takeover. Accordingly, we have a track record of fostering competitive markets in Australia.

Finally, Peters & Brownes believes that the nature of the dairy industry in Western Australia demands innovation and competitive pricing from dairy processors. If the Dairy WA proposal inhibits innovation and competitive prices, our customers will demand change such that Peters & Brownes may need to find alternative sources of milk supply and substitute the use of milk to other ingredients in manufacturing dairy products, or change production centres. Accordingly, there is a real risk that the Dairy WA proposal will create an inefficient structure that will lead to dairy farmers being worse off.

### *Milk as a raw material*

Milk is comprised of two major components, milk fat and milk solids non fat, which is predominantly protein and lactose. Many dairy products such as ice cream, desserts, yoghurt etc can be made from fresh milk and cream or alternatively wholly or in part from butter, butterfat plus milk and whey powder. In addition, non dairy ingredients such as vegetable fat and soy based proteins can be used as substitutes. These ingredients are storage stable and can be sourced from all over the world. Therefore raw milk from Western Australian farmers must remain competitive otherwise substitute raw materials may become a viable and a financially preferable alternative.

## **1.2 Peters & Brownes concerns with the Dairy WA proposal and suggestions of an alternative**

Peters & Brownes believes that Dairy Farmers should be given the opportunity to supply to alternative processors, but processors and dairy companies should equally have the opportunity to work with and nurture key supplier relationships with dairy farmers in arrangements that are mutually beneficial. If Peters & Brownes could afford to pay dairy farmers more we would. We embrace an open relationship with our dairy farmers and through our negotiating and bargaining groups, we believe that we can forge long term and beneficial business relationships. The extent of openness and transparency with our dairy farmers is demonstrated in the attachments to this submission which are commercially confidential, as they provide detailed financial and planning material on our operations.

Accordingly, Peters & Brownes does not see a need for the authorisations sought by Dairy WA and we will explain our reasons in this submission. We believe we have been prepared to negotiate fairly, reasonably and openly with our dairy farmers. Peters & Brownes believes that great care should be taken with the applications for authorisation in that they pose a significant competition concern and will stultify industry development and the development of efficient Western Australian dairy farms.

We also believe that the interim authorisation requested by Dairy WA should not be granted so that time can be given to consider these important issues appropriately. In any event, there is no need for such an authorisation in relation to Peters & Brownes.

The Chairman of the Peters & Brownes Negotiating Committee, Mr Victor Rodwell, has stated for the public record that:

*“I am pleased to report that right from our first meeting the Peters & Brownes executive have worked openly and co-operatively with the negotiating committee, sharing confidential information about their operations to an extent that we had not expected.*

*I have found PB Foods to be honest, up-front and prepared to discuss confidential matters with the negotiating committee in an effort to improve our returns. The approach has been totally different to what we expected and different to the individual farmer negotiations. We really do have a common goal and we really do wish to see farm gate prices improve.”*

In the circumstances, Peters & Brownes believes that in order for dairy farmers not to be disadvantaged and so that their underlying collective bargaining objectives can be retained, in principle the current collective bargaining authorisation A90782 should be extended for a period of time until the Commission can undertake a thorough review and make a determination in relation to the applications for authorisation.<sup>1</sup>

This achieves the objectives of dairy farmers in negotiating with the processors, but does not bring into play the more controversial single desk arrangement that is proposed by Dairy WA. Moreover, such an approach is consistent with the manner in which the issues were previously handled by the Tribunal, and achieves a reasonable balance in the immediate term.

### **1.3 Purpose of submission**

In these circumstances, the purpose of this submission is therefore to:

- provide the Commission with a more balanced factual background information in relation to the dairy industry in Western Australia from the perspective of that State’s largest milk processor;
- note Peters & Brownes’ views on applications for authorisation A90961 and A90962 by Dairy WA; and
- given Peters & Brownes’ views of the success of the current authorisation A90782 and due to the far reaching potentially negative and retrograde implications of the grant of an interim authorisation, suggest that the Commission consider extending authorisation number A90782 until the Commission makes a final determination in relation to the applications by Dairy WA.

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<sup>1</sup> We note that, coincidentally, on 8 April 2005 Australian Dairy Farmers Limited lodged an application to extend authorisation number A90782

#### **1.4 Structure of submission**

This submission is structured as follows:

- Section Two** - **Executive summary**
- Section Three** - **Background on Peters & Brownes**
- Section Four** - **The dairy industry in Western Australia**
- Section Five** - **The requests for authorisation by Dairy WA - a structural analysis**
- Section Six** - **Analysis of the reasons given for the requests for authorisation**
- Section Seven** - **Success of the current collective bargaining authorisation in relation to Peters & Brownes - a positive example**
- Section Eight** - **Analysis of claimed public benefits and detriments**
- Section Nine** - **Conclusion**
- Appendix A** - **[Confidential]**
- Appendix B** - **[Confidential]**

#### **1.5 Further information**

Peters & Brownes would be willing to provide the Commission with additional information on the dairy industry in Western Australia if that would be helpful for the Commission's analysis of the applications for authorisation by Dairy WA.

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## **2 Executive summary**

### **2.1 Introduction**

Peters & Brownes believes that the applications for authorisation by Dairy WA raise significant competition and structural issues for the dairy industry in Western Australia and require careful consideration as to the claimed public benefits given the substantial likely detriments.

Peters & Brownes believes that the public benefits claimed by Dairy WA are at best questionable and that in all likelihood the public detriments far outweigh any public benefits. This is especially the case in relation to the interim authorisation proposal.

*Nonetheless, Peters & Brownes supports the current collective bargaining arrangements (A90782) with dairy farmers and has no objection to them. It would support an interim authorisation to extend the current authorisation to allow it to continue for sufficient time to allow negotiation and to allow the Commission to make a thorough review and determination in this complex area.*

We now discuss our concerns in more detail.

### **2.2 Peters & Brownes appreciates the issues facing the dairy industry in WA and is working with dairy farmers**

Peters & Brownes empathises with individual farmers in relation to obtaining a fair price for their product and labour and has no objection to dealing with farmers on a fair and reasonable basis, but does not believe that the proposed authorisations are the correct mechanisms to achieve this aim. Indeed, the origins of Peters & Brownes' parent company, Fonterra, which is a New Zealand dairy farmers co-operative, ensures that it is cognisant of the issues facing farmers.

Peters & Brownes currently has a strong and successful working relationship with the Peters & Brownes Collective Bargaining Group Negotiating Committee, which was established in 2002 after the Commission provided authorisation for collective bargaining to operate in the Australian dairy industry. The company is very supportive of this approach to negotiation with its farmer suppliers. However, it is also conscious to ensure that a competitive environment is retained given the benefits of a competitive process to both commercial enterprises and consumers. The Peters & Brownes Negotiating Committee is influential in the company's milk supply arrangements. Dairy WA's proposal at best puts this at risk, and at worst destroys it.

Peters & Brownes support the points made by Dairy WA that farmers work hard and in most cases deserve more money for their milk to commensurately reward them for their efforts. Peters & Brownes works hard to pay its farmers as much as it can for their milk, based on the return from the market place in which the company operates. However there are some very real market constraints.

*There are real pressures upon milk processors in Western Australia. The creation of a single desk milk supplier would have serious consequences. The lack of any supply alternatives will have the capacity to stultify competition, as well as stultify improvement in efficient dairy farming and milk production /farming processes. This is a substantial likely public detriment.*

### **2.3 Dairy WA's applications create significant competition concerns**

Peters & Brownes understands that in their effort to improve farm gate milk prices, the WA Farmers dairy section and the Dairy Industry Working Group have been holding meetings with WA dairy farmers to present their case of establishing a dairy farmer controlled milk supplier.

The creation of what is in effect a "single desk" for milk supply will create substantial distortions in the marketplace and will raise significant competition issues in Western Australia, with associated inefficiencies and public detriment.<sup>2</sup> It will also be a significant retrograde step in national competition policy and dairy industry deregulation.

Peters & Brownes is concerned that the authorisation of the proposals by Dairy WA will have a serious impact on the viability of milk processing and importantly the milk manufacturing industry in Western Australia, with significant adverse consequences for consumers.

In its consideration of the Fonterra's previous proposal that to acquire National Foods, the Commission was most concerned to ensure there was an additional milk processor in Western Australia and that milk suppliers had choices. The same competition issue, in terms of having choices, applies equally to the supply of milk to processors.

For further information, see Confidential Appendix A.

### **2.4 A more balanced approach and consideration of the issues facing the Western Australian dairy industry is required**

The Dairy WA submission contains various claims regarding the anticipated benefits of the proposal. Peters & Brownes has concerns with many of those claims and believes that they should be subject to thorough review. In particular, key claims in Dairy WA's submission lack factual foundation. Peters & Brownes believes that:

- when the effects of milk composition are taken into consideration, Western Australian dairy farmers are in fact paid a comparable price for their milk compared with other States in Australia. Peters & Brownes acknowledge that this price may not be enough for some farmers, however this is a competitive price in the market in which this milk is sold. In Western Australia, retail prices for dairy products are 16% to 22% cheaper than in the other States. Most of the milk produced in Western Australia goes into products consumed in Western Australia. If this reduced price were 'passed down', then farmers should in fact receive 16% to 22% less for their milk than in

<sup>2</sup> These issues would seem to be precisely the concerns raised by the ACCC on page 21 of its discussion paper of July 2004 on collective bargaining and in relation to the ADFP collective bargaining application, Authorisation No A90782.

the other States, therefore between 22 and 25 cents/litre. Furthermore, milk suppliers in fact receive more than this amount owing to the 11 cents/litre Dairy Structural Adjustment Programme (“DSAP”) levy on processors, which then gives an overall price to Peters & Brownes farmers, for example, of 33 to 34 cents/litre - the inequity that Dairy WA assert is in fact questionable at best; and

- the problems facing Western Australian farmers are not unique to Western Australia. Not only are all Australian farmers facing similar issues, but so are many other businesses. The variation in costs of production on farm is in the main a legacy of a regulated environment. In other areas of business, including primary production, a large variation in costs of production as reported in Dairy WA’s submission would precipitate a massive and rapid rationalisation, with only the strongest surviving. The Dairy WA proposal will be likely to promote inefficiencies and a public detriment, not a benefit.

## **2.5 The Dairy WA proposal does not in fact benefit farmers**

The Dairy WA proposal does not demonstrate that it will make the total “revenue cake” for farmers any bigger at all. Instead, it wishes to be able to dictate how the cake will be distributed and to whom. It actually takes away the options of individual farmer small businesses and “locks them in” to Dairy WA.

There is potential that if the authorisations are granted, processors will not wish to enter into individual contracts because of inefficiencies and will instead simply move to a 'dial a tanker' of milk system with the so called single desk. Processors will then only take that milk which they can profitably convert and will either mothball or exit some areas of Western Australian production without the need to consider the impact on individual farmers. Depending upon Challenge Co-operative’s ability to profitably process additional milk, the Dairy WA proposal could result in up to 60-100M litres of milk ending up with no obvious 'home'. Peters & Brownes does not believe that Dairy WA’s proposal to transport any excess milk to the Eastern States is viable given its commercial experience.

Accordingly, farmers are likely to see a detriment, not a benefit from the proposal.

Dairy industry rationalisation is important to ensure that Australian dairy farmers are able to compete not only in Australia on fair returns for their efforts, but also on an international basis. Dairy markets are increasingly global. In order to compete, Australian farmers need to be at world’s best practices. The appropriate process is therefore to ensure an appropriate transition to best practice. Peters & Brownes’ Negotiating Committee is seeking to ensure a fair and transparent transition and Peters & Brownes is willing to work with all Western Australian dairy farmers. In this situation not only will the Dairy WA proposal lead to inefficiencies, but there is actually no need for the Dairy WA authorisation proposal.



## 2.6 Conclusion and way forward

Peters & Brownes believes that the issues raised by Dairy WA warrant consideration. However, the consideration needs to be based on a more balanced fact base and based on a wider and more detailed assessment

It is with regret that Peters & Brownes cannot support Dairy WA's applications for authorisation. The arrangement is very problematic from a competition perspective as it creates a single desk to sell a key food product. It is inconsistent with National Competition Policy and with the Commission's analysis of retaining alternative suppliers and purchasers in a competitive process to promote competition and the optimal outcome for consumers.

In the current environment, Peters & Brownes contends that the Commission should instead extend the terms of the current collective bargaining arrangements (authorisation A90782) for a period of time, during which Peters & Brownes will continue to work constructively with farmers to maximise their returns for their milk supply.

Peters & Brownes, together with Fonterra as a farmer based co-operative, are very supportive of dairy farmers and while wishing to pay more for milk supply, do not believe that is possible in the retail environment they are currently facing. However, Peters & Brownes has no objections to, and would support, an interim authorisation to renew the current authorisation A90782 either for a finite duration, or at least until a final determination is made in relation to Dairy WA's proposal.

It is unclear that the benefits claimed by Dairy WA will eventuate. Peters & Brownes believe that it is better to take time to more closely assess the position and to work constructively together than taking any pre-emptive retrograde steps. If such a process was to be facilitated by the Commission, this would be a better result for the industry and consumers.

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## **3 Peters & Brownes**

### **3.1 Introduction**

In order to make an assessment of Peters & Brownes' position and reasoning why Dairy WA's authorisation application is not necessary, it is helpful to understand Peters & Brownes' position in Western Australia. This Section of the submission provides background on Peters & Brownes.

### **3.2 Peters & Browns - the company**

Peters & Brownes is the leading West Australian dairy company. It trades as Peters & Brownes in Western Australia, but as PB Foods Limited nationally and internationally. It is a global ice cream and dairy company based in Perth, Western Australia, producing leading consumer brands for Australia and overseas markets.

Peters & Brownes is a wholly owned subsidiary of the Fonterra Group in New Zealand. In 2002, Fonterra obtained control of PB Foods Limited and merged it, along with Mainland Products Ltd, Tip Top Ltd and Bonland, into Fonterra's global consumer products division, New Zealand Milk. In 2003 it became part of a new entity called New Zealand Milk Australasia, a subsidiary of New Zealand Milk. New Zealand Milk is Fonterra's consumer dairy products business. Fonterra is a farmer co-operative and is the sixth largest dairy company in the world, with a turnover of \$13 billion.

The Peters & Brownes Group has been processing Western Australia's milk since 1886. It purchases approximately 200 ML a year, equal to approximately half of the State's total production.

Peters & Brownes has ice-cream manufacturing facilities in Perth. In 1998, it opened a new liquid dairy processing plant in Balcatta, Western Australia, to manufacture fresh milk, flavoured milk and juice products.

Peters & Brownes also operates another dairy processing operation in Brunswick, in the south-west of Western Australia. That facility produces cheeses, dairy desserts and yoghurt.

Peters & Brownes is the largest processor in the Western Australian dairy industry and Australia's largest exporter of ice cream. Outside Western Australia, Peters & Brownes uses a network of distributors and food brokers to deliver a range of its products to other States. The company has an important influence on the way business is conducted at all levels in the State's dairy supply chain, but is itself subject to constraints imposed by a commercial market for all of the products it sells.

### **3.3 Peters & Brownes products**

Peters & Brownes operates in four key dairy categories:

- (a) beverages (milk, cream and flavoured milk);
- (b) ice cream (take home and impulse);
- (c) dairy foods (yoghurt and dairy desserts); and
- (d) cheese.

Peters & Brownes' portfolio of "fast moving consumer goods" creates an integrated operation "*from paddock to plate*".

In addition to the standard market milk types sold in Western Australia, Peters & Brownes also produces a calcium enriched variety and a heart plus variety that contains added nutrients such as omega 3, vitamins B6 and folate. Peters & Brownes also manufacture a range of flavoured milks under the brand names Brownes Chill and Brownes SupaShake.

Peters & Brownes' products include:

- (a) Brownes (fresh milk);
- (b) Chill and SupaShake (flavoured milk);
- (c) Brownes and Connoisseur (yoghurt);
- (d) Brownes "Tasty Cheddar", "Mild Cheddar", "Vintage Cheddar" and "Light'n Tasty Cheddar" (cheese);
- (e) Brownes (desserts and creams);
- (f) YoGo (produced on an un-related basis by National Foods on the East Coast of Australia);
- (g) Cadbury (ice-cream, supashake, take home ice-cream);
- (h) Connoisseur and Peters (ice-cream);
- (i) Fruccio (non-dairy confection); and
- (j) Brownes (juice).

### **3.4 Exporting Western Australia's dairy products**

Peters & Brownes was the first Australian ice cream company to enter Japan in April 1990. Since then it has secured long term strategic alliances with dairy processing companies Fujiya, Meiji and Lady Borden which have strengthened over the past ten years.

Peters & Brownes also exports fresh milk in both bulk and cartons to Singapore and bulk milk to Malaysia. Peters & Brownes has a long and successful record in exporting dairy products to Asia. The company pioneered the export of fresh milk to Singapore by air freight in 1983, and it remains today the leading imported fresh milk. Peters & Brownes also pioneered the export of liquid bulk industrial milk (in 1000 litre Maxicon and 20,000 litre tankers). Today, Peters & Brownes' exports to Singapore and Malaysia include milk, yoghurt, cream and fresh dairy products, as well as the Meadow Gold and Cadbury Ice Cream brands. Peters & Brownes has a long and successful record of exporting ice cream and dairy products to the Asian region, including markets such as Japan, Korea, Taiwan, Hong Kong, Singapore and Malaysia.

### **3.5 Economic and social contribution**

Peters & Brownes strongly supports the West Australian economy.

Peters & Brownes directly employs over 600 people in Western Australia and creates direct income for more than 330 families working on the farms which supply its milk.

Over \$150 million worth of ancillary services are required to service the Peters & Brownes business each year. This entire amount is spent directly in the Western Australian economy.

Each year the company sells \$45 million of dairy products overseas and over \$60 million of product to the Eastern States. However, Western Australia remains a primary focus for the company's activities, where it sells over \$225 million worth of dairy and ice cream products.

### **3.6 Regional investment**

Peters & Brownes has invested significant amounts of capital in Western Australia in the past ten years to become one of the leading exponents of value-added dairy products in the Asia Pacific region.

At its Balcatta site, the company has spent over \$80 million in developing leading edge beverage and ice cream plants. Peters & Brownes is one of the few ice cream manufacturers with the facilities to make super premium ice cream of consistent quality for the Japanese market. Research into Extended Shelf Life and Eurotainers has allowed the cost effective shipping of fresh milk to Asia, which has created sustainable competitive advantages.

Peters & Brownes has also invested in its regional plant at Brunswick, which specialises in cultured foods. Over \$10 million has been invested in a cheese plant, which resulted in an improved quality of cheddar cheese. At the Wisconsin Cheese competition in 2002, Brunswick cheese was awarded the fifth best cheddar in the world. This recognition, together with the lack of 'oceanic flavour' has enabled Peters & Brownes to penetrate the extremely difficult cheese market in Japan.

### **3.7 The relationship between Peters & Brownes and its farmer suppliers**

It is not only Peters & Brownes' relationship with its customers in Australia and overseas that is important. The relationship with suppliers continues to grow. Peters & Brownes continues to work closely with farmers to improve their businesses and to ensure that it provides them with a pricing structure that serves their business purposes.

Peters & Brownes has a strong commitment to the sustainability of the Western Australian dairy industry. It believes that this commitment is proved through its strong growth in milk supply requirement coupled with market growth within Western Australia, Australia and overseas. It is also proven through the solid relationship with its suppliers and its values of honesty, integrity and professionalism when dealing with all members of the supply chain.

In December 2002, the Western Australian dairy farmers formed a Collective Bargaining Group, in an attempt to explore opportunities that could foster improved returns to farmers. Peters & Brownes' suppliers formed a Negotiating Committee to facilitate dialogue between processors and suppliers. Peters & Brownes has actively consulted with the Negotiating Committee at regular meetings and has shared highly sensitive commercial information such as costings and profitability.

The relationship with the Negotiating Committee has created the understanding amongst farmers that Peters & Brownes is a responsible processor with a long term commitment to the success of the Western Australian dairy industry. This relationship has also provided Peters & Brownes with a clear method and process of direct access and consideration of farmers views and wishes.

The work of a dedicated and highly experienced Farmer Support Team to Peters & Brownes' suppliers is a strong competitive advantage for the company. This Team offers a comprehensive range of financial advice, communication and business management support through farmer extension training. The company is proud that this resource is among the best in Australia and actively champions the cause of the suppliers within the organisation. The professional team have built a strong reputation that now extends to dealings with Peters & Brownes' retail customers in an effort to highlight the issues faced within the dairy industry.

### **3.8 Relationship with the retail sector**

Peters & Brownes has developed a series of close working relationships with the retail sector that transcend its different operating channels. In many cases, business development plans are implemented that offer advice on trade marketing, promotions and category planning to the retail sector. Additionally, the company operates a dedicated field force throughout Australia that works with the retail sector to ensure sales of Peters & Brownes' products are maximised.

### **3.9 Conclusion - Peters & Brownes' commitment to the Western Australian dairy industry**

The result of its innovations and commitment to its products and markets is that Peters & Brownes enjoys a healthy demand for all of its product range.

Peters & Brownes' leading market brands of Peters and Connoisseur Ice Cream and Brownes Dairy continue to drive dairy growth in their respective categories despite being established market leaders. Western Australia is the only State in Australia where regional brands still outsell national competitors in both dairy and ice cream.

Peters & Brownes is committed to the dairy industry in Western Australia. Peters & Brownes has a turnover of over \$400m per year, employs 600 direct employees and supports 143 milk producers, who employ over 330 families on-farm.

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## **4 The dairy industry in Western Australia**

### **4.1 Introduction**

This Section of the submission is intended to provide the Commission with additional background on the Western Australian dairy industry.

### **4.2 Milk industry deregulation in Western Australia**

The Australian dairy industry was deregulated in July 2000 in conjunction with the abolition of the Federal Government's manufacturing milk price support. By July 2000, all States had repealed legislation governing the sourcing and pricing of drinking milk.

Australian dairy farmers now compete in a deregulated environment, where international market forces are the major factor in determining the price received by farmers for their milk. This change has had significant impact on the industry as it comes to terms with the volatility of the free market. For example, during 2003 world commodity prices for products such as cheese were very low.

These impacts of deregulation have varied between Australian States, depending on the relative market share of "drinking milk" which tends to receive a higher farm gate price. In Western Australia, where the relative contribution of drinking milk is much higher than States such as Victoria, the impact of deregulation was greater.

At page 5 of its submission, Dairy WA claims that prior to deregulation:

*"It had not previously been necessary for dairy farmers to individually or collectively negotiate prices with their local dairy processor".*

This statement is incorrect. Prior to deregulation, each farmer had a contract with the Government of Western Australia to supply their market milk, but then they negotiated on an individual basis with a processor with regards to the supply/purchase of their manufacturing milk. Farmers did change the processor to which they supplied their manufacturing milk as a result of the negotiation process.

### **4.3 Snapshot of the dairy industry in Western Australia**

In this Section, Peters & Brownes provides background on the dairy industry in Western Australia:

- (a) number of farmers;
- (b) number of processors;
- (c) trends in volume and prices; and
- (d) level of imports from other States.

### ***Number of farmers***

Currently, Peters & Brownes understand that there are approximately 290 dairy farmers active in Western Australia. The decline in farm numbers since as far back as the 1970s and certainly since deregulation is acknowledged. Evidence provided by Dairy Australia and presented later in this submission at Section 6 would indicate that the rate of decline of farm numbers in Western Australia is not unlike the entire Australian dairy industry and certainly significantly less than in States such as Queensland and New South Wales.

### ***Number of processors***

There are currently four processors in the Western Australian dairy market, being Peters & Brownes, National Foods, Challenge Co-operative and Harvey Fresh. Challenge Co-operative purchases raw milk from farm suppliers and exports or on-sells it to domestic processors in times of higher market demand, as well as producing a range of products for the export market.

Dairy WA's submission suggests at page 21 that it has "anecdotal evidence" that Peters & Brownes is "sourcing supply from Challenge". This is not completely accurate and requires clarification. Peters & Brownes has only sourced additional milk supply from Challenge Co-operative on two occasions. The first was in 2003 when an export customer placed pressure to immediately receive an unscheduled order. The second occasion was in March 2005, when a breakdown in an ultrafiltration plant meant that the company required an additional 170,000 litres of supply at 48 hours' notice. It was not possible to source this volume of additional milk supply from current farmers in the time frame required.

Dairy WA's submission also claims that:

*".... Major processors do not compete with one another for the supply of raw milk at the farmgate...."*

This statement is incorrect. Since deregulation, the market for the supply of raw milk at the farmgate has been competitive. Indeed, since 2000, Peters & Brownes has been very competitive in the market place, attracting 34 new farm businesses to the company. Over the same period, Peters & Brownes has had ten of its suppliers leave the company to supply their milk to other processors. One supplier will commence supplying another processor in May 2005.

### ***Trend in volumes and prices***

Confidential information regarding the trend in volumes and prices appears in Confidential Appendix B.

### ***Level of imports from other States***

Confidential information regarding the level of imports from other States appears in Confidential Appendix B.

#### **4.4 Conclusion**

There are factual inaccuracies in the Dairy WA proposal. The dairy industry in Western Australia cannot be considered in isolation from the broader national and international context. Any proposal to create a single desk at the supply level will greatly affect the industry in Western Australia at all levels. The issues are complex and need careful consideration.



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## 5 The requests for authorisation by Dairy WA - a structural analysis

### 5.1 Analysis of the authorisation requests

#### *Introduction*

Dairy WA is seeking authorisation for five years to permit it to negotiate with processors or retailers on an individual basis with regard to contract prices and terms and conditions relating to the supply of Western Australian raw or packaged milk.

Dairy WA proposes to separately negotiate contracts for the supply of raw milk from Western Australian dairy farmers who have entered into an agency arrangement for the sale of their milk. Dairy WA also wishes to restrict the entry into contracts between dairy farmers and processors or retailers only where Dairy WA has given its consent, and to permit Dairy WA or dairy farmers who have authorised it to act on its behalf, to refuse to supply processors where no current contract is in place.

In Peters & Brownes view, the proposal effectively creates a single desk to sell a key food product<sup>3</sup>. In addition to being contrary to the Commission's preference to enhance, rather than restrict, competition in the supply of a key food item, the proposal is also inconsistent with the Commission's analysis of retaining alternative suppliers and purchasers in the Commission's analysis of Fonterra's previous proposed takeover of National Foods.

Further, the legal structure of Dairy WA's application is most uncertain to say the least, based on varying references to "agency" and also to "collective ownership". It would be very helpful to obtain clarification of whether Dairy WA intends to act as agent or "supplier" of the milk to processors.

#### *Peters & Brownes' position*

In Peters & Brownes' opinion, the sustainable operation of this important Western Australian industry depends on it remaining responsive at all levels to developments in its external environment - and indeed the history of the industry is one of continual adaptation. The dismantling of the quota system in mid-2000 (and the compensation arrangements that accompanied it) has improved the adaptability of the State's dairy industry by opening up the market milk sector to all dairy farmers. Under regulation, a backlog of adjustment had developed. Production economies are now being realised at farm and processor levels and consumers are benefiting.

It follows from these main points that Peters & Brownes strongly opposes any retrograde step in Western Australia to central controls on the dairy industry, such as in the form of a single selling desk. Such a move would involve a reversal of recent improvements in contestability and commercial freedom and would inevitably impact on the economic, social and environmental sustainability of the industry by:

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<sup>3</sup> Milk is an important staple product and is part of the basket of goods used to calculate the CPI.

- (a) severely restricting the future development opportunities of Western Australian dairies in the national and international market;
- (b) impeding farmers who have made investments based on a single pricing policy; and
- (c) requiring significant organisational and financial input.

It is now worthwhile considering the various propositions put by Dairy WA.

## **5.2 Support from farmer suppliers for a single selling desk**

Confidential information regarding the support from farmer suppliers for a single selling desk appears in Confidential Appendix B.

## **5.3 Is the proposal either desirable or sustainable within Western Australia?**

Peters & Brownes strongly believes that Dairy WA's proposal is neither desirable nor sustainable in Western Australia. It would duplicate existing efficient systems that Peters & Brownes has invested in over the past decades. The collection and shipping of milk within the State is already effective and it is highly unlikely that the new entity will achieve significant additional economies of scale. Peters & Brownes contract their milk collection to one company. In the 12 months to March 2005, it maintained a daily utilisation of its tanker capacity of no less than 95%. At some times, utilisation rises to full capacity.

A high proportion of Peters & Brownes' farmers have made significant investment on their farms based on a single milk price for all of their milk. Any change that would jeopardise this single milk pricing arrangement, would place a significant proportion of farmers who supply Peters & Brownes under financial pressure.

A single desk will also create a ceiling on the growth of new opportunities outside of the State that can be developed by companies like Peters & Brownes because it reduces the flexibility in milk utilisation. It is the company's responsibility to configure the value chain and optimise its product portfolio with a balance of domestic and export products, some of which, such as cheese, are currently making a loss at the present international prices. Peters & Brownes' commercial experience provides it with the ideal platform to make the decision on where milk supply should go. It is very difficult to see any industry where it is now considered economically sensible to see a single desk seller within a domestic economy.

Dairy WA's proposal would penalise those farmers who have invested in the past five years to reduce their production costs and were looking to drive their future profitability, by bringing all farmers closer to an "average." It is Peters & Brownes' assertion that these farmers, as small business owners, as well as the financial institutions that funded their investment, which in the main would not embrace Dairy WA's form of "collectivism". These institutions have also funded Peters & Brownes farmers based on a single pricing policy, as it is perceived as a more robust forecast of income. Any change to this form of pricing that would have to be implemented with a single desk could threaten this support.

A claim from those in favour of a single desk is that it would allow all farmers access to the domestic market. However, Peters & Brownes believes that **all farmers** in Western Australia currently have, and will continue to have, access to the domestic market, either directly or indirectly.

Peters & Brownes has approximately 50% of the domestic white milk market in Western Australia, which aligns with the fact that Peters & Brownes purchases approximately 50% of the State's milk supply. The remaining half of the domestic white milk market is split between National Foods and Harvey Fresh. These processors source their milk for this market from their milk suppliers and from Challenge Co-operative, which supplies milk for the domestic market on a dial-a-tanker type arrangement.

#### **5.4 Other elements of Dairy WA's proposal**

Dairy WA's proposal has some quite general and sweeping suggestions as to the potential operation and extent of the operation of the proposed single desk. This includes extension to owning processing assets and selling directly to the retail customers. Peters & Brownes does not believe it is possible to respond to these general statements given the substantial vertical and horizontal competition issues they raise. Dairy farmers and the Commission would realise the practical commercial difficulties and consequences were the proposed single desk to become both a supplier and a competitor. Such a result would only increase the public detriments of the proposal and hasten processors to find alternatives.

#### **5.5 Conclusion**

It is Peters & Brownes' strong belief that Dairy WA's authorisation application will not have the benefits claimed and will be a retrograde structural change for the industry. At a policy level, Peters & Brownes believes the Dairy WA proposal should not be supported. In the next Section, we will consider the individual public benefits claimed to assess the proposal at a more "building block" level. Peters & Brownes believes that analysis also supports our view that the application is based on an erroneous factual foundation and is structurally flawed in the Australian economic environment.

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## 6 Analysis of the reasons given for the requests for authorisation

### 6.1 Introduction

In this Section of its submission, Peters & Brownes raise and review six of the key reasons given by Dairy WA for seeking the authorisations in Western Australia. Six reasons given by Dairy WA for the need for the authorisations include:

- (a) there has been a decline in the volume of milk production;
- (b) the cost of milk production is high;
- (c) the price received by the suppliers is low;
- (d) there is a great deal of farm debt;
- (e) there is a declining number of farmer suppliers; and
- (f) there is a limited negotiating ability between suppliers and processors.

Each of these reasons put forward by Dairy WA is now analysed in detail by Peters & Brownes.

### 6.2 Volume of milk production

Dairy WA claim that there has been a decline in the volume of milk production. In response, Peters & Brownes submit that:

- (a) the fall in milk production is economically insignificant;
- (b) declining milk production is not unique to Western Australia;
- (c) declining state milk production is due mainly to changes in calving patterns, lasting impacts of the 2003 drought, retirement of farmers and declining productivity where specialisation is not occurring and diversification of business opportunities by individual farmers;
- (d) Peters & Brownes has in fact increased milk supply volumes since deregulation; and
- (e) Peters & Brownes dispute Dairy WA's claimed "Swiss Cheese Effect" with respect to its Balcatta operation.

#### *The fall in milk production is economically insignificant*

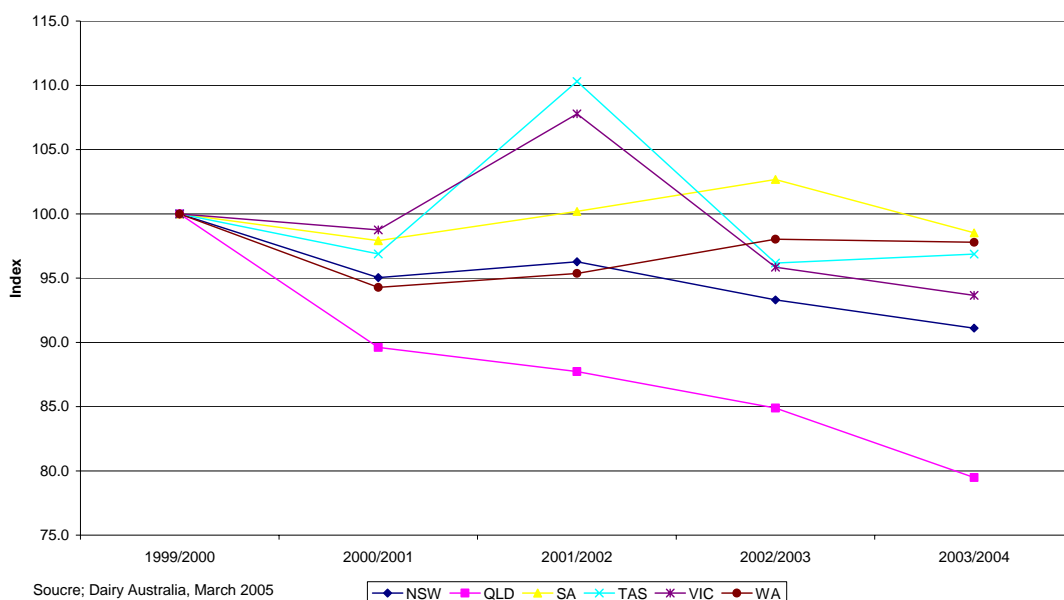
Dairy WA have relied on the very recent decline in the volume of milk production as a reason for the need for the authorisations. It has referred to the export or slaughter of some herds and the exit of farmers from the Western Australian dairy industry.

Peters & Brownes estimates that its total volume of milk production for the financial year 2004/2005 may be approximately 195ML, down from 199ML the previous year, or a 2% fall. A fall of 2% is not substantial and is economically insignificant. Peters & Brownes believes that this decline is not isolated to the Western Australian market, but submit that the decline in milk volumes in the last quarter is mainly due to changes in calving patterns, the lasting impact of the 2003 drought, retirement of farmers, and reductions in productivity and diversification by some farmers none of which is unique to the dairy industry in Western Australia.

***Declining milk production is not unique to Western Australia***

Western Australia is not unique in experiencing declining milk production. This decline is mirrored across most States of Australia, with each experiencing a reduction in milk supply since deregulation. As demonstrated by Figure 1 below, Queensland and New South Wales have had the largest decline in supply, while milk supply in Western Australia has maintained a relatively constant level since the initial fall after deregulation.

**Figure 1 - National milk production indices since deregulation**  
Milk Production Indices



Source: Dairy Australia, 2005

The actual volumes of supply since deregulation are set out in Table 1 below.

**Table 1 - National milk production by volume since deregulation**

Litres 000s		Financial Year				
State Produced	Region	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
NSW	Inland/Central	426,779	414,083	425,071	436,427	408,973
	North Coast	395,268	342,671	322,417	314,407	315,923
	Southern	572,773	568,924	595,414	550,624	545,870
QLD	Central	70,891	61,214	51,510	45,029	42,420
	Northern	130,703	114,666	111,997	106,143	100,190
	South - East	646,803	584,362	580,772	569,021	531,699

Litres 000s		Financial Year				
State Produced	Region	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
SA	SA - All Regions	713,482	698,632	714,881	732,637	702,977
TAS	TAS - All Regions	608,676	589,673	671,384	585,374	589,630
VIC	Eastern	2,035,551	2,025,651	2,191,369	2,007,747	1,888,066
	Northern	2,755,406	2,743,728	3,005,268	2,527,017	2,510,990
	Western	2,078,603	2,014,364	2,208,087	2,049,709	2,035,180
WA	WA - All Regions	411,954	388,400	392,886	403,797	402,860
<b>Grand Total</b>		<b>10,846,889</b>	<b>10,546,368</b>	<b>11,271,057</b>	<b>10,327,932</b>	<b>10,074,778</b>

Source: Dairy Australia, 2005

### *Calving*

Milk supply decline between December 2004 and February 2005 can be explained to some degree by changes in calving patterns. In their effort to reduce production costs, many farmers have changed their calving patterns from a year round basis to a position where they calve large number of cows at two or three times of the year. Those farmers who have chosen not to change their calving patterns will be experiencing higher production costs, which could be impacting on their business viability.

The two main calving periods are September to October and March to April. This means that the farmers adopting this management practice will have significant proportions of their herds (up to 50-60%) not in production during the two months prior to calving. For example, cows calving in September and October will not be in production in July to September, resulting in a lower milk production at that time of the year. Similarly, cows calving in March to April will not be in production in January to March, which is the period for which Dairy WA assert that volumes have been at greatest risk of decline.

Part of the reason for the decline in production between December 2004 and February 2005 can be attributed to a higher proportion of cows not being in production than were in the previous year as these cows were in preparation for calving in March and April 2005.

Milk production increased in October and November 2004 as a result of changes in calving patterns. It is expected that Peters & Brownes' milk supply will increase in April and May 2005 as a result of additional calving cows. Milk supply has increased in the first week of April 2005, and this trend is expected to continue.

### *Drought*

At page 16 of its submission, Dairy WA discounts the impact of the 2002/2003 national drought on milk supply in Western Australia. This does not reflect the views of farmers in 2003. The national drought did significantly increase the price for all feedstuffs nationally and in Western Australia. In particular, grain and hay prices were impacted by 40-60% increases, which had a direct impact on milk supply in 2003.

In many instances, the drought continues to have an impact due to the significant unbudgeted debt that farmers incurred as they purchased feed at higher prices. In many instances farmers in Western Australia are still endeavouring to clear the debt that they incurred as a result of the drought. The direct correlation between the drought and farmers' level of debt cannot be simply overlooked, as it has been in Dairy WA's submission.

***Farmer retirement***

The Dairy WA submission states at page 16 that “a small number of dairy farmers have retired or exited the industry due to ill health”. This statement implies that retirements and exits due to ill health are a minor contributor to the decline in milk supply in Western Australia. However, Peters & Brownes believes that retirement and rural generational issues to be an important factor in the decline of milk supply in Western Australia.

Without knowledge of the reasons for the exit of each farmer from the industry, the experience of Peters & Brownes suggests that Dairy WA's above statement is incorrect. In the past 12 months, Peters & Brownes have had 11 farmers leave dairying. It is believed that all except one farmer left due to age and the need to retire. Table 2 below sets out those farmers as well as what Peters & Brownes understands to be their reason for exiting dairying.

**Table 2 - Farmer details**

	<b>Approximate age</b>	<b>Reason for exiting</b>
1	Mid 50's	Retiring and change to beef
2	Late 70's	Family partnership breakdown and retiring
3	Early 60's	Health reasons
4	60	Retired at 60 as planned
5	Mid 60's	Retired due to age
6	Early 70's	Retirement
7	Mid 60's/son 50	Retirement and small farm
8	Mid 70's	Retirement and small farm
9	Early 60's	Retirement
10	Early 60's	Retirement
11	40's	Have another business and unsure about dairying

*Source: Peters & Brownes*

***Peters & Brownes has increased volumes of milk supply since deregulation***

Confidential information regarding the increased volumes of Peters & Brownes' milk supply since deregulation appears in Confidential Appendix B.

### *The “Swiss Cheese Effect”*

Confidential information regarding the “Swiss Cheese Effect” appears in Confidential Appendix B.

#### **6.3 Cost of milk production**

Dairy WA claims that the cost of milk production is high. Peters & Brownes submits that:

- (a) suppliers in Western Australia face a varying degree of milk production costs such that generalisation is difficult;
- (b) Western Australian suppliers are internationally competitive on a cost of production level;
- (c) some farmers have used the Dairy Structural Adjustment Programme levy to assist efficiency rates;
- (d) Dairy WA will not be able to achieve the transport cost savings it claims; and
- (e) Peters & Brownes shares information on its processing costs.

#### ***High production costs generally***

At page 8 of its submission, Dairy WA claims that the costs of production for many farmers now exceeds the average farmgate price, but then provides information that suggests the costs for Western Australian dairy farmers are between 22 and 31 cents per litre - a huge variation. While it is understood that Dairy WA is wishing to represent all farmers, there is obviously a huge range in costs of production amongst the farmers that they are endeavouring to represent

The lower end of the range of costs suggested by Dairy WA is internationally competitive, however it is doubtful that businesses in a market place could survive with the type of higher cost levels referred to in their submission. If there is such a huge range in the cost structure of Western Australian dairy farmers, then Dairy WA will face great difficulties in representing the interests of all farmers in negotiating prices for supply.

At page 28 of its submission, Dairy WA make a contradictory statement in discussing the public benefit of their proposal. The submission is made that:

*“Western Australian dairy farmers have a lower cost of production than dairy farmers interstate making it feasible for them, subject to transport costs, to supply Eastern State markets”.*

However, page 13 of Dairy WA’s submission claims that transport to South Australia costs 18.6 cents per litre in transport costs. It is difficult to understand how Western Australian milk could be supplied into a very competitive Eastern States market if production costs are generally as high as that claimed by Dairy WA.

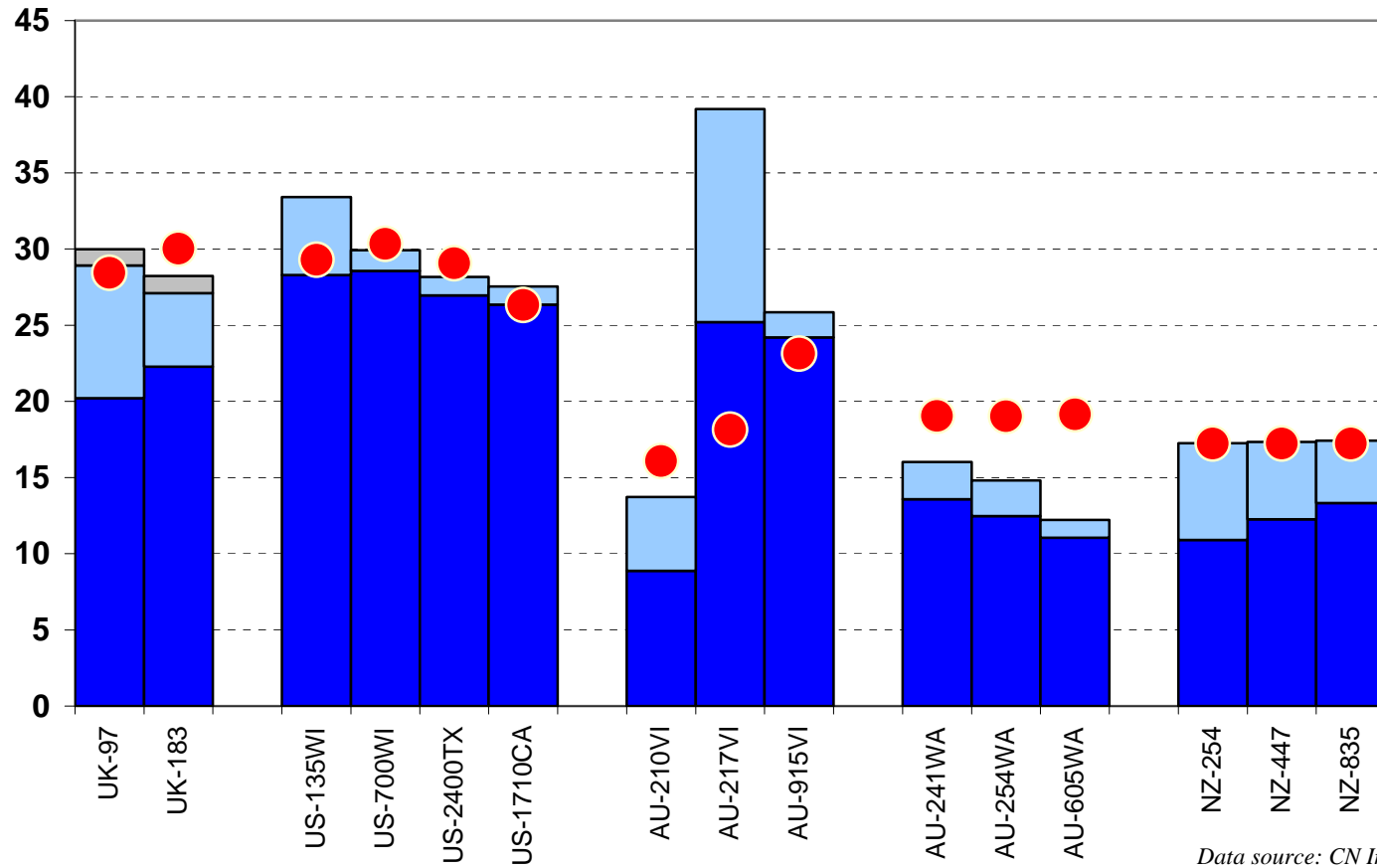


For further information on production costs generally, see Confidential Appendix B.

***International comparison***

The International Farm Comparison Network dairy benchmarking study published in 2004 shows that Western Australia can be as competitive as New Zealand and Victoria in milk production. Figure 2 presents the results of that survey and highlights Australia's ability to compete with the other countries surveyed, and in particular the ability of the Western Australian farmers (AU-241WA, AU-254WA and AU-605WA) to compete with their Victorian (AU-210VI, AU-217VI and AU-915VI) and New Zealand (NZ-254, NZ-447 and NZ-835) counterparts. The three Western Australian farms selected were Peters & Brownes suppliers. One of the farms is amongst the best in the international study, in terms of the cost of production. The selection was coordinated by the Western Australian Department of Agriculture.

Figure 2 - Comparative costs of milk production 2004 (\$US dollars / 100kg)



Data source: CN International survey

■ Costs from P&L account - non-milk returns    
 ■ Opportunity costs (excl. quota)    
 ■ Quota costs (rent and opportunity costs)    
 ● Milk price

### ***Debt levels***

At page 9 of its submission, Dairy WA states that “*debt levels have increased as dairy farmers attempt to become more “efficient”*” through increasing herd sizes and increasing in infrastructure at a time of significantly reduced milk prices.

At the time of deregulation, the Federal Government recognised that the average milk price would decrease in some instances and that in many cases there would be a need for on-farm investment for dairy farmers to become more “efficient” in a deregulated environment.

The Federal Government introduced the Dairy Structural Adjustment Program, which collectively provided \$1.8 billion to Australian farmers. This money was designed to assist farmers with the changes and infrastructure investment to which the submission refers. The amount of money made available to individual businesses varied, however businesses in Western Australia received an average payment of about \$250,000 (\$130 million between 420 farmers).

Many farmers did use the grant money for the intended purpose and invested it in their businesses. However, others chose to engage in alternate activities with their payment, leading the Western Australian Legislative Assembly report into the sustainability of the Western Australian dairy industry to find that:

*“Some farm businesses did not assess their future viability accurately at the time of deregulation. There is a need for businesses to ensure that they are structured appropriately for long term sustainability or to consider leaving the industry”* - page xvi.

Dairy WA’s submissions therefore need to be more accurate insofar as they attribute the cause of higher debt levels solely to deregulation as individual investment decisions of the farmers were also responsible.

### ***Transport costs***

Another factor that Dairy WA claims to be contributing to high costs of production is an “*extremely inefficient*” transport system employed by the processors and for which the farmers are charged. The suggestion is that a saving of 1-2 cents per litre could be achieved with a rationalised transport system.

While it is acknowledged that in some instances, more than one tanker travels down the same road and hence there is room for rationalisation and consolidation of milk collection, Peters & Brownes believes it extremely unlikely that the milk collection cost could be reduced by the 1-2 cents/litre claimed in Dairy WA’s submission.

Following a tender with five national transport companies for the collection of its milk supply in 1999, Peters & Brownes now has its milk collected and transported by one company. The tender process ensured that Peters & Brownes’ milk is collected by a highly competitive and efficient operator. As noted previously, in the 12 months to March 2005, the transport company

maintained a daily utilisation of its tanker capacity of no less than 95%. Utilisation does rise to 100% at certain times. The transport company operates an extremely efficient milk collection operation, which includes having its costs monitored and benchmarked against transport industry standards.

Peters & Brownes' transportation is revenue neutral; it does not profit from milk haulage. Peters & Brownes has disclosed its actual milk collection costs for the 2003/2004 financial year to the Chairman of the Peters & Brownes Negotiating Committee. Peters & Brownes is happy to further discuss its actual milk collection costs with the Commission on a confidential basis. Needless to say, Peters & Brownes does not believe that the cost reduction by Dairy WA is achievable.

For further information on transport costs, see Confidential Appendix B.

### ***Processor costs***

At page 10 of its submission, Dairy WA claims that confidential information on processor costs and retail market returns should be made available to dairy farmers "*in order for them to gauge the health of their industry*".

Peters & Brownes has reported that the average price that it received for a litre of milk had declined by 1.1 cents/litre between 2002 and late 2004. This is based on actual 'scan data', being the price actually paid by the consumer at the supermarket checkout. This disclosure was made in Peters & Brownes' Fact Pack, which it prepared in response to questions asked by its Negotiating Committee and distributed to Peters & Brownes' farmers.

This decline in returns has occurred as a result of increased pressure within the market place, weakening Peters & Brownes' ability to negotiate with customers. It could be argued that the bargaining power that farmers have with Peters & Brownes is not too unlike the position Peters & Brownes has with its customers, particularly at a time of strong market competition.

Peters & Brownes does share information on its costs and returns with members of its Negotiating Committee under confidentiality agreements. It also shares information with the broader supplier base at annual Producer Meetings. At one meeting, Peters & Brownes shared the profile of costs and profits for its entire business, as well as on two product lines, being white and flavoured milk. Examples of these presentations are attached at Confidential Appendix B of this submission.

## **6.4 Prices received by suppliers**

Dairy WA's submission argues that the prices received by suppliers are too low and that its proposal will increase the return to suppliers. Peters & Brownes submits that:

- (a) the submission does not accurately report the price for milk on a composition basis;
- (b) the price of milk is also affected by other factors, such as discounting and imports from Eastern States;

- (c) Peters & Brownes' prices to suppliers do not reflect retail reductions; and
- (d) Peters & Brownes would and will pay more for their milk supply when the retail market place allows for dairy price increases.

***The submission does not accurately report the price for milk on a composition basis***

Care must be taken when drawing conclusions about milk prices both within and between States as differences in milk composition and milk quality payments can account for significant differences. Although it is obviously easier to compare milk prices on a cents per litre basis, suppliers are actually paid in relation to the composition of milk rather than solely by volume. The tables used in Dairy WA's submission make no attempt to compare milk of the same milk composition and quality.

Dairy WA's submission claims that the average farm gate price for raw milk for 2003/2004 for National Foods/Peters & Brownes was 26-27 cents/litre. Peters & Brownes' average farm gate price for milk in 2003/2004 was 28.63 cents/litre for milk with an average milk composition of 3.86% fat (mass/mass) and 3.05% protein (mass/mass). The Peters & Brownes milk price referred to in the Dairy WA submission is therefore not factually correct.

The reporting of average milk prices within Peters & Brownes' supplier base does not clearly demonstrate the actual milk prices received by farmers. Like costs of production, there is a large variation in the actual average milk prices received by farmers. Table 3 demonstrates the very large range in milk average annual milk prices received by Peters & Brownes' suppliers in 2003/2004.

**Table 3 - Milk income benchmarks for financial year 2003/2004**

**Milk Income Benchmarks for 2003/2004**

	Highest 10%	Average	Lowest 10%
Milk Payment c/L	29.91 To 36.13	28.63	22.72 To 26.65

*Source: Peters & Brownes*

The actual range in milk prices received in 2003/2004 was in excess of 10 cents/litre. It is understandable that the 10% of all farmers who received the lower payments will be experiencing business difficulty at this time, particularly should they also have some of the higher costs of production. Experience indicates that many of the farmers who receive the higher milk prices, also have some of the lower costs of production, leading to a profitable business.

The remaining average milk prices referred to in the table on page 6 of the submission, although taken from a Dairy Australia document, are inaccurate as they take no account of the different milk composition between States. According to Dairy Australia's 2004 In Focus, average milk in Victoria contains 5.2% more milk solids than average milk in Western Australia. When the differences in milk composition are taken into account, Peters & Brownes paid nearly 30 cents/litre for a litre of milk with an average Victorian composition in this year, which was significantly higher than the

figure of 26-27 cents/litre claimed in the table on page 6 of Dairy WA's submission.

Table 4 below depicts the pricing if Western Australian milk compositions were to be attributed to the average prices of milk in other States.

**Table 4 - Australian Milk Price Comparisons FY04**

Australian Milk Composition & Milk Prices for 2004

	WA	QLD	NSW	SA	TAS	VIC	Aust
Fat % m/v	3.98	3.81	3.94	3.96	4.32	4.16	4.10
Protein % m/v	3.15	3.21	3.26	3.27	3.36	3.34	3.31
Milksolids % m/v	7.13	7.02	7.20	7.23	7.68	7.50	7.41
% Difference to WA		-1.5%	0.98%	1.40%	7.71%	5.19%	3.93%
Actual Av. Price as reported by DA (c/l)	27.7	33.8	30.9	28.2	27.2	26.7	27.9
Price assuming WA's milk composition(c/l)	27.7	34.3	30.6	27.8	25.1	25.3	26.8

Source ; Dairy Australia In Focus 2004

When compared on a fat and protein corrected basis over the last two years, Western Australia's average price, and Peters & Brownes' prices, have been:

- higher than the prices in the larger production regions of Victoria and Tasmania;
- similar to South Australia and parts of New South Wales; and
- lower than Queensland and other parts of New South Wales.

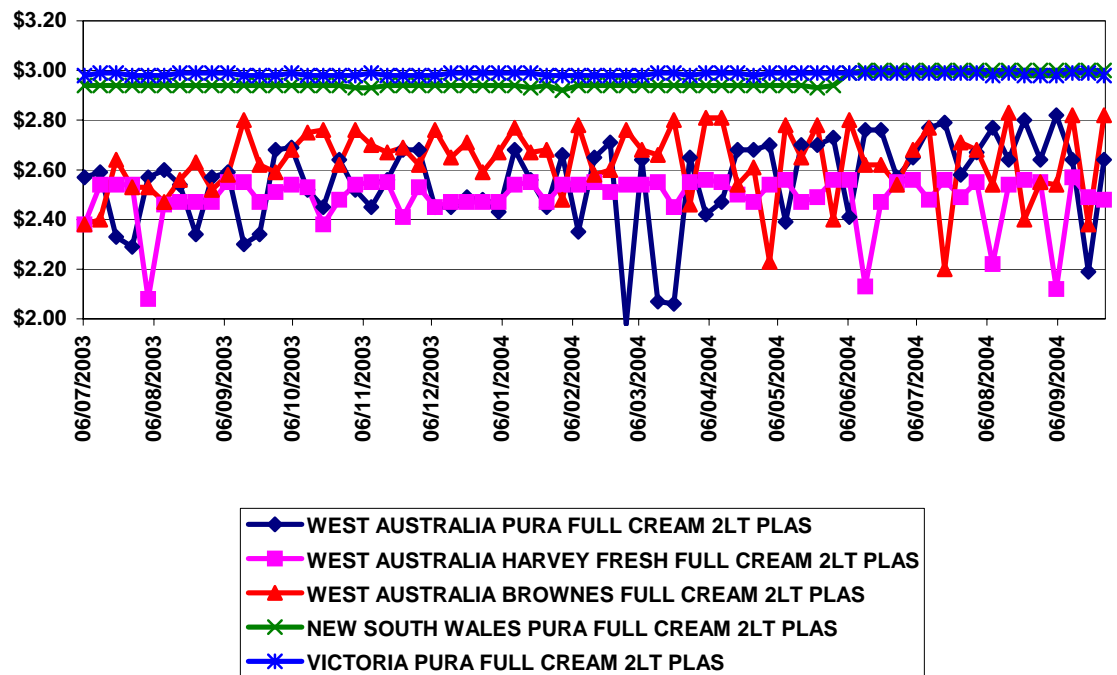
Dairy WA's statements regarding milk pricing are therefore not factually correct and lack factual foundation.

***The price of milk is also affected by other factors***

In Western Australia, the price of white milk is heavily discounted within supermarkets as a means of driving consumer footfall. Figure 3 below details a comparison in the variance of price of two litre full cream milk. While the price of Pura full cream milk in Victoria and New South Wales steadily rose, there were large variations in its price in Western Australia over the same period of time.

Figure 3 - Comparison of variance of 2L full cream milk prices  
2002 - 2004

2-Litre Supermarket Prices - last 65 weeks



Source: Dairy Australia

There is also substantial and more recent evidence to show that the Western Australian market place does operate very differently from the rest of Australia. Table B9 in Confidential Appendix B is sourced from Aztec and clearly demonstrates that dairy products retail in Western Australia for substantially lower prices than they do in other major capital cities.

Peters & Brownes notes that the price received by suppliers is significantly affected by the level of dairy products being manufactured in eastern Australia and sold in Western Australia at discounted prices. While it is pleasing that this important detail is acknowledged in Dairy WA's submission, it makes no reference to the fact that such discounted activity is the major factor contributing to the milk prices paid to farmers for their milk. Further, the submission provides no detail of how this discounted activity could be addressed so that prices to farmers could be improved or changed with the proposed single desk.

Peters & Brownes conduct retail price surveys of dairy products in Sydney, Melbourne and Perth on a regular basis. Its research shows that a basket of dairy products, sold at normal, non discounted list prices in the same supermarket chain at the same time, retail in Sydney and Melbourne for 16-22% less than they do in Perth. This is despite most of these dairy products being manufactured in Victoria and New South Wales and then incurring the significant cost of being transported across Australia. This information is regularly obtained and made available to the Negotiating Committee farmers, the Western Australian Minister for Agriculture and the Shadow Minister.

As a very significant proportion of Peters & Brownes' sales are in the Western Australian marketplace, this disparity in the level of retail prices in Perth is a major factor contributing to the milk prices which farmers receive. Nevertheless, Table B9 clearly highlights that Victoria sells milk, on average for a 20 cent/litre premium over milk in Western Australia. Until the retail prices establish a better parity between States, the price that processors are able to offer suppliers in Western Australia will be affected.

Conversely, if Western Australian consumers paid the same price for their dairy products as the other States, then Peters & Brownes would receive more revenue and would be able to pay its farmers more for their milk. Peters & Brownes has already demonstrated this by putting its price for white milk up and passing on the proportionate increase to its farmers. Market forces determine these matters and the Dairy WA proposal seems to ignore these commercial realities.

***Peters & Brownes' prices to suppliers do not reflect retail reductions***

The second paragraph on page 17 of the Dairy WA submission states, "*There is no or little incentive for processors to improve efficiency when reduction in prices paid by retailers can be passed directly on to dairy farmer suppliers without a reduction in the processors' profit margin*".

Since deregulation in 2000, Peters & Brownes has paid the average farm gate prices for milk as depicted in Table B10 in Confidential Appendix B . Despite the average farm gate price not increasing over the four year period, the price has not declined, as is indicated in the submission.

Peters & Brownes has incurred significant production cost increases (fuel, plastic and labour increases to name a few) as well as declines in some wholesale prices during this four year period.

The company has managed to hold farm gate prices relatively constant by focussing on in-house cost reductions and improvements in production efficiencies. While it is understood that farmers may not fully be aware of how strongly the company has focussed on improving efficiency and cost reduction, it is felt that such a statement as expressed in the submission is grossly incorrect.

The submission states that the "monopsony" position held by processors is preventing farmers from seeking higher prices for raw milk from Eastern States processors. The submissions' own data on Eastern State's milk prices, shown on page 6, although being somewhat limited as it does not take into account the higher average milk composition in States such as Victoria and Tasmania, clearly shows that there have been limited opportunities for Western Australian farmers to obtain higher prices for their raw milk. The farm gate prices are generally within a + 5% of the average farm gate price paid to Peters & Brownes' suppliers. If the bulk milk transport cost claimed in Dairy WA's submission of 18.6 cents/litre for the transportation of milk from South Australia to Western Australia is used, it can be clearly seen that Western Australian farmers are not being denied any opportunity to prosper from selling their raw milk to the Eastern States.



## 6.5 Farm debt

Farm debt is a large issue for the dairy industry in Australia. There is no doubt that this is a tough environment for farmers, with the drought and high grain prices. However there are aspects of Dairy WA's submission which are factually incorrect and Dairy WA's submission does not refer to the Dairy Structural Adjustment Programme levy.

### *Factually incorrect aspects of Dairy WA's submission*

Page 9 of Dairy WA's submission notes the problem of escalating farm debt. Peters & Brownes concurs that the debt being experienced by some farmers and by some service providers is increasing. However, Peters & Brownes notes that:

- the Dairy WA submission fails to note that some of this debt incurred by farmers is planned and budgeted debt which is being adequately serviced. These farmers are not used as examples in the submission;
- other farmers have incurred unplanned debt as a result of the high feed costs in 2003 caused by the national drought and as a result of their business decisions. As noted previously, the drought is not unique to the Western Australian dairy industry such that a State-specific solution is required;
- the submission fails to note that in Western Australia to date there has been little rationalisation of service providers. In other States service providers, particularly dairy supplies providers, have rationalised following deregulation; and
- Peters & Brownes does acknowledge that debt levels are an issue for some farmers, resulting in questionable viability. However, this is not a uniform position for all farmers as implied in Dairy WA's submission.

### *Dairy WA's submission does not refer to the DSAP levy*

Dairy WA's submission does not acknowledge the benefits of the Dairy Structural Adjustment Programme for farmers with debt.

In order to assist farmers in adjusting to the deregulated environment, the Federal Government announced the DSAP in September 1999. The DSAP "involves the imposition of a (retail) Dairy Adjustment Levy of 11 cents per litre on consumers of products marketed as dairy beverages" for a period of 8 years. (ADC, In Focus 2002 p.3).

The dairy adjustment schemes have been good news for Western Australian dairy farmers. Across Australia, the average level of support was expected to be around \$120,000 per producer. In Western Australia, where the quota milk portion of total production was the highest of any State, the average payment per farm was expected to be in excess of \$250,000 over eight years. Some farmers opted to take this payment up front in 2000 to provide them with sizeable funds for investment or debt reduction. Others chose to receive the payment as a quarterly income over the eight year period to supplement their farm gate milk income.

Many Western Australian farmers chose to take their payments as an up-front payment, with the assistance of their banking institutions. In many instances this lump sum payment was used for on-farm capital investment to assist with the restructuring of the farm business. In other instances, the lump sum payment was used to pay existing debt. Some farmers used the payments to make off-farm investments.

Additionally, provision was made for more than \$20 million of State funds to be provided to farmers and other sections of the industry affected by the change. However, this must be balanced against the loss of market milk quota entitlements, which are estimated by some observers to have been worth about \$150 million in the mid-1990s.

The Economics and Industry Standing Committee's report, *The Sustainability of the Dairy Industry in Western Australia*, noted at page xv that debt, and losses from falling retail prices:

*"...have been partly offset by more than \$150 million in adjustment assistance provided by the State and Federal Governments".*

The Report further found at page xvi that:

*"Average DSAP payments to Western Australian dairy farmers are the highest of any state, reflecting the high proportion of milk formerly sold through the regulated market. Western Australia was the only state government to provide complementary assistance to the DSAP".*

The DSAP levy that was introduced in 2000 to pay for the farm payment, is at present a cost to white and flavoured milk processors such as Peters & Brownes. The company must make a monthly payment of 11 cents/litre for every litre of fresh and flavoured milk sold. In theory this money has been collected from the consumer, however the dramatic decline in retail prices for white milk in August 2000 has meant that much of this levy is in fact paid by Peters & Brownes. As such, Peters & Brownes considers it part of the cost of raw materials in the overall costs of obtaining white milk and flavoured milk to market, reducing the operating margin Peters & Brownes receives.

Table 5 below details the payments by Peters & Brownes to Australian Fisheries, Forestry and Agriculture since 2000.

**Table 5 - DSAP levy contribution by Peters & Brownes**

	<b>AFFA Levy</b>	<b>Total Milk Supply</b>	<b>Av. Payment /L</b>
		<i>Litres</i>	<i>Cents/litre</i>
<b>2000/01</b>	\$ 9,514,438	165,361,683	5.75
<b>2000/02</b>	\$ 10,020,912	176,783,113	5.67
<b>2000/03</b>	\$ 10,821,678	189,182,426	5.72
<b>2000/04</b>	\$ 10,546,681	198,993,932	5.30

*Source: Peters & Brownes*

A report produced by the Commission in 2001 on the impact of farm gate deregulation on the Australian milk industry concluded that Australian consumers were receiving lower milk prices since deregulation. The report went on to say that retail price cuts were made possible by reductions in farmer, processor and retail margins for milk. The DSAP levy is but one component.

As noted above, the cost of milk to Peters & Brownes includes the farmgate payment that has been paid directly to the farmer, together with the levy payment which has been indirectly paid to the farmer via the DSAP payment. Since deregulation the total cost of milk for Peters & Brownes has been between 33 and 34 cents/litre, similar to what it was prior to deregulation or the imposition of the levy. This point has not been addressed in Dairy WA's submission.

## **6.6 Number of suppliers**

Dairy WA's submission makes a number of statements regarding the number of suppliers. In response, Peters & Brownes submits that:

- (a) Western Australia is not unique in the decline in supplier numbers;
- (b) Dairy WA's submission fails to refer to investment and growth; and
- (c) Dairy WA's submission fails to adequately reflect the levels of age and retirement.

### ***WA is not unique in the decline in supplier numbers***

WA is not unique in the decline in the number of suppliers. The decline is national. Further, Dairy WA fails to note in its submission that milk supply has fallen by a smaller percentage than the number of farms, indicating efficiency gains within the industry.

According to the data supplied in Dairy WA's submission, farm numbers have declined by 31% (437 to 300) since 1999/2000. Milk supply has declined by 2.1% (412 ML to 403ML) from 1999/2000 to 2003/2004 and according to Dairy WA, will decline over the five year period to the end of June 2005 by 4.8%. While it could be argued that this decline is disappointing, it can be seen from Table B11 in Confidential Appendix B that the milk supply decline in Western Australia has not been unlike that of other Australian States since deregulation. In fact, Western Australia's milk decline has been significantly less than that of Queensland and New South Wales.

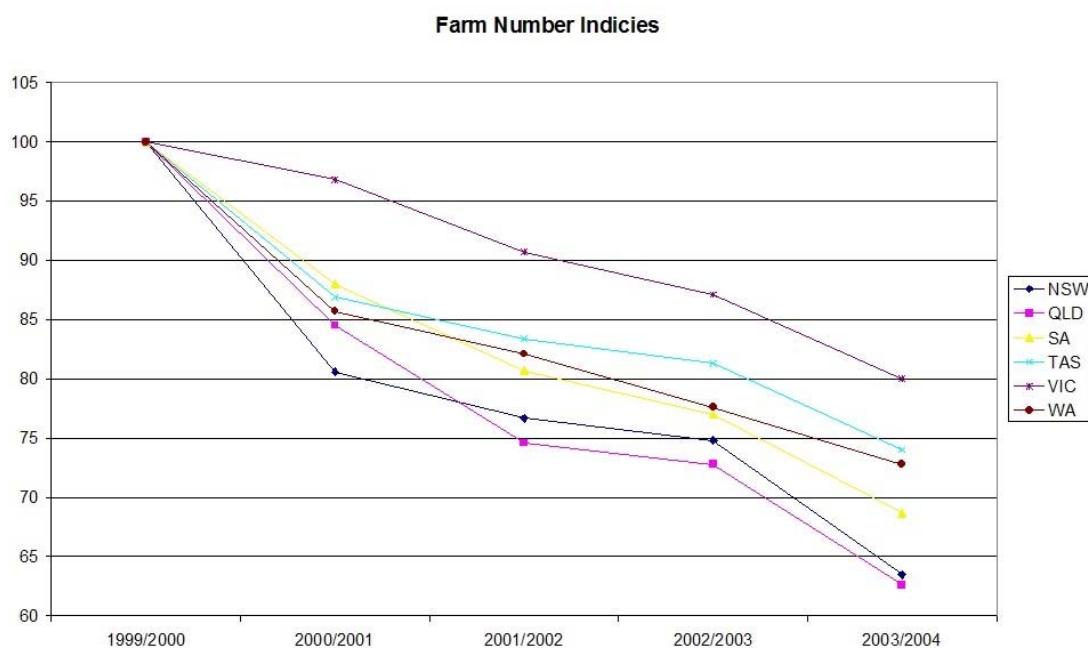
Table 6 and Figure 4 below indicate that the decline in farm numbers in Western Australia not only follows a national trend, but has been much less than in States such as New South Wales and Queensland since deregulation. When analysing the figures since 2003, Western Australia's decline in farm numbers of -4% is much less than all States, including Queensland (-16%), South Australia (-14%), and the national average of -10%.

**Table 6 - Number of farms by region**

<b>Farms by Region</b>		<b>Estimate June 2004</b>	<b>In Focus 2003</b>	<b>Change</b>	<b>% Change</b>
<b>Victoria</b>	<b>Total</b>	<b>6,071</b>	<b>6,801</b>	<b>730</b>	<b>-11%</b>
	East	1,981			
	North	2,329			
	West	1,761			
<b>NSW</b>	<b>Total</b>	<b>1,172</b>	<b>1,290</b>	<b>118</b>	<b>-9%</b>
	Inland/Central	323			
	Southern	356			
	North Coast	493			
<b>QLD</b>	<b>Total</b>	<b>949</b>	<b>1,125</b>	<b>176</b>	<b>-16%</b>
<b>SA</b>		<b>507</b>	<b>587</b>	<b>80</b>	<b>-14%</b>
<b>WA</b>		<b>311</b>	<b>325</b>	<b>14</b>	<b>-4%</b>
<b>Tas</b>		<b>565</b>	<b>597</b>	<b>32</b>	<b>-5%</b>
<b>Aust</b>		<b>9,575</b>	<b>10,654</b>	<b>1,079</b>	<b>-10%</b>

*Source: Dairy Australia*

**Figure 4 - Farm number indices (base of 1999/2000)**



Source: Dairy Australia

### ***Dairy WA's submission fails to refer to investment and growth***

Dairy WA's submission fails to refer to investment and growth in the Western Australian dairy industry.

In 2001 an investment group comprising of three New Zealand farmers and other investors purchased three beef and sheep properties in the south west corner of Western Australia, with the intention of establishing three 1000 cow dairy operations. Two of these farms have now been established, each milking 1000 cows. A third farm is currently under construction, with commencement set down for October 2005. These farms supply Peters & Brownes.

Dairy WA's submission comments on departures from the dairy industry but does not comment on these new farms. The three farms will supply about 16ML, which is equal to 12 average sized farms and 20 small farms of the size often referred to in the submission.

Peters & Brownes contends that there is investment and growth in the Western Australian dairy industry.

### ***Age and retirement***

As noted above, without knowledge of the reasons for the exit of each farmer from the industry, the experience of Peters & Brownes suggests that Dairy WA's claim at page 16 of its submission, that "*a small number of dairy farmers have retired or exited the industry due to ill health*" is not reflecting the full story. This statement implies that retirements and exits due to ill health are a minor contributor to the decline in milk supply in Western Australia, which is incorrect and misleading - there is a sufficient degree of departures due to age.

In the past 12 months, Peters & Brownes have had 11 of its farmers leave dairying. All except one have left due to age and the need to retire. Table 2 in Section 6.2 above sets out what Peters & Brownes understands to be the reason of those farmers for exiting dairying.

## **6.7 Negotiation between suppliers and processors - bargaining power**

Dairy WA's submission implies that the bargaining power between suppliers and processors is limited. In response, Peters & Brownes submits that:

- (a) Dairy WA's claim that suppliers' standard form contracts are provided on a "take it or leave it" basis is incorrect;
- (b) Peters & Brownes' Supply Agreement is similar to those of other milk processors; and
- (c) Peters & Brownes exchanges information with dairy farmers such that its processor costs are disclosed.

### ***Dairy WA's claim that suppliers' standard form contracts are provided on a "take it or leave it" basis is incorrect***

Dairy WA's submission claims at page 23 that dairy farmers are provided with standard form contracts on a "take it or leave it" basis with a single processor. This statement is incorrect.

Peters & Brownes suppliers have an on-going milk Supply Agreement that was developed in June 2000. The Supply Agreement ensures that if the farmer meets standards as detailed in a Code of Practice, Peters & Brownes will continue to purchase a farmer's milk until either party wishes to cease the arrangement. This Supply Agreement can be terminated by the supplier on three months' notice if they wish to change the processor to which they wish to supply. Peters & Brownes may only terminate the Supply Agreement on twelve months' written notice.

The approach of an on-going Supply Agreement was taken after Peters & Brownes held discussions with farmers at the time who were concerned that they would only have a 12 month period of security of supply under an alternative contractual arrangement. At that time, dairy farmers who supplied another processing company had not had their contracts renewed at the end of the 12 month term, leaving them with nowhere to supply their milk. The feeling from Peters & Brownes suppliers was that they preferred to have an on-going Supply Agreement arrangement. None of Peters & Brownes' suppliers has ever raised a concern with the on-going supply agreement or suggested a preference for a contract.

Contrary to suppliers being "locked in" as is alleged at page 23 of Dairy WA's submission, it is the experience of Peters & Brownes that suppliers have taken the opportunity to change processors. Ten Peters & Brownes suppliers have moved to other processors since deregulation. For example, in December 2003, one supplier ceased their Supply Agreement with Peters & Brownes and now supplies their milk to Harvey Fresh. In December 2004, another supplier ceased their agreement and now supplies milk to Harvey Fresh. In February 2005, a Peters & Brownes supplier notified the company

that they wished to cease their Supply Agreement with Peters & Brownes in order to supply their milk to Harvey Fresh. Their milk supply will go to Harvey Fresh in May 2005, being the conclusion of their three month notification period.

Peters & Brownes offers the same transparent milk supply terms and conditions to all suppliers and as such does not discuss individual agreements with each supplier. Peter & Brownes normally does discuss the milk supply terms and conditions of the Supply Agreement with the Negotiating Committee. Some changes to quality payment parameters have been changed after negotiation whereas other payment proposals put forward by Peters & Brownes have not been changed following negotiation.

Peters & Brownes views the comment regarding “take it or leave it” contracts as incorrect as Peters & Brownes’ Negotiating Committee facilitates negotiation.

***Peters & Brownes’ Supply Agreement is similar to those of other milk processors***

The agreement between an individual farmer and Dairy WA will be exclusive and will require consent of both parties should a farmer wish to contract directly with a processor.

Peters & Brownes’ milk Supply Agreement requires that a farmer supply Peters & Brownes with all of that farmer’s saleable milk, and in return provides that Peters & Brownes will purchase all of the saleable milk produced on the farm. In this respect, the agreement not unlike agreements established throughout Australia. For further information, see Confidential Appendix B.

These supply arrangements arise in this way because of the development work undertaken by a processor with a supplier and a preference to see the benefits of that work and investment not given to another processor as a “free rider” on the hard work of others. This is a common commercial arrangement where a purchaser works so closely with a supplier.

***Increasing supply on mutually agreeable terms***

The final paragraph on page 23 of Dairy WA’s submission claims that:

*“Dairy farmers would prefer to have the freedom to agree to commercially viable contractual terms, for example being allowed to increase their supply on mutually agreeable terms and not on the terms of the processors”.*

The document to which this refers is a letter from Peters & Brownes. Peters & Brownes assumes that Dairy WA is concerned about Peters & Brownes’ approach to increased milk supply.

From deregulation in July 2000, Peters & Brownes allowed farmers to grow their milk supply. It was recognised that this was an important strategy that some farmers may wish to adopt under a deregulated environment. The company allowed unlimited growth potential and has accommodated increased growth wherever possible. The company’s milk supply has grown 23% from 20% fewer farmers. This issue is considered further in Confidential Appendix B.

### ***Collection of milk***

Dairy WA's submission refers to concerns relating to farmers not having their milk collected because of their location. Peters & Brownes does not believe that this will be the case with any of its suppliers.

### ***Exchange of information***

Dairy WA's submission claims at page 27 that collective bargaining groups and individual growers "*have had little or no information regarding processors costs*". Again, this statement is not factually correct with respect to the suppliers of Peters & Brownes, whom even Dairy WA acknowledge receive information from Peters & Brownes' Negotiating Committee.

At the 2003 Peters & Brownes Producer Meetings, details of the breakdown of costs and returns for an average litre of white milk and 600ML of flavoured milk were discussed candidly with all Peters & Brownes farmer suppliers who attended. The information that was provided came directly from the company accounts. The Negotiating Committee have requested that this information be updated and presented at the 2005 Producer Meetings to be held in late April 2005. In Peters & Brownes' case, the company is prepared to disclose this type of information with dairy farmers as it clearly demonstrates that in the competitive market that the company must operate, profit margins are kept to very slim levels.

Further, Peters & Brownes has disclosed company costs and margins to members of the Peters & Brownes Negotiating Committee under a signed confidentiality agreement. Members of the Negotiating Committee have been told of the company's actual milk collection cost, the wholesale price that the company receives for white milk from retailers and the returns that the company makes during the year.

The bargaining and negotiating position of suppliers of Peters & Brownes is therefore enhanced by such information. Confidential Appendix B contains confidential copies of previous information presented to dairy farmers to provide documenting support for Peters & Brownes' level of information exchange with its Negotiating Committee.



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## **7 Success of the current collective bargaining authorisation in relation to Peters & Brownes - a positive example**

### **7.1 Introduction**

The Commission will be aware that collective bargaining groups are currently permitted to be formed by dairy farmers with a “shared community interest” in Western Australia under authorisation number A90782. This authorisation permits groups of dairy farmers to collectively negotiate pricing and supply arrangements.

Although the current authorisation is due to expire on 1 July 2005, Peters & Brownes believes that the issues associated with the proposed collective bargaining arrangements should be properly considered in the context of the success of the current authorisation without the need for a rushed review as required by the interim application. The current authorisation has been successful in its operation.

Peters & Brownes’ Negotiating Committee was established under the arrangements of the current authorisation. It has been a positive influence in the negotiating of milk prices with supermarkets, and also in configuring the quality and performance payments to farmer requirements. Despite wishing to move towards a multiple price, Peters & Brownes has acceded to the Negotiating Committee’s request that a single price for milk be maintained. This approach to Peters & Brownes’ relationship with the Negotiating Committee has led to a strong and workable arrangement that can be adopted by other participants in the industry without the need to resort to the process described by Dairy WA in its applications for authorisation - it is a positive example able to be replicated if people so wish as it would lead to improved overall industry efficiency.

***Peters & Brownes has demonstrated that the current authorisation arrangements can, and do, work and believes that it is a viable model for the industry. To make further changes to the negotiation process would further disrupt the industry and create great uncertainty, particularly after so much effort has been expended to make the current arrangements effective.***

In the circumstances it is worthwhile considering how the current authorisation works and the positives involving the Peters & Brownes Negotiating Committee.

### **7.2 Background to the current authorisation**

As a result of national deregulation of the dairy industry on 1 July 2000, the Australian Dairy Farmers Federation (“ADFF”) applied to the Commission in March 2001 for authorisation to allow groups of dairy farmers to collectively negotiate pricing and supply arrangements with the processing companies to which those farmers supplied milk.

The Commission made its determination in March 2002 and, following an application for review by the Australian Competition Tribunal which was finalised in August 2002, granted the authorisation subject to certain conditions necessary to alleviate the anti-competitive detriment of the collective bargaining arrangements.

The Commission's authorisation permits collective bargaining groups to be formed by dairy farmers with a "shared community interest". This requires that all the farmers in a group have a common interest and:

- have similar supply patterns and be located within an economical distance from the processing plant; or
- supply a speciality raw milk product.

The period of the authorisation was determined to be from 1 July 2000 until 1 July 2005.

In December 2002, following the determination of the ACCC and decision of the Australian Competition Tribunal, Western Australian dairy farmers formed a Collective Bargaining Group in an effort to explore opportunities that could foster improved returns to farmers.

### **7.3 Success of the Peters & Brownes Negotiating Committee**

Within the Western Australian Collective Bargaining Group, Peters & Brownes suppliers formed a Negotiating Committee to facilitate dialogue between processors and suppliers. The Negotiating Committee has fostered a close working relationship between Peters & Brownes and its suppliers. Peters & Brownes has actively consulted with the Negotiating Committee at regular meetings and has shared costings and profitability.

These arrangements, which resulted under the framework of the current authorisation, have led to a far greater level of understanding between the Negotiating Committee and Peters & Brownes. This productive relationship can be demonstrated by the publicly expressed views of Mr Victor Rodwell, as noted above at Section 1.2.

This relationship was, in part, the catalyst for Peters & Brownes' positive negotiations with supermarkets and retaining the milk price paid to its farmers in the face of competitors which have been reducing their payments and contracting volumes.

Peters & Brownes' strong relationship with the Negotiating Committee has demonstrated Peters & Brownes' long-term commitment to the Western Australian dairy industry. Although Peters & Brownes is only able to comment on the workings of its own Negotiating Committee and not those of its competitors, it considers that the model that has developed under the current collective bargaining authorisation has been successful and that there is no reason why similar success cannot be achieved across the industry.

#### ***Peters & Brownes' Negotiating Committee has been successful and influential in terms of returns to farmers***

Peters & Brownes Negotiating Committee has been successful. Dairy WA's submission claims at page 17 that:

*"PB Foods Negotiating Group has had no success in negotiating a higher price for raw milk..."*

This statement is incorrect. In August 2003, Peters & Brownes, in conjunction with the Negotiating Committee, was able to announce a half cent increase in the price that it was offering to farmer suppliers, taking the base price to 29 cents per litre based on a successful negotiation as to fair pricing for milk suppliers. Further, the Western Australia Legislative Assembly received a report from the Economic and Industry Standing Committee on "*The Sustainability of the Dairy Industry in Western Australia*" in December 2003. The report acknowledges that Peters & Brownes' Negotiating Committee "*has sought to increase retail milk prices with the benefits shared between farmers, processors and retailers*".

### ***A single milk price - and adaptation to farmers' needs***

The Peters & Brownes Negotiating Committee has, through its negotiations, influenced not only the milk price, but has shown its adaptability through accepting the payment methodology requested by farmers by adhering to a single milk price. In 2003 Peters & Brownes unilaterally increased the price of white milk, and through discussions with the Negotiating Committee increased the price of milk paid to farmers by 0.5 of a cent per litre. Peters & Brownes subsequently adopted the methodology suggested by the Negotiating Committee regarding how this should be paid.

Peters & Brownes operates a single price for all of its milk of a specific amount per litre. In doing this, the Company recognises that all milk in a farmer's tank has the same inherent value. In addition, Peters & Brownes agree to purchase **every** litre of milk that a farmer produces at this price.

The primary reason for the introduction of a single pricing system followed consultation with suppliers who wished to increase farm investment but needed a more reliable stream of income to justify their investment to financial institutions. A single price provides suppliers with a reliable estimate of income, allowing farmers to predict potential returns because all of the milk in the tank is treated the same. Prior to the single milk price, farmers had difficulty in gaining support from financial institutions for investment based on the growth milk price. The single milk price and the corresponding increase in milk supply had the positive effect of allowing Peters & Brownes to pursue value-added opportunities, as it could not rely on the volatility of international commodity markets. Additionally, Peters & Brownes provides its farmers with a twelve month forecast so that they can plan their capital investment.

The Negotiating Committee contacted its farmer constituents and discussed quality payments, both the quality premium payments and any performance or penalty provisions, and subsequently proposed how they wished this to be implemented, and this was adopted by Peters & Brownes without amendment.

Six months ago, Peters & Brownes wished to consider a change to the milk payments system from a single price for all milk to a tier price for milk, a price for white milk, a price for products going into value added, such as ice cream and yoghurt, and finally a price for cheese. After consultation with farmers, the Negotiating Committee recommended that Peters & Brownes stay with a single price for milk, and after considerable discussion this was accepted and adopted.

### *A successful relationship with farmer suppliers*

The current authorisation has ensured that Peters & Brownes has maintained its successful relationship with farmer suppliers.

Peters & Brownes has always had a good relationship with its farmers, and many of its farmers have been suppliers to Peters & Brownes for decades.

The CEO of Peters & Brownes meets with all farmers in three or four separate meetings at different locations at least once a year. From the early stages of the negotiating process Peters & Brownes has established a good rapport and mutual respect with its farmers.

At Negotiating Committee meetings, agenda items are put forward by both sides. The Negotiating Committee plays the major part in developing the agenda of topics for Peters & Brownes' annual meeting with all farmers, which ensures discussion of the issues that the farmer suppliers wish to cover. Much of the information provided to the Negotiating Committee is of a confidential nature, including the financial performance of the company, and the profitability of product segments and customer groups. Generally, there are very few, if any, questions and topics that the Negotiating Committee wishes to cover that have not been answered in full by Peters & Brownes.

On a number of occasions, the Negotiating Committee has asked the company to provide information for farmers, such as the information pack that is quoted by Dairy WA in its submission. Far from being simply a post box, the farmers request the specific information, evaluate it, change it and then disseminate it to the farmer suppliers. This information pack was not simply what Peters & Brownes wished to give to farmers, but instead is based on requests for specific information from the Negotiating Committee and is vetted and disseminated by them, which makes for much more credible and robust information by the time it is received by the farmer supplier.

One of the benefits for Peters & Brownes is the increasing knowledge of the dairy industry by the farmer Negotiating Committee, and for them to be able to answer questions knowledgeably and completely, either from their farmer constituents or the media.

The relationship with farmer suppliers is far more involved, and has a much greater disclosure of information, than any of the other suppliers of raw materials such as sugar, chocolate, milk powder, packaging, etc. This is clearly a commitment by Peters & Brownes to its farmer suppliers as a fundamental stakeholder in the company. Peters & Brownes has been open and frank with the Negotiating Committee in relation to the proposal for a single desk. For further information, see Confidential Appendix B.

Example documents indicating the level of openness and transparency between Peters & Brownes and its Negotiating Committee appear in Confidential Appendix B.

### ***Farmer Extension Team***

Under the arrangements under the current authorisation, Peters & Brownes runs a very effective and efficient Farmer Extension Team (“**Team**”), which assists suppliers greatly in achieving sustainable businesses in the global marketplace. The value which many farmers place on the Team is seen as a significant competitive advantage in the WA dairy industry. Through this Team, Peters & Brownes has assisted farmers to improve their productivity and enhance their returns, and also improve the quality of their milk.

If the authorisations are granted, Peters & Brownes may no longer be able to provide the support that it previously has for farmers, or the advice and improvement programmes currently performed through this Team. It would just not have a farmer base large enough to justify the cost.

Western Australian milk is some of the best milk in the world, and Peters & Brownes are able to convert it into products such as ice cream for the world’s most discerning market, Japan. The work of this dedicated and highly experienced Team with Peters & Brownes milk suppliers is a strong competitive advantage for the company. This Team offers a comprehensive range of financial advice, communication and business management support through farmer extension training. The company is proud that this resource is among the best in Australia and actively champions the cause of the suppliers within the organisation. The professional team have built a strong reputation that now extends to dealings with Peters & Brownes’ retail customers in an effort to highlight the issues faced within the dairy industry.

## **7.4 Conclusion**

Peters & Brownes embraces the values of honesty, integrity and professionalism in its treatment of all stakeholders. It regards farmer suppliers as one of its key stakeholders. Consequently, the formation of the Negotiating Committee under the current authorisation was seen as an opportunity to have more regular contact with a group representative of all of Peters & Brownes farmers. It is also a genuine opportunity to have farmers influence the way in which Peters & Brownes approaches milk supply volume, quality and price, and to provide a mechanism for the exchange of information from supplier and processor perspectives.

In this respect, the current authorisation has clearly been successful. Peters & Brownes believes that the current authorisation should be extended until the Commission completes its analysis of the applications for authorisation. Any change to the status quo will be detrimental to the existing arrangements with Peters & Brownes suppliers and, it is submitted, is unwarranted given the success of the collective bargaining arrangements with Peters & Brownes.

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## **8 Analysis of claimed public benefits and detriments**

### **8.1 The public benefits claimed**

Dairy WA have claimed that the introduction of a milk negotiating agency would have considerable public benefits, including the following:

- (a) improved bargaining power for small producers;
- (b) significant transaction cost savings, particularly in the area of transport costs and providing better economies scaled to processors;
- (c) the redistribution of current monopsony profits;
- (d) easing the transition to industry deregulation;
- (e) improving the viability of small dairy farming businesses; and
- (f) opening up new marketing opportunities by co-ordinating the supply of dairy farmers' milk.

These claims have been dealt with in general terms already in this submission. In this Section Peters & Brownes wishes to deal with them in turn in summary form.

### **8.2 Peters & Brownes does not accept the existence and extent of the public benefits claimed by Dairy WA**

As noted previously in this submission, Peters & Brownes does not accept the existence and extent of the public benefits claimed by Dairy WA. In particular:

- (a) Peters & Brownes believes that the dairy farmers with which it contracts in Western Australia have sufficient bargaining power, and the freedom to contract with the processor of their choice. The imposition of "improvement" on this bargaining power would be negligible. The proposal by Dairy WA as a single milk supplier would not be commercially successful unless it was supported by a mandatory requirement for all processors to deal with that one supplier - a proposition that would be highly problematic from a competition perspective. If a processor was unhappy with supply volumes, quality or price, it would vertically integrate, seek alternative ingredients to white milk, import or change manufacturing location. See Section 5 above for further analysis of this reasoning;
- (b) Peters & Brownes dispute Dairy WA's ability to achieve "significant transaction cost" savings for farmer suppliers, particularly in relation to transport costs. Peters & Brownes does not believe that these costs savings in transport are achievable. See Section 6.3 above for further analysis of this reasoning;
- (c) Leaving aside the use of the term "monopsony" where there are clearly several buyers, it is unclear why dairy farmers under an authorisation are entitled to obtain an immunity from the competition provisions to obtain above normal profits where the other parts of an industry are subject to normal competitive processes. See Section 5 above for further analysis of this reasoning;

- (d) the transition to industry deregulation was eased by the introduction of the Dairy Structural Adjustment Programme by the Federal Government. This money was designed to assist farmers with changes and infrastructure investment. See Section 6 above for further analysis of this reasoning;
- (e) there is sufficient transparency in the arrangements between Peters & Brownes and its farmer suppliers such that it is difficult to see any improvements to viability claimed by Dairy WA. See Section 6 above for further analysis of this reasoning; and
- (f) Peters & Brownes dispute Dairy WA's claim that the authorisations would create new marketing opportunities by co-ordinating the supply of dairy farmers' milk. The reasoning given for the ability for Western Australian dairy farmers to supply Eastern States markets, being its "lower cost of production", appears inconsistent with industry evidence that Western Australian dairy farmers face higher costs of production. See Section 6 above for further analysis of this reasoning.

The Dairy WA proposal also does not consider the economic response by processors to the single desk proposition. The rational economic response would see processors stop dealing directly with farmers and use the "dial a tanker" facility or find alternative sources of supply. In this situation, the Western Australian dairy farmers are likely to be far worse off with the Dairy WA proposal.

### **8.3 Single Desk - countervailing power arguments**

Further, Peters & Brownes notes the Commission's analysis of the application for authorisation by Premium Milk Supply Pty Ltd to collectively bargain farm-gate prices and milk standards with Pauls Limited in 2001. In its analysis, the Commission did not accept all the claimed benefits associated with the proposed arrangements, and in particular, did not consider countervailing power that would lead to increased prices paid by consumers to be a public benefit. Peters & Brownes is uncertain that any ability to increase prices would in fact eventuate, but submits that the same analysis should be applied to the theory behind these authorisation requests from Dairy WA.

### **8.4 Any public benefits will be outweighed by the detriments**

To the extent that grant of an authorisation would create any public benefits, Peters & Brownes submits that these are greatly outweighed by the public detriments.

Peters & Brownes strongly opposes any suggestion that Western Australia should retreat to central controls on the dairy industry, such as in the form of a single selling desk. As previously noted, such a move would involve a reversal of recent improvements in contestability commercial freedom and would inevitably impact on the economic, social and environmental sustainability of the industry by:

- severely restricting the future development opportunities of Western Australian dairies in the global market;
- leading to inefficient dairy practices and businesses being continued to the cost and detriment of the more productive and efficient farmers;
- impeding farmers who have made investments based on a single pricing policy; and
- requiring significant organisational and financial input.

Each of these are significant detriments, and outweigh any public benefits arising from authorisation of the applications.

### **8.5 Interim authorisation**

Peters & Brownes submits that it is not in the public interest to grant an interim authorisation in the nature sought by Dairy WA. If the interim authorisation was to be granted, but then the authorisations were not granted in a final determination, public detriments would result. The dairy industry would be forced to return to supply agreements similar to those currently enjoyed by farmer suppliers and processors. Consumers would face detriment as milk supply and price would be volatile during any resultant transition period.

For these reasons, Peters & Brownes suggests that the current authorisation number A90782 be extended until the Commission makes a final determination in relation to the applications by Dairy WA, and that an interim authorisation not be granted.



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## **9 Conclusion**

Peters & Brownes regrets that it is not able to support the authorisation applications by Dairy WA. Peters & Brownes' views of initial proposals were communicated to the dairy farmer members of Peters & Brownes' Negotiating Committee.

Peters & Brownes would like to continue the successful collective bargaining arrangements that already exist with its dairy farmers through the continuation of the existing authorisation.

Peters & Brownes trusts that this submission will be of assistance to the Commission. Should the Commission have any questions in relation to this submission, Peters & Brownes would be pleased to provide the Commission with further information.

**Peters & Brownes Limited**  
12 April 2005

# Submission to the ACCC

## Appendix A – [Confidential]

[Confidential - information deleted]

# Submission to the ACCC

## Appendix B – [Confidential]

[Confidential - information deleted]

**Non-Confidential Version**

**PB Foods Limited**



**Submission to the Australian  
Competition & Consumer Commission  
in response to requests for authorisation  
A90961 and A90962 by Dairy WA**

12 April 2005