



Deacons

5 May 2005

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Scott Gregson
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Your Ref: A90961 & 90962
Our Ref: 2561250

Dear Scott

Authorisation applications A90961 & A90962 by Dairy WA - National Foods' submissions

1. Background

- 1.1 We act for National Foods Milk Limited (**National Foods**) and are writing in relation to the above matter, about which you sought National Foods' views by letter of 22 March 2005.
- 1.2 On 13 April 2005 we forwarded the ACCC National Foods' submissions in relation to Dairy WA's application for interim authorisation. The purpose of this letter is to set out National Foods' submissions in relation to Dairy WA's substantive authorisation application.
- 1.3 National Foods disagrees with various assertions made by Dairy WA in its submission in support of its authorisation application. Where relevant, National Foods has indicated its position with regard to these assertions in the body of this letter. In addition, National Foods has included, at **Appendix 2** to this letter, its views on statements by Dairy WA with which it disagrees, which have not been covered in the body of this letter. National Foods claims confidentiality over Part 1 of Appendix 2, on the grounds that it contains details of National Foods' pricing, which is commercially sensitive to National Foods.
- 1.4 Dairy WA has lodged two authorisation applications with the ACCC – one in which it seeks it to engage in collective bargaining (authorisation number A90962) (**Collective Bargaining Arrangements**) and one in

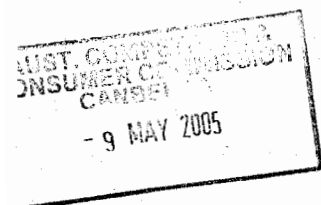
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which it seeks to be able to collectively boycott dairy processors and retailers (authorisation number A90961) (**Collective Boycott Arrangements**). Dairy WA seeks authorisation of the Collective Boycott Arrangements if the ACCC decides to grant authorisation in respect of the Collective Bargaining Arrangements.

- 1.5 The arrangements, in their entirety, that are sought to be authorised in Dairy WA's authorisation applications are referred to throughout this letter as the **Combined Negotiation Arrangements**. In addition, references throughout this letter to conduct of Dairy WA are intended to include conduct engaged in by the Milk Negotiating Agency on behalf of Dairy WA.
- 1.6 In addition to considering the current authorisation application, the ACCC is considering an application (**ADF application for revocation and substitution**) by Australian Dairy Farmers Ltd (**ADF**) for revocation and substitution of the authorisation (**ADFF Authorisation**) granted in 2002 by the Australian Competition Tribunal (**Tribunal**) to the Australian Dairy Farmers Federation. The ADFF Authorisation allows Australian dairy farmers to collectively negotiate with (but not collective boycott) dairy processors. It also allows ADF to engage in limited discussions with supermarkets.
- 1.7 National Foods is in the process of completing a submission to the ACCC in relation to the ADF application for revocation and substitution. National Foods broadly supports the ability of dairy farmers to collectively negotiate with dairy processors. However, as will be detailed in its submission to the ACCC, this is subject to any further authorisation being for a term, and subject to conditions, which are acceptable to National Foods.

2. **Executive summary**

- 2.1 The ACCC should refuse both of Dairy WA's applications for authorisation because, whether considered individually or in combination, they would lead to substantial public detriment in the Western Australian dairy industry, which would not be outweighed by any public benefits.
- 2.2 The anti-competitive detriment likely to arise out of the Combined Negotiation Arrangements is as follows:
 - (1) The Combined Negotiation Arrangements would substantially distort market forces in the Western Australian dairy industry, and would be likely to result in:
 - (a) increased milk prices, as the Collective Boycott Arrangements, and / or the potential for the Collective Bargaining Arrangements to involve Dairy WA representing every dairy farmer in Western Australia, would allow Dairy WA to substantially increase raw milk prices paid by dairy processors and retailers. Given the tight margins that processors operate under, processors would seek to pass these cost increases on to retailers, which, despite their countervailing power and subject to price protection which

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may exist in current supply contracts, would be likely to accept these increased costs so as to maintain a viable processing sector. Retailers would be likely to pass these cost increases on to consumers in the form of higher milk prices;

- (b) to the extent that processors are faced with prohibitively high raw milk prices in contracts negotiated with the Milk Negotiating Agency, and they are unable to pass these costs through to retailers, a reduction in the volume of milk supplied in Western Australia. These processors would be likely to be forced to scale down or close their businesses, which would cause efficiency losses in the industry, through the diversion of resources from efficient uses;
 - (c) entrenched barriers to entry through the development of long-term contracts between dairy farmers and dairy processors;
 - (d) dairy farmers being denied any role in the negotiation of contracts of supply to processors and retailers, as Dairy WA is seeking to break the direct relationship that exists between processors and farmers, and negotiate all supply contracts that the farmers that it represents enter into;
 - (e) a total inhibition of competition between dairy farmers if the Milk Negotiating Agency represents every dairy farmer in Western Australia and, as a result, the removal of any incentive for innovation in the supply of raw milk by dairy farmers. This would risk leading to the adoption of identical, industry-wide contracts throughout Western Australia, with Dairy WA, as a single bargaining agent, potentially negotiating on behalf of every dairy farmer in Western Australia. Accordingly, farmers with location or scale advantages will be forced to subsidise less efficient, more marginal farm operations;
 - (f) the formation of a monopoly for the supply of raw milk to processors in Western Australia, if the Milk Negotiating Agency represents every dairy farmer in Western Australia; and
 - (g) the possibility of disclosure of confidential information of processors and retailers. Dairy WA would become privy to information that is confidential to processors in the course of its negotiating role and, under the proposed terms of the Combined Negotiating Arrangements, does not face any restrictions upon disclosing that information to other processors or dairy farmers.
- (2) National Foods notes statements made by the ACCC in its June 2004 publication entitled '*ACCC Collective bargaining and boycott discussion paper*' (**Collective Negotiation Discussion Paper**) to

the effect that it requires strong justification before allowing collective boycott activity to obtain immunity from the TPA. As elaborated upon in paragraphs 6.3 and 6.4 below, Dairy WA's Collective Boycott Arrangements would be likely to have clearly anti-competitive effects. In the light of these likely anti-competitive detriments, Dairy WA has not provided any valid justification for seeking immunity to engage in collective boycotting, and has not provided any evidence that the Collective Boycott Arrangements would lead to such benefits to the public that the conduct should be allowed to take place.

- (3) In making its public benefit arguments, Dairy WA appears to be relying exclusively upon particular public benefits that the ACCC has in the past identified could arise out of collective bargaining arrangements. However, Dairy WA has not demonstrated how the particular public benefits that it has identified would be likely to arise out of the Combined Negotiation Arrangements.
- (4) Dairy WA has not demonstrated that the public benefits (if any) of the Combined Negotiation Arrangements would outweigh the clear anti-competitive detriments likely to arise. Accordingly, National Foods submits that the ACCC should refuse to grant authorisation to Dairy WA in respect of both the Collective Bargaining Arrangements and the Collective Boycott Arrangements.

3. Lack of detail of proposed arrangements

- 3.1 As indicated in its submission to the ACCC regarding Dairy WA's application for interim authorisation, National Foods considers that Dairy WA has not provided sufficient detail as to the operation of the proposed arrangements for which it seeks authorisation, to allow interested parties to fully assess the likely competitive effects of the proposed arrangements.
- 3.2 In particular, Dairy WA has not provided any information on crucial aspects of the Combined Negotiation Arrangements such as:
 - (1) the intended constitution and operation of the Milk Negotiating Agency, with which processors such as National Foods would potentially be forced to negotiate all raw milk supply arrangements;
 - (2) the rationale behind Dairy WA's proposal to enter into supply contracts with retailers directly, the way in which it is proposed that such contracts will operate, and the way in which it is proposed that milk will be distributed from the Milk Negotiating Agency to retailers;
 - (3) how Dairy WA proposes to guarantee the supply of adequate volumes of raw milk to processors, throughout the year; and
 - (4) how Dairy WA proposes to manage milk-balancing issues in the market.

3.3 If Dairy WA provides further information about the proposed operation of the arrangements, National Foods may wish to provide the ACCC with a supplementary submission in which it sets out its views on the likely competitive impact of the further aspects of the proposed arrangements that Dairy WA discloses.

4. Test for granting final authorisation

4.1 Section 90(6) of the *Trade Practices Act (TPA)* does not permit the ACCC to grant authorisation in respect of a provision (not including an exclusionary provision) of a proposed contract, arrangement or understanding, or in respect of proposed conduct, unless it is satisfied that the provision or the conduct would be likely to result in a benefit to the public that would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result.

4.2 Similarly, section 90(8) of the TPA does not permit the ACCC to grant authorisation in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied that the proposed provision would be likely to result in such a benefit to the public that the proposed contract, arrangement or understanding should be allowed to be made.

4.3 The ACCC indicated in its *'Guide to authorisations and notifications'* that despite the variation in the language of these tests, it adopts the view that was taken by the Trade Practices Tribunal in *Re Media Council of Australia (No. 2)*¹ that, in practical application, the tests are essentially the same.

5. Likely counterfactual

5.1 In weighing the relevant public benefits and anti-competitive detriments likely to arise from the Combined Negotiation Arrangements, the ACCC compares the position that would be likely to exist in the future if the authorisation was granted with the position if the authorisation was not granted.

5.2 At present, Western Australian dairy farmers have immunity to collectively bargain (but not to collectively boycott) subject to the conditions of authorisation set down by the Tribunal in 2002. Immunity for this conduct will exist until 30 June 2005. Importantly, the terms of that authorisation expressly prohibit all Western Australian dairy farmers operating as a single collective bargaining group.

5.3 On 13 April 2005, the ACCC received the ADF application for revocation and substitution. The ADF has sought a five-year extension of the immunity of dairy farmers to collectively bargain with dairy processors.

5.4 Accordingly, the relevant counterfactual situation against which the ACCC should compare the conduct proposed by Dairy WA is:

¹ (1987) ATPR 40-774 at 48, 419

- (1) until 30 June 2005 – groups of dairy farmers that meet the criteria set down by the Tribunal are able to collectively bargain with dairy processors; and
- (2) after 30 June 2005 – depending upon the outcome of the ACCC's consideration of the ADF application for revocation and substitution, dairy farmers will either:
 - (a) be permitted to continue to collectively bargain with dairy processors according to whatever conditions the ACCC places upon a substitute authorisation that it may grant to the ADF; or
 - (b) operate in a fully deregulated environment, in which dairy farmers would supply raw milk to processors on an individual basis.

5.5 One of Dairy WA's arguments in support of the ACCC granting it with interim and final authorisation is the expiry of the ADF Authorisation in June 2005. This argument would be negated if the ACCC determines to grant the ADF application for revocation and substitution.

6. National Foods' submissions

6.1 The Combined Negotiation Arrangements would be likely to lead to substantial public detriment, arising out of the substantial lessening of competition and distortion of market forces that would be likely to result.

6.2 Further, the proposed arrangements would not be likely to lead to any public benefits. Dairy WA has not provided any evidence as to how the public benefits that it has identified would be likely to result from the Combined Negotiation Arrangements.

6.3 Anti-competitive detriments

- (1) The Combined Negotiation Arrangements would be likely to lead to substantial public detriment, as outlined in paragraphs (4) to (35) below. As demonstrated below, this would be the case in relation to both the Collective Bargaining Arrangements, and the Collective Boycott Arrangements, whether the likely effects of these applications are considered individually or in combination.
- (2) This would be likely to be the case whether the Combined Negotiation Arrangements are compared with a situation where dairy farmers negotiate individually with dairy processors (that is, where the ACCC does not grant the ADF application for revocation and substitution), or where dairy farmers collectively bargain with dairy processors in the same way as they currently do (that is, where the ACCC grants the ADF application for revocation and substitution).

- (3) The serious anti-competitive effects of the Combined Negotiation Arrangements would be likely to be particularly exacerbated by the following features of the proposed arrangements:
- (a) the binding nature of the proposed relationship between Dairy WA and the farmers that it will represent;
 - (b) the lack of restriction upon the coverage and composition of the bargaining group;
 - (c) the existence of the threat of boycott; and
 - (d) the fact that negotiations would be undertaken by a single body.

Increase in price of milk to consumers

- (4) The fact that the Combined Negotiation Arrangements are proposed to extend to the price at which raw milk will be supplied to dairy processors and retailers will distort market forces and lead to an increase in the price of raw milk to processors and retailers, which is likely to be passed on to consumers.
- (5) This would be likely to be the case whether the ACCC granted authorisation to Dairy WA in respect of its Collective Bargaining Arrangements alone, or both its Collective Bargaining Arrangements and Collective Boycott Arrangements.
- (6) Considering first the impact of the Collective Bargaining Arrangements alone, representation by Dairy WA is proposed to be open to every dairy farmer in Western Australia, thereby potentially eliminating the scope for any competition to exist for the supply of raw milk to processors in Western Australia.
- (7) This would potentially turn Dairy WA into a monopoly supplier of raw milk to processors in Western Australia, and would enable Dairy WA to extract a monopoly rent from processors. These price increases would not be constrained by imports, because international imports of fresh milk for drinking are not viable because of the distance involved, and the perishable nature of the milk, and interstate imports, while possible, would involve substantially increased costs due to the high freight cost associated with transporting drinking milk to Western Australia. Further, there are no close substitutes for fresh raw milk as supplied by producers to processors. Processors would have little alternative but to accept the higher prices charged by Dairy WA.
- (8) Given the low margins that processors currently operate under, it would be necessary for processors to pass this cost through to retailers in order to remain viable. Despite their strong countervailing power, supermarkets would not expect processors to absorb increases in farmgate prices, as this would put the processing industry at risk of not being viable.

- (9) There would be no reason why supermarkets would absorb such cost increases, particularly given tight milk margins post-deregulation. Further, once processed, drinking milk is a staple commodity with inelastic demand, therefore higher costs would tend to be passed on to consumers.
- (10) Accordingly, under the Collective Bargaining Arrangements alone, prices to consumers would be likely to rise as a result of the proposed arrangements.
- (11) National Foods wishes to highlight in this regard that the proposed ability of Dairy WA to represent every dairy farmer in Western Australia is in direct contradiction to a condition imposed by the Tribunal in its consideration of the ADFP Authorisation in 2002. The Tribunal imposed a number of conditions upon the ability of dairy farmers to collectively bargain. Condition 3 specified that collective bargaining groups could not constitute all the farmers in, amongst other places, Western Australia.
- (12) This condition had been originally imposed by the ACCC, which had previously noted, in its final determination in relation to the ADFP Authorisation, that the ability to form collective bargaining groups that are not restricted in the geographic scope of their membership has the potential to result in substantial anti-competitive detriment, through the formation of monopolies of dairy farmers in certain areas.
- (13) Further, the proposed ability of Dairy WA to represent every dairy farmer in Western Australia would directly contradict the ACCC's condition of authorisation in the ADFP Authorisation that farmers that comprise a collective bargaining group should have some 'shared community interest', which would include, for example, having similar supply patterns and being located within an economic transportation range of a processor's plant.
- (14) That is, the ACCC considered that in order to protect competition, farmers would have to meet certain criteria that determined whether particular dairy farmers and dairy processors would bargain with each other. However, if Dairy WA is permitted to represent all dairy farmers in Western Australia, it would be in a position to collectively bargain on behalf of farmers who shared no community interest at all, in this way directly contradicting a factor that the ACCC previously considered to be important in protecting competition between dairy processors and farmers.
- (15) In addition to the likely effect of the Collective Bargaining Arrangements, Dairy WA's proposed power to boycott processors and retailers under the Collective Boycott Arrangements would further strengthen its ability to require that processors and retailers pay prohibitively high prices for raw milk. If processors or retailers refused to pay the prices charged by Dairy WA, they would risk

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being boycotted from dealing with, potentially, every dairy farmer in Western Australia, for an unspecified period of time.

- (16) Given the strong potential for substantially increased retail prices, consumers would be likely to be considerably worse off as a result of the Combined Negotiation Arrangements.

Reduction in volume of milk processed in Western Australia and diversion of resources from efficient uses

- (17) To the extent that price increases that result from the Combined Negotiation Arrangements are not passed on to consumers, the proposed arrangements would still be likely to lead to market distortions, in that they could lead to the closure of efficient dairy processors, and the diversion of those resources to less efficient uses.
- (18) Given that Dairy WA would potentially face no competition from other Western Australian farmers, it would face no competitive discipline to maintain pricing at an efficient level. Dairy processors faced with artificially lower returns, who are not able to pass on price increases to retailers, and who have no bargaining power to remedy the situation, would have no incentive to remain in the market, and would be likely to choose to direct their resources elsewhere. This has the potential to substantially reduce the volume of milk supplied in Western Australia.
- (19) The Combined Negotiation Arrangements would also have the potential to impact upon the quality of the products supplied by dairy farmers, as they would no longer be subject to any competitive discipline that would otherwise serve as an incentive for them to maintain their product and service standards.

Long term impact upon Western Australian dairy industry sustainability

- (20) Farmgate prices for the supply of milk are determined by world market prices and local market conditions.
- (21) Any attempt by Dairy WA to artificially increase the price of milk is unsustainable for the industry because it prevents the determination of the price of milk by these market conditions.
- (22) This would have the effect of distorting market signals, and give rise to the risk that resources would be directed away from the supply of milk and towards other uses, which may not be in the long-term interests of industry efficiency.

Entrenchment of increased barriers to entry and denying involvement by dairy farmers in contract negotiation

- (23) The proposed arrangements have the effect of entrenching highly anti-competitive behaviour in the market, through:

- (a) raising barriers to new entry through the likely establishment of long-term, restrictive contracts in the market between dairy farmers (through Dairy WA) and dairy processors; and
 - (b) denying dairy farmers any role in the negotiation of the terms and conditions upon which they will supply raw milk to processors and retailers.
- (24) Rather than equalising the bargaining positions of dairy farmers and processors in their dealings with each other, the Combined Negotiation Arrangements would place Dairy WA (on behalf of the dairy farmers it represents) in a position of total bargaining control over processors, and would place processors in a position in which they would be unable to negotiate competitive terms and prices.
- (25) For example, by being able to threaten dairy processors and retailers with collective boycott, and potentially being in a position to represent every dairy farmer in Western Australia, Dairy WA would be likely to have the ability to secure long-term contracts between itself (on behalf of dairy farmers) and dairy processors, which would be a substantial hurdle for new processor entrants to overcome to compete with incumbents.
- (26) The Combined Bargaining Arrangements would also allow Dairy WA to lock dairy farmers into lengthy contracts with it, and provide Dairy WA with the ability to prevent dairy farmers from entering into contracts with processors and retailers for unspecified, and potentially lengthy, periods of time.
- (27) This would directly contradict one of the public benefit arguments accepted by the ACCC in its consideration of the ADFP Authorisation - that allowing collective negotiation by farmers would give them experience in negotiating with processors, which they did not have to do prior to deregulation. By removing the role of farmers in the contract negotiation process, the Collective Bargaining Arrangements would in fact make it more difficult for them to move towards a deregulated environment in which they would be required to negotiate all supply contracts with processors.

Total inhibition of competition and reduction in incentive for innovation

- (28) In the ADFP Authorisation, the Tribunal imposed the following important conditions in order to minimise the anti-competitive detriment likely to arise out of the arrangements:
- (a) dairy processors were to be able to choose whether to negotiate with collective groups of farmers. Dairy processors were to be able to negotiate with one, or some, of the dairy farmers within a particular group based on their own commercial requirements;

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- (b) farmers were to retain the right to negotiate and enter into individual contracts; and
 - (c) farmers were to be able to leave collective groups on giving reasonable notice.
- (29) These factors are not present in the current proposed arrangements. Instead:
- (a) Dairy WA is seeking to break the direct relationship that currently exists between processors and the dairy farmers that it will represent, with all milk supply contracts in Western Australia to be entered into between Dairy WA (through the Milk Negotiating Agency) and the processor. Processors wishing to enter into contracts with dairy farmers that are represented by Dairy WA would be unable to negotiate individually with these suppliers without the consent of Dairy WA. Dairy WA has not provided any indication as to the basis upon which it will exercise its discretion to consent to such contracts;
 - (b) farmers who choose to be represented by Dairy WA will be unable to negotiate individual contracts with processors if these are not consented to by Dairy WA, even if they are not happy with the terms of agreements negotiated by Dairy WA, or if they are of the view that they could negotiate better terms; and
 - (c) Dairy WA has provided no information as to the rights of farmers to exit their contracts with Dairy WA.
- (30) If Dairy WA represents all Western Australian dairy farmers, processors would be forced to deal with Dairy WA in order to purchase any raw milk in Western Australia.
- (31) The proposed arrangements would prevent the maintenance of any ongoing competition between dairy farmers in their dealings with processors. Farmers are unlikely to have any incentive to innovate, to be price competitive, or to improve their quality of service under the proposed arrangements.

Development of industry-wide contracts in Western Australia and possibility of disclosure of confidential information

- (32) Dairy WA proposes to be the single bargaining agent that will act on behalf of, potentially, every dairy farmer in Western Australia. This has the capacity to further entrench anti-competitive conduct into the market, as it has the potential to lead to identical contracts being entered into between all dairy farmers and processors throughout Western Australia, with no variation to take account of differences in the operations and efficiency characteristics of individual businesses. With the lack of competition between farmers removing any incentive for innovation in the market, such

industry-wide contracts would risk leading to the protection of inefficient and poor-quality suppliers.

- (33) There will be a much-reduced scope for contracts to be negotiated that take account of specific demand and supply characteristics of particular businesses. As recognised by the ACCC in its ADFP Authorisation, common representation would also increase the potential for an industry wide price fixing arrangement to arise. This would have the effect of eliminating any price competition in the Western Australian dairy industry.
- (34) Having a common bargaining agent also raises the risk of the disclosure of confidential information. As the entity responsible for negotiating milk supply contracts with all processors and retailers on behalf of all dairy farmers, Dairy WA would become privy to confidential information of processors and retailers. Dairy WA has not disclosed any terms of the Combined Negotiation Arrangements that would limit the disclosure of this confidential information by Dairy WA to other processors or retailers, or to dairy farmers not involved in contracts with the particular processor. The disclosure of commercially confidential information in this way would comprise a substantial public detriment.
- (35) The elimination of price competition between farmer suppliers and processors in Western Australia would, in addition to removing any incentive for farmers to innovate and improve their own efficiencies, significantly diminish the incentive and capacity for processors to invest in upgraded production facilities. Under-investment by processors was a characteristic of the regulated industry that existed prior to 1 July 2000. National Foods considers the Combined Negotiation Arrangements would, if authorised, create a platform for a de-facto re-regulation of the milk industry in Western Australia, with a strong likelihood that many of the behaviours seen in a regulated industry would return.

6.4 No justification for need to collectively boycott

- (1) The ability for dairy farmers to boycott processors and retailers causes the proposed arrangements to have particularly anti-competitive effects. The ACCC acknowledged in its Collective Negotiation Discussion Paper that, if used strategically, the power of a collective bargaining unit to collectively boycott could give the collective bargaining unit a degree of countervailing power that goes well beyond that necessary to address any imbalance in market power issues. The ACCC indicated that it requires strong justification before allowing collective boycott activity to obtain immunity from the TPA.
- (2) As the ACCC noted in a letter to the Minister for Agriculture, Forestry and Fisheries, Kim Chance MLC, in 2003, when considering the ADFP Authorisation, it did not consider that

conferring an ability on a supplier to withhold supply was in the public interest, and therefore it did not authorise such conduct.

- (3) Dairy WA has not demonstrated any credible justification for requiring the power to engage in collective boycott activity. Dairy WA has cited as its sole reason for seeking the ability to collectively boycott the fact that:

'At the present time we anticipate that a power of collective boycott may be necessary to facilitate collective bargaining occurring'.

- (4) National Foods submits that this does not provide sufficient justification for Dairy WA seeking immunity to engage in conduct which is clearly anti-competitive, and which would enable Dairy WA, potentially, to act to the competitive detriment of Western Australian dairy processors, retailers and consumers as a result of it being in a position of total bargaining control over processors and retailers.

6.5 Public benefits significantly overstated by Dairy WA

- (1) Dairy WA has sought to frame its public benefit arguments around particular public benefits that the ACCC typically has regard to when assessing collective negotiation arrangements. However the public benefit arguments lack merit in the current case, as Dairy WA has not demonstrated how the public benefits it has identified would be likely to arise out of the Combined Negotiation Arrangements.

Improvement in bargaining power

- (2) Given the ability of dairy farmers to collectively negotiate with processors following the ADFP Authorisation in 2002, Dairy WA has not provided evidence that an imbalance in bargaining power still exists in Western Australia between dairy farmers and processors. Dairy WA cites the inability of the National Foods Collective Bargaining Group and the PB Collective Bargaining Group to negotiate adequately as an indication of an imbalance in bargaining power between the parties².
- (3) However, Dairy WA has not substantiated these comments with any evidence of an imbalance in bargaining power.
- (4) Dairy WA suggests that by providing dairy farmers with more bargaining power, Dairy WA will be able to remove the direct link between farmers and processors, and supply processors in the most cost effective and efficient manner possible. However Dairy WA provides no evidence as to how it proposes to achieve these benefits.

² Page 23 Dairy WA's submission

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- (5) Dairy WA also suggests that by increasing the bargaining power of farmers, both farmers and processors would benefit from reliability of supply and improved efficiencies³. However, Dairy WA does not explain how this increase in reliability or efficiency is likely to occur.
- (6) National Foods does not hold a position of undue bargaining power in its negotiations with dairy farmers, as evidenced by National Foods' dealings with the dairy farmers with whom it enters into supply contracts. For example:
- (a) National Foods does not require that farmers enter into contracts with it that are inefficient or anti-competitive. In seeking to enter into supply agreements with its Western Australian dairy farmers, National Foods enters into consultation with its farmers, individually, and through the National Foods Consultative Group, and previously, with the National Foods Collective Bargaining Group. The terms of contracts that National Foods enters into with its dairy farmers result from consultation and negotiation;
 - (b) National Foods pays more for its milk than any other scale fresh milk processor in the Western Australian dairy industry. Comparative milk prices are included at **Appendix 1**. National Foods claims confidentiality in relation to the information in Appendix 1, on the grounds that it contains details of National Foods' pricing, and details of its producers, which are commercially sensitive to National Foods;
 - (c) National Foods currently supports its dairy farmer suppliers in a number of ways, including through the provision of the following services:
 - (i) the Partners Programme – this is an initiative of National Foods that is aimed at providing its suppliers with access to bulk-procured goods and services at cheaper prices than suppliers would face if they were procuring these goods and services individually;
 - (ii) Study Tours – National Foods provides tours to a range of suppliers that provides suppliers with access to international best practice farm practice, and the opportunity to network with National Foods' national supply base. There have been two tours over the last three years to North East USA and South West Canada. The next trip is planned for California in March 2006; and
 - (iii) Milk Supply Field Support - National Foods provides its suppliers with guidance regarding product

³ page 23 Dairy WA submission

quality, and planning assistance to determine optimum supply arrangements. The services provided in this way include:

- (A) explaining contract terms and conditions to suppliers;
- (B) liaising with logistics services providers regarding problems that arise with milk collection, and complaints from drivers, where required;
- (C) providing assistance to suppliers with on-farm testing of milk for antibiotic residue;
- (D) undertaking vat temperature and hot water system checks on a regular basis;
- (E) providing bacteria test results every 10 days;
- (F) providing suppliers with information about product quality, if requested;
- (G) undertaking audits in circumstances where a supplier has a quality problem such as high somatic cell count;
- (H) organising meetings and functions for suppliers, and supplier consultative groups;
- (I) providing assistance to suppliers in relation to onfarm food safety plans;
- (J) liaising with the Department of Health in relation to the auditing of suppliers' onfarm food safety plans;
- (K) liaising with the Department of Agriculture regarding extension activities, and raw milk bacterial identification service;
- (L) providing assistance to suppliers with any payment enquiries;
- (M) providing information to suppliers regarding National Foods' procurement plans and quality standards; and
- (N) advising suppliers of National Foods' future plans, to allow suppliers' plans to be adjusted accordingly; and

- (d) where possible, National Foods exhibits flexibility in the application of its contracts with suppliers, in ways that have included the following:
- (i) waiving penalties for undersupply of contract volumes over the 2004 financial year, and so far in the 2005 financial year;
 - (ii) discussing flexible payment arrangements where suppliers have wished to enter into sharemilking arrangements; and
 - (iii) allowing its suppliers to supply other companies such as Challenge Dairy and local cheese companies, even where this has caused a variation in the quantity of raw milk that National Foods is able to obtain from these suppliers. In this way, National Foods has operated as a balancer.
- (7) National Foods' ability to continue to provide these services to its Western Australian dairy farmer suppliers would be likely to be jeopardised in the event that Dairy WA obtains immunity to engage in the Combined Negotiation Arrangements, and this leads to an increase in the price National Foods is required to pay for raw milk in Western Australia.
- (8) Dairy WA asserts that processors have held the price of milk in Western Australia down to a level below production costs⁴. National Foods submits that this statement is inaccurate on the grounds that processors do not have the power to influence the price of milk. Since deregulation, the world market determines farmgate prices for manufacturing milk, and the price for market milk is determined by a combination of world market prices and local market forces.
- (9) The lack of control that processors have over the price of milk was recognised by the ACCC in its 2001 report entitled *'Impact of farmgate deregulation on the Australian milk industry: study of prices, costs and profits'*. The ACCC expressed its view that processor bargaining power, and therefore the ability to influence price, is weak.
- (10) From National Foods' perspective, given its reliance on the drinking milk market, and given the perishable nature of drinking milk, National Foods cannot acquire from suppliers more milk than it needs to supply in that market. The milk that National Foods sources totally reflects the customer demand in the dairy market segment that it supplies. National Foods does not possess the market power to adjust the volume or price of milk that it acquires from producers so as to artificially increase its own returns.

⁴ page 23 Dairy WA submission

- (11) In actual fact, rather than addressing any alleged imbalance in bargaining power, National Foods submits that the likely effect of the Combined Negotiation Arrangements would be to cause an imbalance in the bargaining positions of farmers, retailers and processors. The arrangements would place dairy farmers, through Dairy WA, in a position of total bargaining control over dairy processors and retailers.
- (12) Given Dairy WA's proposed power to boycott, and the fact that Dairy WA could potentially eliminate any competition between Western Australian dairy farmers by acting on behalf of all of them, the effect of the arrangements would be to force dairy processors and retailers to accept any terms and conditions of supply dictated by Dairy WA, regardless of the commercial impact of the terms and conditions upon them.
- (13) Accordingly, National Foods does not accept the validity of this public benefit argument made by Dairy WA.

No evidence of transaction cost savings.

- (14) Dairy WA asserts that the Combined Negotiation Arrangements would be likely to reduce transaction costs. However, it provides no evidence of any transaction costs that would be reduced as a result of the proposed arrangements.
- (15) The only cost to which Dairy WA makes reference is the cost of transporting milk in Western Australia. Any possible savings in transport costs would not constitute transaction cost savings.
- (16) In any case, Dairy WA has not provided evidence to substantiate the claims it has made as to its ability to effect transport cost savings. In particular, it would be necessary for Dairy WA to demonstrate that any reduction in transport costs that it is able to secure would not be at the expense of meeting all transport fleet management requirements such as scheduling requirements, occupational health and safety standards, quality management standards and appropriate licensing requirements.
- (17) Dairy WA indicated that farmers have approached processors about the possibility of using other trucking companies to deliver raw milk, and have had these offers refused by the processors⁵. National Foods wishes to confirm that no dairy farmer has presented it with any serious offer in this regard. The issue has in the past been raised verbally with National Foods, but was not progressed to the stage of a formal proposal being presented to National Foods. National Foods remains open to any sustainable improvements in the collection and transportation of raw milk, provided all relevant standards and performance criteria are complied with.

⁵ page 14 Dairy WA submission

- (18) National Foods is of the view that the cost savings that Dairy WA cites as being likely to arise with a rationalised transport system in Western Australia are overstated. National Foods utilises the vast bulk of its transport fleet, and constantly improves fleet efficiency to minimise cost rises associated with fuel, wages and other cost rises. National Foods does not use its fleet as a profit centre.

Redistribution of monopsony profits

- (19) Dairy WA's suggestion that dairy processors in Western Australia hold monopsony power⁶ is entirely inaccurate. There is no location in Western Australia where producers face an uncontested market for the supply of raw milk. Accordingly, by definition, no processor in Western Australia is able to operate as a monopsonist.
- (20) National Foods competes strongly with other processors for the acquisition of milk in Western Australia and the supply of milk to retailers, and in fact pays the highest price for raw milk as compared with any other processor.
- (21) Western Australian suppliers have a choice of processors to supply raw milk to, and it is at all times open for National Foods' Western Australian suppliers to supply other processors as well. Currently, in fact, Challenge and Harvey Fresh are seeking additional raw milk supplies in Western Australia, and National Foods and Peters & Brownes are seeking additional Summer volumes.
- (22) Dairy WA's statement, on page 17 of its submission, that processors experience no pressure to become more efficient, is incorrect. It is at all times necessary for processors to maximise their efficiency, and National Foods has made a significant investment in Western Australia, employing 200 staff directly, and indirectly employing a range of service providers such as freight / transport providers, engineering and maintenance support personnel, and sales / marketing support staff.
- (23) National Foods supports eighty-seven farm suppliers throughout Western Australia, as evidenced by Table 2 in Confidential Appendix 1. These suppliers range in size from small producers (who produce less than 750 000 litres of milk annually) to large producers, who supply over 2 million litres annually. National Foods invested close to \$100 million dollars in Western Australia in the early 1990's, and continues to invest in Western Australian operations. For example, National Foods recently made a substantial ongoing investment commitment to its Bentley facility, aimed at improving efficiency and waste management.
- (24) Rather than addressing any alleged monopsony power issues, the Combined Negotiation Arrangements would provide dairy farmers

⁶ page 5 Dairy WA submission

with monopoly power in relation to their supply of raw milk to processors. As outlined in paragraph 6.3(7) above, given the power for Dairy WA to collectively boycott processors and retailers, and the potential for Dairy WA to represent every farmer in Western Australia, the proposed arrangements would potentially deliver monopoly power to Dairy WA, and place Dairy WA into a position to be able to extract monopoly rents from processors and retailers.

- (25) Processors and retailers would then be likely to either pass these price rises on to consumers in the form of higher retail prices, or otherwise limit their acquisition of milk from Dairy WA if Dairy WA charges prohibitively high prices that cannot be passed through to consumers. Accordingly, rather than comprising a public benefit, consumers would be likely to be worse off as a result of the proposed arrangements.

Proposed arrangements would amount to re-regulation of the Western Australian dairy industry

- (26) National Foods entirely disagrees that the proposed arrangements are necessary to ease the transition of the Western Australian dairy industry to deregulation. Deregulation occurred in 2000, and several measures, such as the Dairy Structural Adjustment Program, were implemented soon after this time to assist dairy farmers to adjust to the new market environment.
- (27) The process of deregulation in July 2000 saw the dismantling of State and Federal milk support arrangements. Part of this program involved the provision of a support package totalling \$1.8 billion dollars to eligible farmers. The package was designed to support the process of transition from a regulated to a deregulated market, to ensure farm suppliers either restructured their operations, or exited the industry.
- (28) Average payments to farmers across Australia totalled \$118 000 per farm. In Western Australia, farmers received an average payment of \$237 000 per farm. Consumers continue to pay increased milk prices in order to fund these support packages, in the form of a levy of 11 cents on each litre of milk sold. This was implemented in July 2000, and was expected to be in place for at least eight years.
- (29) National Foods submits that the proposed arrangements extend much further than merely assisting the industry's transition towards deregulation. The arrangements being proposed by Dairy WA amount to re-regulation of the Western Australian dairy industry, with a single negotiating agent negotiating the price for, potentially, every dairy farmer in Western Australia.
- (30) The Tribunal granted authorisation to dairy farmers in 2002 to collectively bargain with dairy processors for the specific purpose

of enabling a smooth transition by Australian dairy farmers to the newly deregulated market. The Tribunal's previous authorisation was intended to be transitional, and was intended to provide dairy farmers with time in which to develop or enhance their skills in negotiating with processors. It was not intended to constitute an alternative form of regulation of the industry. In contrast, Dairy WA's proposed arrangements seek to entirely remove dairy farmers from the contract negotiation process. As a result, National Foods submits that these arrangements would actually make it more difficult for farmers to operate in a deregulated environment. Accordingly, National Foods submits that the proposed arrangements would entirely undermine the success of deregulation of the dairy industry.

- (31) National Foods notes comments by the ACCC in a letter to the Minister for Agriculture, Forestry and Fisheries, Kim Chance MLC in November 2003. The ACCC indicated at this time that vesting all Western Australian milk in a single entity for sale by tender to dairy processors would be likely to have profound and significant adverse implications for the development of an efficient deregulated market, and the benefits to consumers that this would otherwise bring.
- (32) The ACCC indicated in its Collective Negotiation Discussion Paper that, in cases where authorisation is sought for collective bargaining on the grounds of easing the transition of the market to deregulation, it is necessary that the industries demonstrate a clear commitment and movement towards operating in a deregulated market. The ACCC went on to say that arrangements that prevent or hinder deregulation occurring (such as those that effectively seek to replace one set of regulated arrangements with another) are unlikely to be considered by the ACCC to produce a public benefit.
- (33) Dairy WA's authorisation application demonstrates absolutely no commitment towards operating in a deregulated environment at any stage in the future. The fact that the proposed arrangements restrict competition to a substantially greater degree, and propose to provide Dairy WA with substantially greater power than the Australian Dairy Farmers Federation, or any collective bargaining group under the arrangements for which the Tribunal provided authorisation in 2002, is evidence of this. Accordingly, Dairy WA's argument that the Combined Negotiation Arrangements are necessary so as to ease the transition to industry de-regulation is entirely without merit.

No evidence that exiting farmers were operating efficiently

- (34) Dairy WA has indicated that the proposed arrangements are necessary so as to ensure the continued viability of small dairy farm businesses.

- (35) National Foods does not accept Dairy WA's argument in this regard, as Dairy WA has not provided any evidence to demonstrate that the businesses that are exiting the industry were operating efficiently, or that allowing Dairy WA to collectively bargain on their behalf would ensure their continued viability.
- (36) The 2003 report by the Economics and Industry Standing Committee entitled *'The Sustainability of the Dairy Industry in Western Australia'* in fact made the finding that as at 2003, the most efficient dairy farmers continued to operate profitable dairy businesses⁷.
- (37) If businesses that are exiting the industry were not operating efficiently, it would not be a public benefit to prevent their exit by causing anti-competitive detriment to other parts of the industry.
- (38) In any case, there are other reasons that farmers may choose to exit an industry besides a lack of profitability, such as the utilisation of land for alternative rural uses or other developmental opportunities, generational changes and demographic movements. Accordingly, the exit of farmers from the Western Australian dairy industry cannot be solely attributed to rising debt levels and an inability to operate viably.

Opening up new markets

- (39) Dairy WA has indicated that one of the roles of the Milk Negotiating Agency will be to seek new markets in Australia and overseas.
- (40) However, Dairy WA has not provided sufficient information about the nature of these potential new opportunities, to enable National Foods, or any other interested party, to assess the likelihood of it occurring, its validity as a public benefit, or whether such opportunities would only be available if Dairy WA was able to collectively negotiate and collectively boycott on behalf of all Western Australian dairy farmers.
- 6.6 In summary, National Foods submits that all Dairy WA's public benefit arguments lack merit. Dairy WA has made inaccurate statements as to the power held by processors in the market, and it has not demonstrated that the public benefits that it has identified would be likely to arise as a result of the Combined Negotiation Arrangements. Further, National Foods cannot identify any other public benefits that would be likely to arise out of the proposed arrangements.
- 6.7 National Foods considers that the proposed arrangements would be likely to lead to substantial public detriment through the substantial lessening of competition and market distortion that would be likely to result.

⁷ Finding 52 of the Committee

05/05/2005

6.8 National Foods submits that Dairy WA has not demonstrated that the public benefits (if any) of the proposed arrangements would outweigh the clear anti-competitive detriments likely to arise. Accordingly, National Foods submits that the ACCC should refuse to grant authorisation to Dairy WA in respect of both the Collective Bargaining Arrangements and the Collective Boycott Arrangements.

We would be pleased to elaborate upon the issues raised in this submission. Please contact Anita George or me if you would like to do so. Otherwise, we look forward to meeting with you on 16 May to discuss National Foods' views in more detail.

Yours faithfully

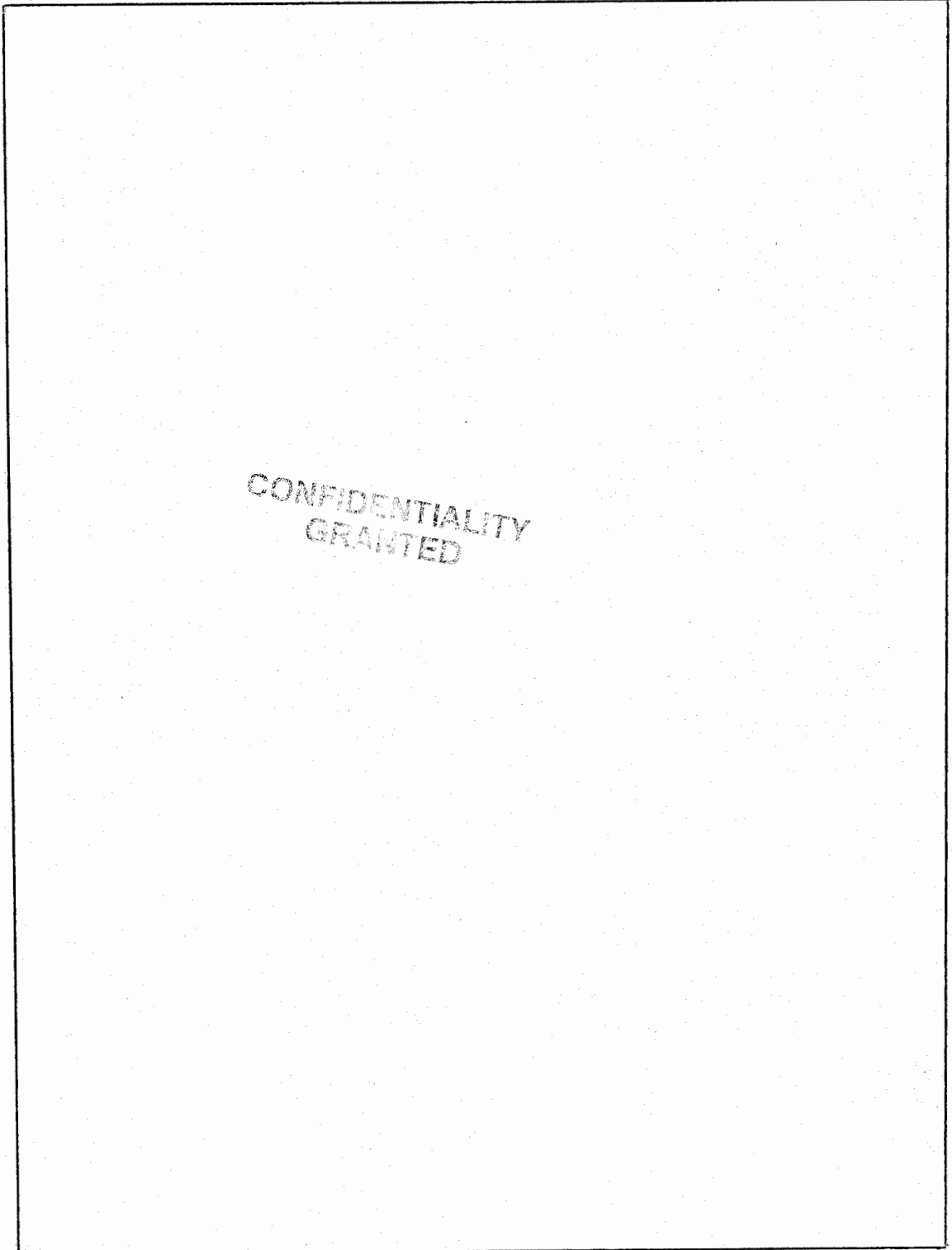


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**Restriction of publication of Appendix 1
in its entirety is claimed**

Appendix 1 – confidential



Appendix 2

CONFIDENTIALITY
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2. On page 11 of its submission, Dairy WA refers to statistics in a report by the Economics and Industry Standing Committee on the Sustainability of the Dairy Industry in Western Australia, which compared dairy farm exit rates in various Shires of Western Australia. Dairy WA stated that this table indicated that the Harvey and Capel shires had the lowest exit rate, with an exit rate of 22%. However, it appears that Dairy WA may have overstated this exit rate, as the table that Dairy WA refers to on page 35 of the report indicates that there was a 0% exit rate from Bunbury Shire, and a 12% exit rate from Albany.
3. Dairy WA's statement on page 15 of its submission that processors and supermarkets have increased or maintained their gross profit is incorrect in relation to processors.

In fact, the statement is inconsistent with the information provided in the NCC's report to the Productivity Commission entitled *'Dairy Now and Then: The Australian Dairy Industry Since Deregulation'*, that Dairy WA refers to as supporting its statement.

This report makes specific reference to processors facing increased costs since 2000 due to increased costs of supplying non-grocery retail segments. This has been due to higher distribution costs and brand support expenditure. The report specifically indicates that the reference to a small increase in processing gross margins does not take into account the additional costs of servicing the non-supermarket sector.

This view is also supported by the Economics and Industry Standing Committee 2003 report into *'The Sustainability of the Dairy Industry in Western Australia'*, which indicated on page 36 the Committee's observation that both dairy farmers and processors had been disadvantaged by rapid falls in milk prices that occurred after deregulation.

4. National Foods disagrees with the version of events put forward by Dairy WA on page 19 of its submission, in which it described a 40% reduction in the volume of National Foods' purchases in 2003, without warning to the Collective Bargaining Group Negotiation Committee or its suppliers.

Dairy WA has overstated the overall reduction in the volume of National Foods' purchases. The overall contraction in volume was 27.5%, made up of a reduction of 40% in winter, and 15% in summer.

As National Foods indicated to the Chairman of its Collective Bargaining Group Negotiating Committee in 2003, National Foods' decision was not made without any warning being provided to the Bargaining Group. National Foods had indicated several times previously, verbally and in writing, that it was unable to guarantee that it would maintain its milk volumes at the level that they were prior to the reduction.

National Foods was forced to reduce the volume of its purchases due to commercial pressures including the loss of domestic and international milk sales, and a contraction of National Foods' export business. Suppliers were provided with National Foods' reasons for the reduction in its volume of purchases.