



Australian
Competition &
Consumer
Commission

Draft Determination

Applications for Authorisation

lodged by

Dairy WA

in respect of

the establishment of a milk negotiating agency to collectively bargain on behalf of Western Australian dairy farmers with milk processors, retailers and service providers to the dairy industry; and to collectively boycott milk processors under certain circumstances.

Date: 17 October 2005

Commissioners:

**Samuel
Sylvan
King
Martin
McNeill
Smith
Willett**

Authorisation nos. A90961 & A90962

Public register no. C2005/497

Executive summary

The Application

On 16 March 2005 Dairy WA Limited (Dairy WA) lodged applications for authorisation A90961 and A90962 with the Australian Competition and Consumer Commission (the ACCC).

The proposed arrangements

In summary, Dairy WA has sought authorisation to allow it to establish a milk negotiating agency to collectively bargain on behalf of dairy farmers with processors, retailers and service providers on the terms and conditions (including price) of supply and delivery of raw milk (collective bargaining).

Dairy WA has also sought authorisation to allow its members to withhold the supply of raw milk from processors under certain circumstances (collective boycott). These circumstances include the entering into of direct negotiations between processors and dairy farmers who have appointed Dairy WA to act on their behalf, without the consent of Dairy WA.

ACCC assessment of the proposed arrangements

The ACCC has assessed the claimed public benefits and potential public detriments that may arise from the establishment of the proposed milk negotiating agency based upon the information available to it. The ACCC notes that, despite requests made to Dairy WA, aspects of the material provided by the applicant are lacking in detail which may otherwise have assisted in the assessment of the proposal.

Generally, the ACCC considers that collective bargaining agreements, which set uniform terms and conditions (including price), are likely to lessen competition relative to the situation where such collective arrangements do not exist.

In addition the ACCC considers that collective boycotts have the potential to cause serious disruption to industry participants, consumers and the economy in general. The withdrawal, restriction or limiting of supply of any good or service in a market results in consumer detriment (higher prices and restricted choice); adversely affects businesses' ability to fulfil contracts, service debt and meet business projections; and negatively impacts on returns on capital investments suppressing future investment in an industry.

Having considered the information provided by Dairy WA and interested parties, the ACCC is concerned that the proposed milk negotiating agency has the potential to result in significant public detriments, these include:

- the arrangements have the potential to significantly depress competition between

dairy farmers on matters such as price;

- the arrangements have the potential to unduly restrict the ability of dairy farmers to deal directly with processors;
- the arrangements have the potential to introduce industry-wide pricing agreements;
- the arrangements are likely to significantly limit the input of dairy farmers into contracts negotiated with processors;
- the arrangements may have a significantly detrimental impact upon Challenge and existing surplus milk arrangements; and
- the arrangements are likely to artificially increase barriers to entry and exit for dairy farmers and may also artificially increase barriers to entry and expansion for processors.

Having considered the information provided by Dairy WA and interested parties, the ACCC is of the view that the public benefits likely to arise from Dairy WA's proposal are likely to be minimal. This is particularly the case having regard to the current ability of dairy farmers to collectively bargain under the nationally authorised arrangements (Australian Dairy Farmers, A90966).

Draft determination

Following consideration of the arguments advanced by Dairy WA and interested parties, the ACCC can not be satisfied that the public benefits likely to result from the proposed arrangements are likely to outweigh the potential public detriments of those arrangements.

Accordingly the ACCC proposes to deny authorisation to applications A90961 and A90962.

Interim authorisation

Dairy WA sought interim authorisation to establish a milk negotiating agency and to enter into preliminary negotiations with processors and service providers to the dairy industry on behalf of dairy farmers who had appointed it to negotiate on their behalf. On 25 May 2005, the ACCC postponed its decision on interim authorisation until draft determination. A decision on the application for interim authorisation, by virtue of this draft determination, is now unwarranted.

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1 Introduction

- 1.1 The Australian Competition and Consumer Commission (the ACCC) is the Australian Government agency responsible for administering the *Trade Practices Act 1974* (the TPA). A key objective of the TPA is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.
- 1.2 The TPA, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an 'authorisation'. Broadly, the ACCC may 'authorise' businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.
- 1.3 The ACCC conducts a comprehensive public consultation process before making a decision to grant or deny authorisation. Upon receiving an application for authorisation, the ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.4 The TPA requires that the ACCC issue a draft determination in writing proposing either to grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the ACCC will take into account any submissions received from interested parties. This document is a draft determination in relation to applications for authorisation A90961 and A90962 lodged with the ACCC by Dairy WA Limited (Dairy WA) on 16 March 2005.
- 1.5 Once a draft determination is released, the Applicant or any interested party may request that the ACCC hold a conference. A conference provides interested parties with the opportunity to put oral submissions to the ACCC in response to a draft determination. The ACCC will also invite interested parties to lodge written submissions on the draft.
- 1.6 The ACCC then reconsiders the application, taking into account the comments made at the conference (if one is requested) and any further submissions received, and then issues a written final determination. Should the public benefit outweigh the anti-competitive detriment the ACCC may grant authorisation. If not, the authorisation will be denied.
- 1.7 The ACCC also has the power to grant interim authorisation at the time the application is lodged or at a later stage. Interim authorisation protects the arrangements for which authorisation is sought from legal action under the TPA while the ACCC considers and evaluates the merits of the application.

2 Background

- 2.1 The ACCC notes that as the Australian dairy industry is a large, complex and diverse sector of the economy, there is a significant amount of information, data and research available concerning it. However, this section of the draft determination will only include that information which the ACCC considers to be directly relevant to the evaluation of the application for authorisation by Dairy WA.
- 2.2 The ACCC acknowledges that the data and information throughout the draft determination have been sourced from the following reports.
- ABARE, Jan 2005: *A Review of the Australian Dairy Industry*
 - Dairy Australia, 2005: *Australian Dairy Industry in Focus 2004*
 - Dairy Australia, 2005: *Dairy 2005: Situation and Outlook Report to the Australian Dairy Industry*
 - National Herd Improvement Association of Australia Inc, 2004: *Australian Dairy Herd Improvement Report 2003/2004*
 - Ridge Partners, Nov 2004: *Dairy – Now and Then: The Australian Dairy Industry Since Deregulation*
 - Productivity Commission, 2005: *Trends in Australian Agriculture*, Research Paper, Canberra.
- 2.3 Full copies of these reports can be accessed through the ACCC website or by contacting the relevant organisation directly.

The dairy industry and deregulation

- 2.4 It has been recognised that the opportunity cost of a regulated system, consisting of producer subsidies and marketing supports, which restricts producers' options and flexibility to innovate and limits the capacity to capture marketing opportunities, is significant.¹
- 2.5 The dairy industry in Australia was one of the most highly assisted and regulated industries with effective rates of assistance, just prior to deregulation of 19% for manufacturing milk and more than 200% for market milk, compared with a total average effective rate of assistance for the aggregated agricultural sector of 6%.²
- 2.6 A number of features of the regulated environment included:
- a separate dairy industry in each state with restricted interstate trade;
 - an artificial separation of market milk and manufacturing milk;

¹ Productivity Commission, 2001 *Impact of Competition Policy Reforms on Rural and Regional Australia*, Canberra.

² Productivity Commission, 2001 op.cit.

- high effective rates of assistance relative to the average effective rate for the entire agricultural sector; and
 - farm gate prices for market milk significantly above import parity prices.³
- 2.7 A direct result of the highly regulated dairy industry in Australia was higher domestic retail prices for dairy products which attracted imports of cheaper dairy products from Australia's trading partners (particularly New Zealand following the Closer Economic Relations agreement).
- 2.8 Following decades of regulatory control pressure for change in the structure of the dairy industry came most notably from within the dairy industry itself, predominantly from the industry in Victoria which is the biggest dairy state. Other exogenous developments placed the industry under increased pressure to become more flexible and more efficient, namely:
- (i) technological developments;
 - (ii) changes in consumer tastes;
 - (iii) environmental considerations; and
 - (iv) domestic and international trade policies creating pressure for liberalisation of agricultural markets.

The Australian Dairy Industry

- 2.9 Australian dairy farmers have operated in a deregulated environment since 2000, where international prices are the major factor in determining the price received by farmers for their milk.
- 2.10 Over the past two decades the dairy industry has experienced significant change and has undergone substantial restructuring which can be attributed to a number of factors, namely:
- deregulation of the statutory marketing arrangements;
 - the severe 'once in a century' drought;
 - fluctuations in world market returns; and
 - volatile currency conditions.
- 2.11 Nationally, the total number of dairy farms has steadily declined since the 1970's. The number of dairy farmers has more than halved and the processing and distribution sectors have been significantly rationalised. A consolidation of farms together with exits from the industry has resulted in the growth in the size of the average dairy farm and growth in the average herd size.⁴
- 2.12 According to ABARE, this restructuring has promoted a more efficient industry and has enabled significant growth to occur in the value of Australian

³ Edwards, Geoff 2003, *The Story of Deregulation of the Dairy Industry*, La Trobe University, Victoria

⁴ Dairy Australia, June 2005, op.sit. p.30

production.⁵ Along with New Zealand, Australia is one of the lowest cost milk producing countries.

- 2.13 Approximately 10.1 billion litres of milk was produced in Australia in the 2004-05 year, with a farmgate value of \$2.8 billion and an export value (after manufacturing) of \$2.46 billion. Approximately 20% of total milk produced is consumed as drinking milk and the rest is used in manufacturing dairy products such as cheese, ice cream, skim milk powder, yoghurt, butter and cream. Victoria is the largest milk producing region, producing 66% of national milk production.⁶
- 2.14 Dairy farming occurs in all Australian states, however, it is mainly concentrated in those areas which have high average rainfall or have reliable irrigation systems. Milk is produced year round in Australia, with approximately two thirds of dairy farms, especially those in Tasmania and Victoria, varying their production according to the season. The months of September to January see the highest production. Milk production in the remainder of the states is generally more evenly spread across the year.
- 2.15 Dairy herds declined in the 1980's, yet milk production rose as a result of productivity increases and improved yields per cow. Milk production rose considerably in the 1990's and into the 2000's as a result of increases in cow numbers and improvements in productivity and output peaked at 11.3 billion litres in 2001-02.
- 2.16 This increase in production, together with a declining Australian exchange rate and improved world prices for major dairy products, resulted in significant growth in Australian exports, particularly from the mid-1990's to 2001-02.
- 2.17 As a result of the 2002-03 drought which carried through into the 2004 production year, lower world prices and a strengthening Australian dollar in the past two years, milk production and milk prices fell and feed costs rose, which contributed to significantly lower incomes in 2002-03 and 2003-04.
- 2.18 With the exception of the 2002-03 drought year, estimated farm cash incomes and rates of return from dairying have consistently outperformed all but the cropping industry since 1989-90 and sheep in 2003-04. ABARE considers that this indicates that those farmers remaining in dairy have coped well with the phasing out of government support over the past fifteen years and that the drought in 2002-03 was a major factor in reducing average farm income and rates of return in that year.

⁵ ABARE, Jan 2005, op. cit. p.1

⁶ ABARE, Jan 2005, op. cit. p.5

- 2.19 ABARE's survey of dairy farms indicates a significant improvement in farm cash income is expected in 2004-2005. On average, farm incomes are projected to increase in the 2005-06 year by 26%.⁷
- 2.20 Dairy farm incomes have differed considerably between states and are a function of (i) the percentage of milk sold for manufacturing or drinking; (ii) international prices; (iii) transport costs; and (iv) input costs, eg. feed and supplements. Farms in states that have more manufacturing milk and more seasonal production are more reliant on export milk and receive a lower milk price.
- 2.21 The family farm remains the dominant enterprise structure. Approximately 61% of farms employ only family labour, and only a minority of enterprises employ full time external employees.
- 2.22 Significant challenges remain and these have been identified:
- productivity improvements;
 - input costs – the long term trend is for input costs to rise at a rate faster than the growth in milk prices;
 - pasture management – optimal pasture utilisation is essential in reducing reliance on feed stuffs and grains;
 - water rights and requirements – this varies in significance across regions;
 - the cost and availability of labour – increased competition from regional industries which offer better working conditions;
 - international trade policies; and
 - new low cost entrants into world markets (eg. Brazil and Argentina).

The processing sector⁸

- 2.23 Milk processing is highly concentrated in Australia with three dominant processors – National Foods Milk Ltd (now a fully owned subsidiary of San Miguel Corporation), Dairy Farmers and Parmalat Australia – reported to supply over 80 per cent of all drinking milk. There is also a number of small regional and niche market milk processors. Although milk processing is highly concentrated, there appears to be strong competition in the sector.
- 2.24 The intake of milk by farmer owned co-operatives represents around 62 per cent of total Australian milk production, with the two large Victorian co-operatives – Murray Goulburn and Bonlac Supply Co. – together accounting for just under 50 per cent of national supplies. The other large co-operative, Dairy Farmers, receives another 12 per cent of the nation's milk.

⁷ Dairy 2005, op. sit. p.27

⁸ ABARE, Jan 2005, op. sit. p.29

- 2.25 Over the past two decades there has been significant rationalisation and restructuring in Australia's milk processing and manufacturing sector. This structural reform has mainly been driven by the expansion of multinational food corporations and the removal of competition restrictions such as regulated state markets and government assistance. This has resulted in a highly competitive dairy manufacturing and processing sector.
- 2.26 Dairy Australia notes that while Australian dairy companies will directly drive the consolidation changes, the inevitable future changes in ownership of dairy companies and brands will most likely be driven by overseas interests. It considers that the domestic industry does not currently possess the capital to achieve the necessary restructuring.⁹

The Retail Sector

- 2.27 The domestic retail environment creates a challenge for processors, manufacturers and/or brand owners (collectively referred to as processors in this draft determination) in balancing priorities in response to the changing industry supply chain and marketplace.
- 2.28 In assessing the impact of the deregulation of market milk, the ACCC's 2001 report estimated that average net profit margins of Australian milk processors were significantly lower in the first six months after deregulation than before deregulation. It was concluded that consumers captured the benefits of deregulation rather than milk processors and retailers.
- 2.29 In recent years there has been a strong shift to generic milk. It is however, less pronounced in the smaller states. In Western Australia it is understood that while Peters and Brownes has recently engaged in heavy discounting of their branded milk in supermarkets, the price received by farmers for their milk has not been affected.
- 2.30 The compulsion for dairy product marketers will be to continue to invest in innovation in order to survive.
- 2.31 Australia's broader domestic retail market for the sale of manufactured dairy products and drinking milk is dominated by the two incumbent supermarket chains, Coles Myer Ltd and Woolworths Limited. These supermarket chains account for around 60% of all domestic dairy sales; the food service industry (restaurants, cafes) accounts for around 12%; and the remainder is divided between other outlets such as other supermarkets and non-supermarket retailers.
- 2.32 It is significant to note that since the deregulation of the dairy industry, Coles and Woolworths have adopted a strategy of selling reduced price generic milk in a bid to attract more customers. Over the past five years, this has led to a significant

⁹ *Dairy 2005: Situation & Outlook*, op. cit. p.

- increase in the sale of non-branded generic milk and reciprocal decreases in the sale of branded milk.
- 2.33 The considerable changes being implemented by Australia's major chain retailers have significant implications for dairy processors and dairy producers. The supply chain efficiencies of major domestic dairy companies will continue to undergo cost and service-delivery pressure in coming years.
- 2.34 Future prospects for dairy products in the domestic market will be determined by how well retailers and processors work together to grow the category amidst an increasingly complex set of factors impacting on consumer spending on dairy products.

Transport

- 2.35 More cost effective transport and concentration of industry processing capacity has meant that milk is moved over long distances for further processing. For instance, Dairy Farmers is understood to use 'B Double' trucks to move milk from South Australia to Sydney for manufacturing while Murray Goulburn transports milk from the south east region of South Australia to its factory near Warnambool in Victoria.¹⁰
- 2.36 In some of the smaller milk producing states efficiency gains have also been made in milk collection. In Western Australia for example, factories have been converted to collection centres to improve efficiency and lower costs.

Export Market

- 2.37 In 2003-04 Australia exported 51 per cent of its annual milk production and more than 65% of its output of manufactured products in the form of commodities such as cheese, milk powders and butter. As a consequence, farm gate prices, particularly in the manufacturing states of Victoria and Tasmania are closely aligned to returns from exported products.
- 2.38 Australia's dairy product exports decreased 1.6% in the 2004/05 year. However, average export returns increased 10.3% boosting Australian export sales values by 8.5% to \$2.5 billion.¹¹
- 2.39 Australia's share of the world market has grown at a rate of 10% per annum since 1995, peaking in 2002 at 17% but falling away to 13% in 2003. Global consumption of dairy products will continue to grow and the short term world demand is expected to remain firm.
- 2.40 A significant flow on effect from this reliance on exports is that the price paid for milk to Australian dairy farmers, especially those in states which are highly

¹⁰ ABARE, Jan 05, op. cit. p.30

¹¹ Dairy Australia, August 2005 *Fortnightly Update*, Issue 16

geared toward producing manufactured goods (Victoria, Tasmania and South Australia), is heavily linked to international milk prices. Whilst the impact of international price fluctuations is not as pronounced for those dairy farmers who produce milk mainly for the domestic markets (Western Australia, Queensland and New South Wales), the entire dairy industry is affected by events on international markets.

- 2.41 In addition to the industry's significant export focus, Australia is an open market for dairy products, which ensures returns to the dairy manufacturing sector are further linked to world market conditions.

Western Australia

- 2.42 Milk production in Western Australia at 396 million litres in 2004-2005 (down from 403 million litres in the previous year) represents 3.9% of total national milk output and represents 2-3% of Western Australia's gross value of agricultural production.¹²
- 2.43 Western Australia has the smallest herd numbers and the least cows of all the dairy states with 241 herds totalling 73,000 cows at June 2004 (an increase of 8,000 since March 2000). Average per cow production in 2004 was 6,250 litres, the highest average per cow production in Australia (7% lower than 2003).
- 2.44 In line with the national experience, there have been a high number of farm exits in Western Australia – approximately 30% since 2000 (419 farms in 1999-2000; 285 in 2004-05). Production has remained in line with pre-deregulation levels, as farm sizes have grown on average by more than 33% and the remaining producers have increased their scale to achieve better farm efficiencies.¹³
- 2.45 According to Dairy Australia, Western Australia was not as severely affected by the drought as the dairy states on the east of the country; however, Western Australian dairy farmers were affected by global increases in feed grains and national shortages which led to increases in feed costs.
- 2.46 The largest proportion of milk production in Western Australia is processed into fresh dairy products. Dairy 2005: Situation and Outlook reports that milk flows in the region exceed the requirement for fresh product processing by 25-30%.
- 2.47 There are four main processors in Western Australia and a number of smaller, niche, boutique manufacturers. PB Foods Ltd (trading as Peters & Brownes) and National Foods Milk Ltd (now a wholly owned subsidiary of San Miguel Corporation) are the two major processors. Challenge Dairy Co-operative Ltd (Challenge) was established in 2001 to act as a balancing mechanism for dairy farmers and processors post deregulation. Approximately 47% of Western Australian dairy farmers are currently members of Challenge. Harvey Fresh

¹² Dairy Australia, September 2005 *National Milk Production Report*

¹³ Ridge Partners, Nov 2004: o.p.s.t. p.50

(1994) Ltd (trading as Harvey Fresh) is a family owned milk processor located in Harvey, 160kms south of Perth. Harvey Fresh is the smallest market milk processor and is supplied by approximately 20 dairy farmers.

- 2.48 Coles Myer Limited (CML) is Australia's largest retailer and currently has 76 stores in Western Australia. Woolworths operates supermarkets in all Australian states and the Northern Territory and currently has 60 supermarkets in Western Australia.
- 2.49 The competitive tendering process for the rights to supply private label lines to each of the major chains now drives the market share and returns of the major dairy processors from the packaged milk sector. Woolworths awarded its national contract for private label milk to National Foods Milk Ltd. CML awarded its Western Australian contract to supply its private label lines to Peters & Brownes.
- 2.50 The major supermarkets have increased their share of the packaged milk business from 45% to 56% in the past 5 years. However, in Western Australia the independent supermarket sector and the "route" sales channel – convenience stores, small corner stores and other outlets – provide retail competition and remain a competitive outlet for branded packaged milk.
- 2.51 In 2003/04, the average price of branded milk increased 3% and offset a 1% decline in private label prices.
- 2.52 In 2003/04 supermarket milk sales in Western Australia were 115mL which represents 10.3% of total national supermarket milk sales. Nationally, branded supermarket milk sales in 2003/04 were 525mL down from 538mL in 2001/02. Private label supermarket milk sales in 2003/04 were 587mL up from 509mL in 2001/02. Extrapolating from this data, we can infer that branded supermarket milk sales in Western Australia were approximately 54mL and private label supermarket milk sales were approximately 60.4mL.
- 2.53 Milk prices in the region paid by the two major processors are driven by a combination of factors which include the value/price that is achieved by Challenge Dairy from its commodity manufacturing operations; and the price necessary to secure the necessary flow of milk for fresh product requirements.

Related authorisations

- 2.54 In March 2002 the ACCC granted authorisation to Australian Dairy Farmers' Federation Ltd (A90782) - now known as Australian Dairy Farmers (ADF) allowing groups of dairy farmers to collectively negotiate contractual terms and conditions with dairy processing companies. Under this arrangement the ADF, or another common agent, is not permitted to represent farmers in price/supply negotiations. In August 2002 the Australian Competition Tribunal granted authorisation to Australian Dairy Farmer's Federation Ltd allowing groups of

dairy farmers to collectively negotiate contractual terms and conditions with dairy processing companies.

- 2.55 As the 2002 authorisation was due to expire in July 2005, on 8 April 2005 the ADF lodged an application (A90966) for revocation and substitution seeking to extend the period of immunity for a further 5 years. On 18 May 2005 the ACCC granted interim authorisation to ADF to allow Australian dairy farmers to continue collective negotiations with processors while the ACCC considers the substantive application for authorisation.
- 2.56 The ADF, in its submission supporting its application for revocation and substitution, has acknowledged that collective bargaining has been ineffective in a number of instances. This is largely attributed to the initial unwillingness of processors to participate in the bargaining process and to reach an outcome. The ADF considers, however, that recent developments show far greater promise of an effective (win-win) outcome being achieved.
- 2.57 Collective boycotts are not a feature of the ADF authorised arrangements.
- 2.58 The ACCC granted authorisation (A90745) to Premium Milk Ltd (Premium) in December 2001 to represent 580 south east Queensland dairy farmers (through six co-operatives) in collective bargaining negotiations with Paul's Ltd (now fully owned by Parmalat Australia Ltd). The negotiations included, but were not limited to, collectively negotiating farm-gate prices and milk standards. Authorisation was granted until 30 June 2005.
- 2.59 On 13 May 2005, Premium lodged an application seeking revocation of authorisation A90745 and substitution by authorisation A90972. The ACCC granted interim authorisation to Premium on 16 June 2005 and is currently considering its substantive application. The ACCC issued a draft determination proposing to grant authorisation to Premium's application on 5 October 2005.

3 Dairy WA's application

- 3.1 On 16 March 2005, Dairy WA lodged applications for authorisation A90961 and A90962 with the ACCC.
- 3.2 Applications were made under section 88(1) of the TPA for an authorisation under that subsection:
 - (a) to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be or might be, an exclusionary provision or would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA; or
 - (b) to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision or has the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA.
- 3.3 Dairy WA seeks authorisation to establish a collective bargaining group, namely a milk negotiating agency, open to all Western Australian dairy farmers who appoint it to negotiate and enter into contracts for the supply, and in certain circumstances, the delivery of their milk to processors or retailers.
- 3.4 Dairy WA is an unlisted public company. The majority of current dairy farmers in Western Australia are shareholders.
- 3.5 Dairy WA was formed from the Dairy Industry Authority (DIA) which was disbanded on deregulation of the industry in 2000. The Western Australian State Government transferred all DIA assets to Dairy WA. All dairy farmers, who had been producing during the previous 12 month period, were granted A class voting shares. Following retirement or exit from the industry, the A class shares become B class non-voting shares.
- 3.6 Dairy WA's role is to make strategic commercial investments that will strengthen the Western Australian dairy industry and improve the stability, viability and profitability of dairy farmers in Western Australia in a manner consistent with its corporate responsibilities.
- 3.7 In September 2004 Dairy WA was appointed by dairy farmers to undertake the role of establishing a milk negotiating agency. Dairy WA may establish a separate legal entity to carry out the role of the milk negotiating agency.
- 3.8 The collective bargaining arrangements for which Dairy WA seeks authorisation are:
 - i. Dairy WA proposes to establish a collective bargaining group (being the milk negotiating agency) open to all Western Australian dairy farmers

who appoint it to negotiate and enter into contracts for the supply and in certain circumstances the delivery of their milk to processors or retailers. Dairy WA anticipates that the arrangement will create improved economies of scale and encourage improved efficiencies in the Western Australian dairy industry particularly in the area of transport and the provision of milk supply to the closest processing plant.

- ii. Dairy WA proposes to negotiate on behalf of the Western Australian dairy farmers who have authorized it to do so and enter into contracts with any retailer or processor willing to negotiate with it for the purchase of that milk. It is proposed that each negotiation would take place separately at the conclusion of the dairy supply contracts that are currently in force.
- iii. Property in the milk does not pass to Dairy WA; it is an agency arrangement for the negotiation, sale and where agreed by the parties, the delivery of milk.
- iv. Dairy WA proposes to enter into voluntary written agreements with dairy farmers in Western Australia to collectively negotiate supply contracts for their milk. It is anticipated that these agreements will be individualized in relation to their terms and conditions based on the requirements for the supply of milk and any special conditions agreed with the dairy farmer, for example 5 days or 7 days supply, transport arrangements, option to supply additional milk should new contracts become available, as well as pricing arrangements.
- v. Dairy WA proposes to enter into individually negotiated agreements with processors or retailers for the supply of milk collectively owned by Western Australian dairy farmers who have authorized it to do so in writing. It is anticipated that each contract would be individualized based on the agreed outcome of the negotiations.
- vi. Dairy WA may arrange for transport services for milk on behalf of Western Australian dairy farmers who have authorized it to do so, where contracts negotiated with processors or retailers permit a choice of transport services.
- vii. Dairy WA may arrange access for Western Australian dairy farmers to independent testing facilities for milk for the purpose of complying with standards and quality requirements under the supply agreement entered into by Dairy WA on their behalf with processors.
- viii. If Western Australian dairy farmers have established a tolling arrangement for the processing of their milk products, Dairy WA proposes, if authorized to do so by them in writing, to negotiate and contract for the sale and delivery of those products on those Western Australian dairy farmers behalf. Dairy WA during the term of the authorisation, will not undertake milk processing or sales to retail customers.

3.9 In addition to the collective bargaining arrangements, Dairy WA has also sought authorisation to allow its members to engage in 'collective boycotts'.

3.10 The collective boycott arrangements for which Dairy WA has sought authorisation are:

- ix. Provisions preventing a dairy farmer who has authorized Dairy WA in writing to act on his behalf from negotiating directly or entering directly into contracts with processors without the consent of Dairy WA. It is intended that the contract entered into by dairy farmers with Dairy WA is to be binding and exclusive. Non-compliance to result in collective boycott of that processor or retailer by other dairy farmers contracted to Dairy WA.
- x. Provisions to permit Dairy WA or dairy farmers who have authorized Dairy WA in writing to negotiate and enter into contracts for supply on their behalf, to refuse to supply processors where no current contract is in place.
- xi. Provisions to permit Western Australian dairy farmers who have appointed Dairy WA as their agent may refuse to supply processors where no current contract is in place or where there are changes to the terms and conditions and price offered by a processor that has not been agreed with Dairy WA and the processor seeks to enforce the contract with the dairy farmer.

Other details of the proposed arrangement

- xii. Authorisation is sought by Dairy WA for an initial period of 5 years to allow Dairy WA to negotiate with processors or retailers on a processor-by-processor and retailer-by-retailer basis on behalf of Western Australian dairy farmers who authorize it to act on their behalf for the supply of milk.
- xiii. It is anticipated that each contract between Dairy WA and a processor or retailer would be individual based on the agreed outcome of the negotiations in relation to terms and conditions and price. In some circumstances Dairy WA may also arrange for testing or delivery if those terms are included in the contract.
- xiv. Dairy WA will separately negotiate contracts for the supply of milk from Western Australian dairy farmers who authorize to act on their behalf. It is not intended that there be a direct relationship between the dairy farmer and any particular processor as the terms and conditions of supply would be between the Agency and the processor.
- xv. Dairy WA intends that the agency arrangements be open to all dairy farmers in Western Australia given the small and declining number of dairy farmers remaining in the industry.

Parties covered by the Dairy WA arrangements

- xvi. *Dairy Farmers* – Dairy WA is seeking authorisation to allow all present and future dairy farmers in Western Australia who enter an agreement to appoint Dairy WA (or a body established by it for that purpose), to collectively negotiate with dairy processors or retailers in Western Australia, Australia and internationally, on their behalf.

xvii. *Dairy Processors* – including:

- (a) Peters and Browns Limited;
- (b) National Foods Milk Limited;
- (c) Harvey Fresh Pty Limited;
- (d) Challenge Co-operative Limited;
- (e) Challenge Australian Dairies Pty Ltd;
- (f) Casa Dairy Products;
- (g) Mundella Foods Pty Ltd; and
- (h) Harvey Cheese.

xviii. *Retailers* – including:

- (a) Woolworths Limited;
- (b) Coles Supermarkets Australia Pty Ltd; and
- (c) Foodland Associated Limited.

3.11 Dairy WA has sought authorisation for arrangements that may be entered into in the future with any other dairy processor or retailer – the arrangements are not intended to be limited to only the abovementioned dairy processors and retailers.

Term of the authorisation

3.12 Dairy WA sought authorisation for an initial period of 5 years to allow Dairy WA to negotiate with processors or retailers on a processor-by-processor and retailer-by-retailer basis. An initial period of 5 years would enable Dairy WA to negotiate longer term contracts, where appropriate, with both suppliers and processors to provide greater certainty for both parties.

Interim authorisation

3.13 On 21 March 2005 Dairy WA requested interim authorisation to allow for:

- 1. the establishment of the milk negotiating agency;
- 2. the milk negotiating agency to enter into preliminary negotiations with processors seeking to enter new contracts;
- 3. the milk negotiating agency to enter into discussions with processors in relation to proposed unilateral changes to ongoing contracts;
- 4. the milk negotiating agency to enter into negotiations with transportation and milk testing companies, in particular obtaining estimates/quotes; and
- 5. Dairy WA to take steps to put milk on the interstate spot market.

3.14 Dairy WA claimed that the ‘crisis’ in the dairy industry in Western Australia and the rapidly deteriorating economic well being of individual farmers are grounds for urgency in granting interim authorisation.

- 3.15 On 25 May 2005 the Commission decided to postpone the decision on interim authorisation in relation to Dairy WA until draft determination, on the basis that:
- the complexity of the proposed arrangements requires considerable evaluation in order to correctly assess the net public benefit flowing from the arrangements;
 - the lack of detail regarding the operational details of the proposed agency precludes the necessary consideration of the effects of the proposed arrangements;
 - preliminary assessment and interested party submissions have raised concerns that the competitive dynamics of the market may be affected so that the market may be prevented from returning to its pre-interim state should final authorisation be denied;
 - Western Australian dairy farmers can continue to collectively bargain with processors under the terms of the ADF interim authorisation granted by the ACCC on 19 May 2005.

4 Submissions received by the ACCC

Submissions by the applicant

- 4.1 The conduct for which authorisation is sought is outlined in Section 3 of this draft determination.
- 4.2 Dairy WA provided a number of submissions in support of its applications as well as a series of reports on the dairy industry in Australia and Western Australia. Copies of these submissions are available on the ACCC's Public Register.
- 4.3 Dairy WA submits that the need for a milk negotiating agency has been precipitated by the unsustainable price currently received by Western Australian dairy farmers for their milk. Dairy WA submits that the collective bargaining arrangements proposed will increase the price to dairy farmers with a consequential improvement in overall industry sustainability. The requirement for the milk negotiating agency is based on:
- escalating reduction in raw milk volumes;
 - costs of production exceeding average farmgate price;
 - escalating farm debt resulting in exits from the industry;
 - failure of the collective bargaining process authorised under the A90782 authorisation
- 4.4 Dairy WA has submitted that the proposed milk negotiating agency would have considerable public benefits including: :

Improved bargaining power

- Dairy WA submits that if the dairy farmers had an adequate competitive bargaining position they would not enter into contracts that are lower than their cost of production. Dairy WA considers that by allowing dairy farmers to effectively negotiate as a group across the South West of Western Australia and with different processors, the result will be an improved bargaining position through managing and supplying significant volumes of milk at a price and on conditions that should improve the likelihood of the Western Australian industry surviving and allow dairy farmers to negotiate for the sale of milk at a price that more equitably allocates surplus profits. The applicant submits the benefit of improved dairy farmer bargaining power is to reduce the likelihood of industry failure and to limit the need for higher priced import replacements to consumers.

Significant transaction cost saving

- Dairy WA submits that milk negotiating agency would seek to arrange on behalf of its members a more efficient transport service to reduce the inefficiency in the current transport system. It is anticipated that there will be a significant reduction in transport costs from the current 9 cents per

litre in some areas. Transaction cost savings resulting from transport improvements would improve the viability of the industry.

- Dairy WA submits that allowing dairy farmers a choice of trucking companies may significantly reduce costs to dairy farmers, thereby making the industry more competitive and efficient, reducing overall costs

The re-distribution of current monopsony profits

- Dairy WA submits that, despite the continuing downward pressure on the price received by dairy farmers, dairy processors still earn a similar proportion of the retail sales value to that which it earned previously. If the current situation is left unchecked, there will be a dramatic fall in the supply of milk and the additional cost of transporting dairy products from interstate to make up any necessary shortfall in the whole milk market, as well as manufactured milk products, would result in increasing prices to Western Australian consumers or alternatively potential shortfall in supply.

Easing the transition to industry deregulation

- Dairy WA submits that the transition to industry deregulation has not been as successful as would have been hoped. Deregulation resulted in aggressive price cuts to dairy farmers who were unable to easily access other buyers for their milk either in Western Australia or interstate. The aim is for the milk negotiating agency to enter into contracts with dairy farmers to voluntarily engage their services to seek out and obtain better prices for their milk and improved terms and conditions.

Improving the viability of small dairy farms

- Dairy WA submits that the aim of the milk negotiating agency is to provide for a more cohesive and efficient industry which may result in improved stability in the industry in the future.

Opening up new markets

- Dairy WA argues that Western Australian dairy farmers, who have lower costs of production than dairy farmers interstate creates the potential, subject to transport costs, for them to supply eastern state markets.

Avoiding reduced production

- Dairy WA submits that due to shortages of supply and the high cost of import replacement from the eastern states consumers will be paying higher retail prices in the long term. This reduced raw milk production will result in increased operating costs (creating further barriers for new entrants) and a loss of processors due to plants being uneconomic to operate.

Limiting escalating farm debt

- Dairy WA submits that debt levels and the costs of financing these debts will continue to increase as dairy farmers attempt to become more efficient by increasing herd sizes and investing in infrastructure at a time of significantly reduced prices.

Reducing industry exits

- The exit of dairy farmers from particular regions will result in particular dairy production regions falling below critical mass with the closure of processing plants and the loss of support services to the area, creating what has been termed a “Swiss cheese effect”. It is argued that this will have a real but inequitable public cost with respect to the localised effect on rural communities, which will not be borne evenly throughout the Western Australian community.

Competing with imports from interstate

- Manufactured dairy products will be imported into Western Australia at a minimum price of South Australian retail plus freight. It is submitted that when imported manufactured dairy products have total market share with the removal of manufactured dairy products processed in Western Australia, their prices will rise substantially.

Submissions by interested parties

- 4.5 The ACCC sought submissions from a wide range of interested parties in relation to the applications for authorisation and the request for interim authorisation. Ten written submissions were received, copies of which are held on the ACCC’s public register. In addition, the ACCC received a significant number of oral submissions from dairy farmers and two written submissions for which confidentiality was requested and granted.

Processors

PB Foods Limited (trading as Peters & Brownes)

- 4.6 Peters & Brownes is a wholly owned subsidiary of the Fonterra Group in New Zealand. Fonterra, a farmer co-operative and the sixth largest dairy company in the world, obtained control of PB Foods Limited in 2002.
- 4.7 Peters & Brownes has been processing milk in Western Australia since 1886. It purchases approximately 200 million litres of milk a year which is equivalent to almost 50% of the state’s total output. It has an ice-cream manufacturing facility and a liquid dairy processing facility in Perth and other dairy products are produced at Brunswick, 150kms south of Perth. Peters and Brownes is supplied by 143 dairy farmers (employing 300 families) and employs approximately 600 people.

- 4.8 Peters and Brownes does not support the proposal to establish a milk negotiating agency as it believes there is the real risk that the proposal will create an inefficient structure that will lead to dairy farmers being worse off. It submits that many of the assertions in the submission are factually incorrect and structurally flawed.

Public Benefits

- 4.9 Peters and Browns did not identify any public benefits associated with the proposed arrangements.

Anti-competitive detriment

- 4.10 Peters & Brownes submits that:
- the Dairy WA proposal would duplicate existing efficient systems that Peters & Brownes has invested in over the past decades;
 - it is highly unlikely that the new entity will achieve significant additional economies of scale; and
 - a single desk will create a ceiling on the growth of new opportunities outside the state because it reduces the flexibility in milk utilisation.
- 4.11 In Peters & Browne's opinion the sustainable operation of the dairy industry in Western Australia depends on it remaining responsive at all levels to developments in its external environment. Peters & Browne's considers that the establishment of a single selling desk 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:
- i. severely restricting the future development opportunities of Western Australian dairies in the national and international market;
 - ii. impeding farmers who have made investments based on a single pricing policy; and
 - iii. requiring significant organisational and financial input.

Australian Co-operative Foods Limited (trading as Dairy Farmers)

- 4.12 Dairy Farmers is a major participant in the Australian dairy market. It is a co-operative which obtains most of its milk from Dairy Farmers Milk Co-operative Limited whose 2400 members own 80% of Dairy Farmers Milk Co-operative Limited, and are located in New South Wales, Queensland, South Australia and Victoria. Dairy Farmers does not have any dairy farmer members located in Western Australia.
- 4.13 Dairy Farmers opposes Dairy WA's applications for authorisation of collective boycotts. It does not oppose the application for authorisation of collective bargaining; however, it opposes any interference by Dairy WA in the contractual

arrangements between the seller (the processor) and the retailer in respect of the supply of milk.

Public benefit

- 4.14 Dairy Farmers submits that there can be no public benefits that outweigh the level of public detriment that would be caused by a collective boycott.

Anti-competitive detriment

- 4.15 Dairy Farmers submits that the impact of collective boycotts and the consequential anti-competitive impact cannot be justified in any circumstances; and foresees an overwhelming detriment to consumers if the supply of milk in Western Australia was stopped or restricted.
- 4.16 Dairy Farmers is concerned that any dairy farmer who has authorised Dairy WA to act on his behalf would be prevented from individually negotiating directly with processors. In this circumstance, the very people that Dairy WA is seeking to assist could be detrimentally affected by being prevented from subsequently individually negotiating directly with processors.

National Foods Milk Limited (NFML)

- 4.17 NFML submits that the ACCC should refuse 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.
- 4.18 NFML submits that 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.

Public Benefits

- 4.19 NFML submits that Dairy WA has not demonstrated how the particular public benefits that it has identified would be likely to arise out of the combined collective bargaining and collective boycott arrangements; nor has it demonstrated that the public benefits (if any) would outweigh the clear anti-competitive detriments likely to arise.

Improvement in bargaining power

- 4.20 NFML does not accept the validity of this argument, on the grounds that:
- under the AIDFF authorisation A90782, dairy farmers have the ability to collectively negotiate with processors;
 - Dairy WA has provided no evidence as to how the removal of the direct link between farmers and processors will achieve the efficiencies claimed;

- Dairy WA has not explained how reliability of supply and improved efficiencies can be achieved by increasing the bargaining power of dairy farmers;
- NFML does not hold a position of undue bargaining power in its negotiations with dairy farmers;
- processors do not have the power to influence the price of milk;
- the milk sourced by NFML totally reflects the customer demand in the dairy market segment it supplies; hence NFML 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;
- the effect of the proposed arrangements would be to cause an imbalance in bargaining power by placing dairy farmers, through Dairy WA, in a position of total bargaining control over dairy processors and retailers;
- 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.

Transaction cost savings

- 4.21 NFL submits that Dairy WA has provided no evidence of any transaction costs that would be reduced as a result of the proposed arrangements. It submits that the only costs referred to are transport costs and believes the claimed cost savings are overstated.

Re-distribution of monopsony profits

- 4.22 Given the existence of a number of processors competing strongly for the acquisition of suppliers' milk, NFML submits that no processor in Western Australia is able to operate as a monopsonist.
- 4.23 NFML submits that the proposed arrangements would provide dairy farmers with monopoly power in relation to the supply of raw milk to processors and place Dairy WA in a position to be able to extract monopoly rents from processors and retailers.

Easing the transition to industry deregulation

- 4.24 NFML submits that the proposed arrangements extend much further than assisting the industry's transition towards deregulation and argues that they amount to re-regulation of the Western Australian dairy industry, with a single negotiating agent negotiating for the price for, potentially, every dairy farmer in Western Australia.
- 4.25 NFML contends that deregulation occurred in 2000 and a number of government programmes were implemented at that time to assist dairy farmers to adjust to the new market environment and points to the 11 cents levy on milk which consumers will continue to pay for at least eight years.

Improving the viability of small dairy farms

- 4.26 NFML submits that Dairy WA has not provided any evidence to demonstrate that the dairy farmers who are exiting the industry were operating efficiently, or that allowing Dairy WA to collectively bargain on their behalf would ensure their continued viability.
- 4.27 NFML argues that it would not be a public benefit to prevent the exit of inefficient businesses by causing anti-competitive detriment to other segments of the industry.

Opening up new markets

- 4.28 NFML submits that Dairy WA has not provided sufficient information regarding these potential new opportunities to enable assessment of the likelihood of it occurring, its validity as a public benefit or whether such opportunities would be available if Dairy WA was able to collectively negotiate and collectively boycott.

Anti-competitive detriment

- 4.29 NFML submits that the collective bargaining and collective boycott arrangements would substantially distort market forces in the Western Australian dairy industry and would result in:
- increased milk prices to consumers;
 - a reduction in the volume of milk supplied in Western Australia;
 - entrenched barriers to entry through the development of long-term contracts between dairy farmers and dairy processors;
 - dairy farmers being denied any role in the negotiation of contracts of supply to processors and retailers;
 - a total inhibition of competition between dairy farmers and a removal of any incentive for innovation in the supply of raw milk by dairy farmers, if the milk negotiating agency represents every dairy farmer in Western Australia;
 - 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
 - the possibility of disclosure of confidential information of processors and retailers.

Retailers

Woolworths Limited

- 4.30 Woolworths submits that no entity should be allowed to:
- artificially construct a monopoly or near monopoly supply of commodity goods which are of vital public interest;
 - engage in anti-competitive conduct that is clearly not intended to result in a greater choice for consumers in price, quality and service;
 - receive authorisation to engage in boycotts of processors and/or secondary boycotts of processors and retailers arising from negotiations between an individual retailer or processor and a dairy farmer.

Public benefits

Improved bargaining power for small producers

- 4.31 Woolworths submits that collective bargaining may increase bargaining power for small milk producers which should be applied to the benefit of the consumer in a market where processing capability and consumption volumes will not increase; however, the 'bargaining power' includes the right to enforce boycotts, which must not be used to disrupt supply.

Significant transaction cost saving, particularly in the area of transport costs and providing better economies scaled to processes

- 4.32 Woolworths considers that it may reasonably be expected that at least for some time the disruption of an orderly market may lead to inefficiencies and the potential for higher costs being passed onto consumers.

The re-distribution of current monopsony profits

- 4.33 Woolworths notes that Dairy WA's submission has identified 6 milk processing outlets. Re-distribution of profits at the production level should not result in a detriment to the public benefit.

Improving the viability of small dairy farming businesses

- 4.34 Woolworths submits that this application, if approved, whilst intended to support small dairy farming businesses, should not be at the expense of consumers. The change in market dynamics may result for example in fresh milk importation from other states becoming more viable, or the removal of further processed milk products to production in other states, in either case adversely affecting viability of small dairy farms in Western Australia.

Opening up new marketing opportunities by co-ordinating the supply of dairy farmers' milk negotiating agency

- 4.35 Woolworths considers that 'marketing opportunities' may be lost as well as gained in any shift of the availability of supply.

Coles Myer Ltd (CML)

4.36 CML has provided submissions opposing both the request for interim authorisation and the substantive application made by Dairy WA, arguing that the arrangements would bring no public benefits. CML submits that the applications do not:

- reflect the main principles required to preserve competition as determined by the ACCC in authorisation A90782 on 12 March 2002¹⁴ and reinforced by the Australian Competition Tribunal (the Tribunal) in its decision on 16 August 2002¹⁵;
- recognise the need to ensure that any collective negotiations between farmers do not significantly affect the price consumers pay for milk;
- address the terms imposed by the Tribunal.

Public benefits

Improved bargaining power

4.37 CML submits that the proposed arrangements, if approved, could result in increased cost prices from dairy farmers which may ultimately be passed onto consumers. In this context, CML alleges that the assertion that processors and supermarkets are siphoning off surplus profit is without any factual basis.

Transaction cost savings

4.38 CML submits that any savings made with a more efficient transport service are likely and expected to flow to the particular dairy farmers who can take advantage of consolidated loads and not the public generally. It is accepted that there may be some localised community benefit that flows from keeping small farms operating in the short term but questions whether these farms can compete for the market that is available in Western Australia, interstate or overseas over the longer term.

Re-distribution of monopsony profits

4.39 CML questions how the re-distribution of monopsony profits, which it contends are not available, could lead to a public benefit. It submits that if a monopoly negotiating agency extracted better returns to farmers from cost increases rather than productivity/efficiency gains, these would result in increased prices to consumers.

¹⁴ Australian Dairy Farmers' Federation Limited application for authorisation A90782 12 March 2002. A copy of the Determination is available on the ACCC's website at www.accc.gov.au

¹⁵ Application by National Foods Limited [2002] to the Australian Competition Tribunal, 16 August 2002

Easing the transition to industry deregulation

- 4.40 CML submits that Dairy WA has not demonstrated how the activities proposed in easing the transition to industry deregulation could deliver a public benefit.

Improving the viability of small dairy farms

- 4.41 CML submits that the largest 40% of Western Australian dairy farms produce more than 80% of the State's milk and an industry focused on domestic production could see the State's total milk requirement satisfied by fewer than 80 farms.

Opening up new markets

- 4.42 CML submits that Dairy WA does not need authorisation to seek out new markets for its members' production locally, interstate or possibly overseas.

Anti-competitive detriment

- 4.43 CML submits that the applications for authorisation do not recognise the need to ensure that any collective negotiations between farmers do not significantly affect the price consumers pay for milk.

Others

Minister for Agriculture and Forestry, the Honourable Kim Chance MLC

- 4.44 In his initial submission of 5 April 2005, the Minister supported Dairy WA's applications for authorisation based on the fact that prices paid to milk producers in Western Australia is significantly lower post deregulation and does not cover the costs of production which he contends will have adverse consequences for the whole industry in Western Australia.
- 4.45 In a second submission of 26 April 2005, the Minister submitted that he supports the initiative to improve the bargaining power of dairy producers and that the Western Australian government is fully supportive of any initiative that seeks equitable business outcomes for Western Australian dairy farmers without weakening the competitive position of Western Australian processors in either domestic or international markets.

Australian Government Department of Agriculture, Fisheries and Forestry

- 4.46 The Department submits that it generally supports collective bargaining under the provisions of the TPA as a negotiation tool for small businesses such as primary producers, as it can provide a mechanism to achieve better prices and more flexible conditions of supply when dealing with large businesses. The Department notes that the complex and technical competition issues requiring assessment as part of the Dairy WA application.

- 4.47 The Department submitted that the Dairy Industry Adjustment Package (a programme worth \$1.78 billion) continues to successfully meet the objective of assisting the dairy industry and dairy communities to make the transition to a deregulated environment whilst also providing the opportunity to farmers who wish to exit to do so.

Senator David Johnston, Senator for Western Australia

- 4.48 The ACCC received a submission from Senator David Johnston on 29 June 2005, following consultation with a group of constituents operating in the dairy industry.
- 4.49 Senator Johnston acknowledges there are complex and technical competition issues in the collective bargaining / collective boycott proposal in Dairy WA's application. However, he submits that there is an overriding consideration, which is the capacity to preserve a commercial milk production capability in Western Australia.
- 4.50 Senator Johnston submits that the Western Australian consumer will soon be confronting a market that will have contracted to produce a shortfall of up to 100 million litres where price will be the only tool against a steadily increasing demand, milk occupying the position it does for consumers.
- 4.51 Senator Johnston submits that Dairy WA's proposal would have gone a substantial way toward promoting greater competition within the industry and providing a stable and cost efficient outlook for both producers and consumers.

Confidential submissions

- 4.52 The process whereby the ACCC assesses applications for authorisation or notification is very public, transparent and consultative. The TPA requires the ACCC to maintain a public register in respect of authorisation and notification applications.
- 4.53 Applicants and interested parties can request that a submission, or part of a submission, be excluded from the public register. The ACCC is required under the TPA to exclude from the public register upon request details of:
- secret formulae or process;
 - the cash consideration offered for the acquisition of shares in the capital of a body corporate or assets of a person; or
 - the current manufacturing, producing or marketing costs of goods or services.
- 4.54 The ACCC also has the discretion, under s89 of the TPA, to exclude material from the public register if it is satisfied that it is desirable to do so, either by reason of the confidential nature of the material or for any other reason.

4.55 The ACCC received a number of confidential submissions from interested parties which are summarised below.

Interested parties

4.56 Interested parties submitted that Dairy WA's submission failed to demonstrate any public benefits associated with the proposed industry model and the establishment of a milk supply monopoly would effectively reverse deregulation and its associated benefits.

4.57 It was also submitted that the overhead costs of running the collective bargaining and transport system will exceed the price gains that may be achievable through voluntary collective bargaining.

4.58 It was submitted that, in addition to creating an environment which will make it difficult for existing processors to invest in the expansion of their facilities, the restrictive collective bargaining regime would deter investment in new processing facilities in Western Australia.

Submissions received from dairy farmers

4.59 The ACCC also received a significant number of confidential submissions from dairy farmers. A summary of those submissions follows.

4.60 Western Australian dairy farmers submit that the proposed milk negotiating agency will provide them with a united voice and the negotiating strength to negotiate a higher price for their milk for processors resulting in the continued viability of their businesses and increased incomes.

4.61 The potential public benefits of the proposed milk negotiating agency identified by dairy farmers included:

- higher returns to dairy farmers;
- a successful, viable and sustainable dairy industry;
- survival of local regional community through increased employment opportunities, improved services and projects;
- consumers are assured of a fresh, high quality product.

4.62 A number of dairy farmers are opposed to the establishment of a milk negotiating agency and submit that the proposal, which they believe has not been systematically costed, is not commercially sustainable. These farmers consider that the Western Australian dairy industry is operating in an open global environment and that the price paid to dairy farmers is dictated by the prices obtained on the international commodity markets.

4.63 A number of dairy farmers noted that deregulation of the dairy industry was government policy and was heralded for a decade prior to formal removal of government assistance and disbandment of the state marketing authorities.

During that time dairy farmers were advised and encouraged to prepare for the inevitable restructuring of their businesses necessary for competing in an unregulated market.

- 4.64 These farmers submit that a single desk agency will prevent the development of the industry so that Western Australian dairy products can continue to compete in national and international markets and will severely jeopardise the gains and improvements made as a result in deregulation.
- 4.65 Dairy farmers have submitted that they are uncertain as to the detail of the proposal and are uncertain as to who will bear the risk if the milk negotiating agency is unsuccessful in negotiating contracts for the total volume of milk produced by dairy farmers. A number of dairy farmers identified Challenge Dairy Co-operative (CDC) as the 'sump' for surplus milk produced in the State and accordingly submitted that CDC is the key to ensuring that the proposed milk negotiating agency works
- 4.66 A number of submissions by dairy farmers identified the following anti-competitive detriments associated with a collective boycott:
- capacity to meet contracts would be adversely affected;
 - commercial reputations would be damaged if not destroyed;
 - market share following the lifting of a boycott would be badly affected;
 - engaging in such activity would result in a transfer of competitive advantage within the affected markets;
 - engaging in such activity would result in the transfer of ultimate power to a monopoly single desk (being the milk negotiating agency); and
 - such activity would stifle investment in the dairy industry in Western Australia.

Dairy WA's response to submissions received by the ACCC

- 4.67 Dairy WA submitted responses to a number of submissions received which are summarised below.

Collective boycotts

- 4.68 Dairy WA submits that it is not its intention to disrupt milk supply to consumers. Significant disruption is unlikely because:
- contract renewal dates are staggered, only one processor is likely to be affected;
 - other processors in the market would source additional milk through Challenge Dairy Co-operative (Challenge);
 - in the event that Challenge was the target of a boycott, Western Australian consumers would not be affected because Challenge does not supply the domestic market;

- Dairy WA would only seek to implement a boycott if negotiations had broken down and all other avenues had failed to resolve the deadlock;
- Dairy WA accepts that it is necessary to have a notice period (possibly of 14 days) prior to a boycott being implemented to allow retailers to make alternative arrangements with other processors; and
- milk is highly perishable coupled with minimal farm storage, the cost to dairy farmers is a strong disincentive for Dairy WA to implement the boycott.

4.69 Dairy WA does not propose that the establishment of the milk negotiating agency will have significant impact on consumers. However, it states that the Western Australian dairy industry is in market failure and the loss of the industry would have significant and long lasting effects on the cost of milk to consumers in Western Australia.

Inefficiencies and the potential for higher costs

4.70 Dairy WA submits that the introduction of more cost effective transport arrangements, giving dairy farmers a choice of transport systems, is unlikely to disrupt the existing market, and argues that creating a competitive market for transport should improve efficiencies and lower costs.

Redistribution of profits and detriment to the public benefit

4.71 Dairy WA submits that the redistribution of monopsony profits would be a public benefit as it would assist dairy farmers to receive a sustainable price whilst not necessarily increasing the retail price paid by consumers. It submits that retailers set the price of milk to consumers and argues that there does not seem to be a direct correlation between the price for raw milk and the retail price of milk. Dairy WA quotes evidence to suggest that the retail price of fresh milk to consumers has increased while the average price of raw milk paid to Western Australian dairy farmers has fallen. Dairy WA submits that there does not appear to be a direct benefit to consumers associated with the drop in prices paid to Western Australian dairy farmers.

Easing the transition to industry deregulation

4.72 Dairy WA submitted that the activities proposed must be a public benefit as the result will be the ongoing maintenance of viable dairy farms.

Viability of small dairy farming businesses

- 4.73 Dairy WA argues that whilst Western Australian dairy farmers provide a higher percentage of milk to the white milk market, their raw milk prices remain lower than prices interstate and argues that a price rise of 10 cents per litre (plus transport costs) would be necessary before import parity was reached. Dairy WA argues that this is unlikely unless processors chose to loss-lead milk prices.
- 4.74 Dairy WA submits that without authorisation it would be difficult for small farmers to develop or take advantage of any high value export markets which may

be developed. Dairy WA acknowledges that increasing world prices for milk should improve the viability of the Western Australian industry.

Marketing opportunities

- 4.75 Dairy WA submits that it hopes to provide a more flexible and adaptive approach to satisfy the requirements of dairy farmers and the needs of existing and future processors for Western Australian milk.
- 4.76 Dairy WA argues that the price differential for raw milk, between Western Australia and the eastern states, ranges from 8 – 21 cents per litre. This price differential and the circumstances in which Western Australian dairy farmers find themselves now justify the opening up of interstate markets. It submits that the shortfall in production in the NZ dairy industry has resulted in increasing prices in the world markets opening up opportunities for Western Australian milk given the proximity to Asia.

Individual negotiations with dairy farmers and the agency

- 4.77 Contracts between dairy farmers and the milk negotiating agency will be for a specified period of time matching the arrangements with the processors. Dairy farmers could make other arrangements at the conclusion of the milk negotiating agency contract. Dairy farmers will have the capacity, subject to the consent of the milk negotiating agency, to contract outside the agency arrangement.

Negotiating with retailers

- 4.78 Dairy WA at the request of its members may arrange for the tolling of milk for sale to retailers. Dairy WA submits that the option was canvassed because of the common nature of tolling and the potential for obtaining better returns for its members and increasing competition for the benefit of consumers.

Additional comments

- 4.79 Dairy WA proposes that participation in the milk negotiating agency will be a voluntary decision made by dairy farmers made in their own interests, and not 'artificial', ie. not a creature of statute.
- 4.80 Dairy WA submits that there is no direct link between the market for raw milk and consumers and argues that there is a clear distinction between the price for manufactured milk and white milk. Dairy WA contends that it is the processors who determine product range not dairy farmers.
- 4.81 Dairy WA proposes that the milk negotiating agency would have contracts with the processors and in turn those contracts would be mirrored by contracts with dairy farmers, involving ongoing obligations on the dairy farmer, the milk negotiating agency and the processor.

5 Statutory provisions

- 5.1 Application A90961 was made under sub-section 88(1) of the TPA to make and give effect to arrangements where a provision of the proposed arrangements might be an exclusionary provision within the meaning of section 45 of the TPA.
- 5.2 Under subsection 90(8) of the TPA, the ACCC may grant authorisation in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision if it is satisfied that the proposed contract, arrangement or understanding would result or would be likely to result in such a benefit to the public that it should be allowed to be made and given effect to.
- 5.3 Section 90(8) requires the ACCC to determine whether in all the circumstances, the public benefits are such that the conduct should be authorised. The test requires a balancing of the public benefits and detriments but when considering detriments does not limit consideration to those constituted by a lessening of competition.
- 5.4 Application A90962 was also made under sub-section 88(1) of the TPA to make and give effect to arrangements that might substantially lessen competition within the meaning of section 45 of the TPA. In assessing an application made under sub-section 88(1) to make and give effect to arrangements that might substantially lessen competition within the meaning of section 45 of the TPA, the relevant test that Dairy WA must satisfy for authorisation to be granted is outlined in sub-section 90(6).
- 5.5 Under section 90(6) of the TPA, the ACCC may grant authorisation in respect of a proposed contract, arrangement or understanding that may have the purpose or effect of substantially lessening competition if it is satisfied that:
- the proposed contract, arrangement or understanding would result or be likely to result in a benefit to the public; and
 - that benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the proposed contract, arrangement or understanding.

Benefits and detriments

- 5.6 In deciding whether it should grant authorisation, the ACCC must examine the detriments of the arrangements or conduct, particularly those arising from any lessening of competition, and the public benefits arising from the arrangements or conduct and weighing the two to determine which is greater.
- 5.7 Should the public benefits or expected public benefits outweigh the detriments, the ACCC may grant authorisation. If this is not the case, the ACCC may refuse authorisation or, alternatively, may grant authorisation subject to conditions as a means of ensuring that the public benefit outweighs the detriment.

5.8 Public benefit is not defined by the TPA. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements...the achievement of the economic goals of efficiency and progress.¹⁶

5.9 Similarly, public detriment is not defined in the TPA but the Tribunal has given the concept a wide ambit. It has stated that the detriment to the public includes:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including one of its principal elements the achievement of the goal of economic efficiency.¹⁷

5.10 The ACCC also applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and any detriment generated by arrangements for which authorisation has been sought.

5.11 Under this test, the ACCC compares the public benefit and detriments generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the counterfactual.

5.12 Section 88(10) of the TPA provides that an authorisation may be expressed so as to apply to, or in relation to, another person who becomes a party to the proposed arrangements in the future.

5.13 In this instance, in addition to seeking authorisation for itself and its members, Dairy WA has also expressed its application so as to apply in relation to future parties. Specifically, future dairy farmers in Western Australia (being members or non-members of Dairy WA) who enter into an agreement to appoint Dairy WA or a body-established for it for that purpose to collectively negotiate on their behalf with dairy processors or retailers in Western Australia, Australia and internationally.

¹⁶ *Re 7-Eleven Stores, Australian Association of Convenience Stores* (1994) ATPR ¶41-357 AT 42677. The Tribunal recently followed this approach in *Qantas Airways Limited* [2004] ACompT 9, 16 May 2005.

¹⁷ *Re 7-Eleven Stores* at 42683.

6 ACCC Assessment

- 6.1 The ACCC's evaluation is in accordance with the statutory test outlined in section 5 of this draft determination. As required by the test, it is necessary for the ACCC to assess and weigh the likely public benefits and anti-competitive detriments flowing from the proposed arrangements.
- 6.2 For ease of reference processors and manufacturers will be collectively referred to in this draft determination as 'processors'. In particular:
- PB Foods Limited (trading as Peters & Brownes);
 - National Foods Milk Limited (NFML);
 - Challenge Dairy Co-operative Ltd; and
 - Harvey Fresh (1994) Ltd. (trading as Harvey Fresh)
- will collectively be referred to as 'Western Australian processors' in this draft determination.

Assessment of the proposed arrangements

- 6.3 As noted, the ACCC may only grant authorisation if it is satisfied that the proposed arrangement would result or be likely to result in a net benefit to the public. In order to fully consider the benefits and detriments of any proposal, it is essential that all details and elements of the proposed arrangement are provided to the ACCC, and interested parties, for consideration.
- 6.4 The ACCC, in assessing the milk negotiating agency arrangements proposed by Dairy WA, is concerned that a number of features of the proposed arrangements remain undefined.
- 6.5 Following several telephone discussions and a meeting with Dairy WA, the ACCC wrote to Dairy WA on 28 April 2005 requesting further information regarding the proposed arrangements.
- 6.6 On 11 May 2005, Dairy WA provided a response to the ACCC's schedule of questions. This response noted in part that Dairy WA had engaged consultants and advisors to assist it in developing a business plan for the milk negotiating agency, including preparation of budget projections, logistical requirements and to provide recommendations as to milk pricing models, distribution channels, and the system for remuneration of the milk negotiating agency by dairy farmers.
- 6.7 In response to questions raised regarding other features of the proposal, including the terms and conditions of the agency agreement to be entered into by dairy farmers (eg. termination provisions, assignment or transfer of rights), Dairy WA advised that contractual conditions and provisions would require lengthy discussion with dairy farmers. The ACCC has not been advised whether these discussions have been conducted/completed.

- 6.8 In August 2005 the ACCC wrote to Dairy WA inviting it to provide any additional information, in particular the business plan, which it would like the ACCC to consider in assessing its applications for authorisation. To date the ACCC has not received any response or additional information from Dairy WA. Accordingly, the ACCC has assessed Dairy WA's application for authorisation on the basis of the information currently available to it.

Market definition

- 6.9 The first step in assessing the public benefits and anti-competitive detriment of the conduct for which authorisation is sought is to consider the relevant market(s) in which that conduct occurs.
- 6.10 Defining the markets affected by arrangements proposed for authorisation assists in assessing public benefit and anti-competitive detriment from any lessening of competition from the arrangements. However, depending on the circumstances, the ACCC may not need to comprehensively define the relevant markets, as it may be apparent that a net public benefit will or will not arise regardless of this definition.

Submissions on the relevant markets

- 6.11 In its submissions in support of its application Dairy WA has not specifically addressed the issue of the relevant market. It has however provided some general comments which the ACCC considers to be relevant to its consideration. According to Dairy WA:
- processors operating in Western Australia are monopsony purchasers in a number of specific geographic regions. According to Dairy WA this is in part due to transport arrangements;
 - Western Australian processors do not compete in acquiring raw milk;
 - Western Australian dairy farmers are tied to a single processor;
 - Western Australian dairy farmers are paid lower than national average prices;
 - Western Australian dairy farmers are unable to seek out alternate markets and higher prices for raw milk from interstate processors;
 - Western Australian dairy farmers have no bargaining power as individuals or through processor specific collective bargaining groups;
 - production of raw milk in Western Australia is declining;
 - Western Australian processors lack the necessary incentives to improve efficiency; and
 - nationally marketed dairy products are sold in Western Australia at heavily discounted prices.
- 6.12 Submissions provided by Western Australian processors have disputed Dairy WA's contention that they are in a monopsony position and that they do not

compete for the supply of raw milk. In this respect it has been submitted that several dairy farmers have elected to move between processors in Western Australia. By way of example, Peters & Brownes has noted that since deregulation it has attracted 34 new suppliers and ten of its suppliers have moved to other processors.

- 6.13 In their confidential telephone submissions, a number of farmers confirmed that they had transferred between processors.
- 6.14 NFML has further submitted that there is no location in Western Australia in which processors face an uncontested market for the supply of raw milk and therefore, by definition, no processor is able to operate as a monopsonist.
- 6.15 Western Australian processors have also submitted that it is incorrect to suggest that they do not face pressures promoting a need to become more efficient. More generally, Dairy Farmers has submitted that in its view processors must be efficient producers in order to meet the demands of the market and further that all participants in the dairy industry in Australia continue to strive for efficiencies.

ACCC assessment of the relevant markets

- 6.16 Having considered the materials before it, the ACCC is of the view that it is not necessary for it to comprehensively define the relevant markets in order for it to conduct its assessment of the Dairy WA proposal. Rather, the ACCC considers that the identification of general market parameters will provide an appropriate framework for its analysis of the public benefits and detriments of the proposed arrangements.
- 6.17 In this instance, the ACCC considers that the supply of raw milk by dairy farmers to processors within the geographic boundaries of Western Australia is the primary area of competition likely to be affected by the proposed arrangements. The ACCC also considers that the downstream markets for the supply of fresh milk and processed dairy products are relevant to its assessment of Dairy WA's proposed arrangements. Some of the relevant features of these areas of competition are discussed below.

The supply of raw milk by dairy farmers to processors

- 6.18 As noted above, the ACCC considers that the primary area of competition likely to be affected by Dairy WA's proposal is the market for the supply of raw milk by dairy farmers to processors in Western Australia. The ACCC notes that some of the features of this area of competition relevant to its assessment of anti-competitive detriment include:
- competition between dairy farmers for supply contracts with processors;
 - an ability of dairy farmers, subject to their contracts, to transfer from one processor to another; and
 - processors having significant negotiating and buying power.

Further information concerning the market for the supply of raw milk is set out in Section 2 of this draft determination.

- 6.19 The ACCC notes that following the deregulation of the Australian dairy industry and the dismantling of state statutory marketing authorities, the traditional state and regional boundaries have become less relevant.
- 6.20 In this respect ABARE has noted that whilst it remains important for processors to obtain their supply of raw milk from dairy farmers located within close proximity to processing facilities (due to the perishability of milk), improvements in bulk milk transport has allowed processors to obtain raw milk supply from more distant sources.¹⁸
- 6.21 While noting these technological improvements in bulk transport, given the vast distances between Western Australian and central and eastern state processors, the ACCC considers that it is unlikely that these barriers have been reduced to such an extent that the market for the supply of raw milk would be defined beyond the geographical boundaries of Western Australia.
- 6.22 This is not to say that there doesn't exist occasions in which raw milk may be supplied to or beyond Western Australia, nor does it suggest that further technology or transport improvement would not facilitate greater substitution in the future.

Downstream markets for the supply of fresh milk and processed dairy products

- 6.23 Whilst, the ACCC considers that the primary area of competition occurs between dairy farmers and the dairy processors who currently supply or acquire, or could potentially supply or acquire, milk from one another, the ACCC is of the view that there are a number of related areas of competition which may be relevant to its consideration of Dairy WA's applications.
- 6.24 In particular, the ACCC considers that any detriment resulting from a reduction in competition in the primary market is likely to have an effect on, or be affected by, the downstream markets for the supply of fresh milk and processed dairy products.
- 6.25 For example, the ACCC considers that any price increase resulting from the collective bargaining arrangements has the potential to flow into the domestic, in particular the Western Australian, retail market for drinking milk. Similarly, the ACCC considers that any price increases are likely to flow into the (broader) domestic and export markets for manufactured dairy products.

¹⁸ ABARE: *A Review of the Australian Dairy Industry*, January 2005, Canberra.

- 6.26 Therefore, the ACCC considers that the downstream markets for drinking milk and dairy products are likely to be relevant to the application insofar as they affect, or are affected by, the collective bargaining arrangements.
- 6.27 In this respect the ACCC notes that Western Australian processors supply fresh milk to the major supermarkets, delicatessens, food service industry, independent retailers and the hospitality and catering industries in Western Australia. The ACCC understands that packaged drinking milk is generally not transported to, or from, Western Australia.
- 6.28 Western Australian processors also supply processed dairy products such as cheese, UHT milks, yoghurts and ice creams. However it is clear that these processed products are imported and exported to/from Western Australia, including to/from overseas markets.
- 6.29 In light of these features, the ACCC considers that the product and geographic scope of the markets for processed dairy products are quite broad.

Counterfactual

- 6.30 When assessing the economic impact of the proposed arrangements, the ACCC applies the 'future with-or-without test' established by the Tribunal to identify and weigh the likely public benefit and potential anti-competitive detriment that may result from the arrangements for which authorisation is sought.
- 6.31 Under this test, the ACCC compares the public benefit and anti-competitive detriment likely to be generated by the proposed arrangements in the future if the authorisation is granted with those which could potentially occur if the authorisation is not granted. This requires the ACCC to make a reasonable prediction as to what will happen if authorisation is denied. This forecast is referred to as the counterfactual.

Submissions on the counterfactual

- 6.32 In its application, Dairy WA submits that the future without the proposed arrangements is likely to be dire and could ultimately result in the demise of the industry in Western Australia. Dairy WA forecasts that, if the ACCC does not grant authorisation to the proposed arrangements, there will be escalating exits from the industry resulting in Western Australian processors and retailers importing fresh milk and dairy products from the eastern states with a consequent increase in the retail prices to Western Australian consumers.
- 6.33 Dairy WA submits that without authorisation dairy farmers in Western Australia will have no bargaining power and no input into their contracts with the processors, who will continue to offer contracts to dairy farmers on a 'take-it-or-leave-it' basis.

- 6.34 Dairy WA submits that collective bargaining arrangements in Western Australia, carried out under the 2002 ADF Authorisation (A90782), have not worked as well as could be hoped. Dairy WA submits that the condition of the ADF authorisation that collective bargaining groups must not be comprised of all the dairy farmers in Western Australia imposes particular difficulties given the small number of dairy farmers participating in the industry and their geographical limitation to the south west of the state. Dairy WA suggests that the total number of dairy farmers in Western Australia would be significantly smaller than a single potential collective bargaining group in the eastern states.
- 6.35 Dairy WA submits that the direct relationships that exist between producers and processors under the ADF collective bargaining authorisation result in significant pressure being placed on dairy farmers not to enter into effective negotiations. Dairy WA has further submitted that there has been pressure placed upon dairy farmers by processors not to enter into functional collective bargaining arrangements.
- 6.36 Western Australian processors have submitted that, in the event that the ACCC were to grant authorisation to Dairy WA's proposed arrangements, current major capital investments in the Western Australian dairy industry would be jeopardised and future investment in the industry would be severely curtailed.
- 6.37 Peters & Brownes has expressed concern that if the proposed milk negotiating agency is granted authorisation it would result in a 'dial-a-tanker' system. Peters and Brownes consider that this would lead to uncertainty and insecurity for dairy farmers, and will adversely impact on productivity and remove any incentive for innovation in the industry. Peters and Brownes has further submitted that any fall off in productivity and innovation will negatively affect the competitive advantage of Western Australian dairy products in international markets.
- 6.38 In confidential telephone submissions, a number of dairy farmers have submitted that the Dairy WA proposal would return the Western Australian dairy industry to a similar situation as the regulated regime prior to 2000. These farmers consider that in these circumstances their substantial on-farm investments would be compromised and that the strategies they have implemented to manage the transition from a regulated environment would be negated/reversed.

ACCC's consideration of the counterfactual

- 6.39 The ACCC has previously considered arrangements under which small primary producers propose to collectively bargain with the processors that they supply. Generally the ACCC has considered that the most likely situation, in the absence of an authorisation to collectively bargain or some form of industry regulation, is one in which these producers are offered largely standard form contracts with little capacity to negotiate variations on terms or conditions.

- 6.40 The ACCC understands that under current arrangements, dairy farmers supplying *only* Challenge Dairy Co-operative or Harvey Fresh engage in direct negotiations with their processor.
- 6.41 For those dairy farmers supplying Peters & Brownes and another processor (generally NFML), it is understood that these farmers are generally members of the Western Australian Collective Bargaining Group formed under the ADF authorisation (A90782).
- 6.42 The Western Australian Collective Bargaining Group is comprised of separate, processor-based negotiating committees. Under these arrangements dairy farmers supplying Peters and Brownes and NFML may choose to engage in collective negotiations.
- 6.43 In this environment, the ACCC considers that, were it to deny Dairy WA's application but were to grant the ADF application for revocation and substitution (see Section 2), the counterfactual is likely to be one in which the status quo would prevail. That is, Western Australian dairy farmers would be able to engage in collective negotiations under the terms of the ADF authorisation.
- 6.44 However, in the event that the ACCC does not grant the ADF authorisation to engage in collective bargaining, the likely counterfactual would be a situation where Western Australian dairy farmers would negotiate individually for the supply of raw milk with processors.
- 6.45 For the purpose of its assessment of the Dairy WA proposals, the ACCC proposes to consider the likely benefits and detriments to the public under each of these potential counterfactuals.

7 Effect on competition

- 7.1 Section 88 of the TPA allows the ACCC to grant immunity from legal action for parties to engage in certain anti-competitive conduct which may include collective bargaining and / or collective boycotts.
- 7.2 In general terms, collective bargaining agreements to negotiate terms and conditions (including price) for independent businesses covered by that agreement are likely to lessen competition relative to a situation where each of the businesses individually negotiate their own terms and conditions. However, the extent of the detriment and the impact on competition of the collective arrangements will depend upon the specific circumstances. In simple terms under its collective bargaining application, Dairy WA proposes to establish a collective bargaining group to represent dairy farmers in negotiations with processors, and potentially retailers, in relation to the supply of milk.
- 7.3 Collective boycotts, in the context of collective bargaining, usually involve participating businesses engaging in a combined withdrawal of goods or services or jointly agreeing not to acquire goods or services from another business. In the current application, Dairy WA proposes to withhold supply of milk to processors that deal directly with a participating farmer. Collective boycotts have the potential to impact negatively on competition.
- 7.4 As discussed in Section 5, the ACCC must assess the extent to which the proposed arrangements give rise to any detriments. With regard to the proposed collective boycott, the ACCC must be satisfied, in all the circumstances, that the proposed arrangements would have the result, or be likely to result, in such a benefit to the public that the arrangements should be allowed. In relation to the collective bargaining arrangements, the ACCC must ensure the public benefit outweighs the detriment constituted by any lessening of competition that flows from the proposed arrangements.

Dairy WA's submission on anti-competitive effect

- 7.5 Dairy WA submits that the anti-competitive effect of the proposed milk negotiating agency arrangement is minimal and argues the following:
- the power of a collective boycott may be necessary to facilitate collective bargaining;
 - competition for supply will occur between farmers as they strive to produce milk with the appropriate quality and composition levels demanded by different processors;¹⁹

¹⁹ Dairy WA's response, 23 May 05, to National Foods Milk Ltd's submission. See www.accc.gov.au

- there is no basis for the suggestion that the presence of the milk negotiating agency will raise barriers to entry;
- the incentive to innovate and improve quality would be the prices paid by the milk negotiating agency to the farmers. Contractual requirements in relation to milk quality and composition, negotiated with the milk negotiating agency would continue to provide incentives for farmers to be innovative and price competitive;
- it is not the intention of Dairy WA to disrupt the supply of milk to consumers and argues that significant disruption is unlikely to occur because milk contract renewal dates are staggered so that only one processor is likely to be affected by a collective boycott at any one point in time; and
- the most significant detriment from any use of boycott provisions would be suffered by the dairy farmers and not the processors as dairy farmers would lose not only the income from the milk withheld, but would also incur costs in disposal of the milk. As such, it is argued that it is most unlikely that boycott provisions would actually be activated by the milk negotiating agency, as to do so would be to the detriment of farmers.²⁰

7.6 Dairy WA has submitted that it would only seek to implement a boycott if negotiations had broken down and all other avenues had failed to resolve the deadlock and would initiate a notice period of 14 days of intention to implement a boycott, to allow supermarkets the opportunity to arrange for additional milk through other local processors.²¹

7.7 Dairy WA submits that consumers should not experience an increase in price, as a result of the activities of the proposed milk negotiating agency, because processors and retailers will take a drop in their margins.

Interested parties' submissions on anti-competitive detriments

7.8 A number of dairy farmers have submitted that the arrangements for which authorisation is sought have not been fully determined and they are unsure as to the potential consequences for the industry and their businesses if the proposed milk negotiating agency is unable to find a purchaser for their milk. Dairy farmers have also submitted that consumers in Western Australia can sustain an increase in the retail price of milk and dairy products because they have experienced the lowest prices in Australia since deregulation of the dairy industry. They submit that any increase in retail prices would bring them into line with prices in the eastern states.

7.9 Peters & Brownes submits that the Dairy WA proposal would duplicate existing efficient systems that it has invested in over the past decades and it is highly unlikely that the new entity will achieve significant additional economies of scale.

²⁰ Dairy WA's response, 23 May 05, to National Foods Milk Ltd's submission. See www.accc.gov.au

²¹ Dairy WA's response, 23 May 05, to Woolworths Limited's submission. See www.accc.gov.au

It submits that the sustainable operation of the dairy industry in WA depends on it remaining responsive at all levels to developments in its external environment.

- 7.10 Peters & Brownes submits that the establishment of a single selling desk will create a ceiling on the growth of new opportunities outside the state and will reduce the flexibility in milk utilisation. This 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:
- severely restricting the future development opportunities of Western Australian dairies in the national and international market;
 - impeding farmers who have made investments based on a single pricing policy; and
 - requiring significant organisational and financial input.
- 7.11 One confidential submission argued that the overhead costs of running the proposed milk negotiating agency and transport system would exceed the price gains that may be achievable through the current collective bargaining arrangements (under ADF authorisation). It was submitted that the proposed milk negotiating agency is establishing a monopoly giving Dairy WA substantial power without this power being balanced by the acceptance of responsibility for its actions.
- 7.12 Further confidential submissions noted that the power to boycott a processor is an extremely powerful tool which will impact on processors' ability to meet their supply contracts; affect processors' market share which may be difficult to reclaim following the lifting of a boycott; transfer competitive advantages within the market; and affect consumers through higher retail prices and restricted choice.
- 7.13 NFML submits that the collective bargaining and collective boycott arrangements would substantially distort market forces in the Western Australian dairy industry and would result in:
- increased milk prices to consumers;
 - a reduction in the volume of milk supplied in Western Australia;
 - entrenched barriers to entry through the development of long-term contracts between dairy farmers and dairy processors;
 - dairy farmers being denied any role in the negotiation of contracts of supply to processors and retailers;
 - a total inhibition of competition between dairy farmers and a removal of any incentive for innovation in the supply of raw milk, if the milk negotiating agency represents every dairy farmer in Western Australia;
 - 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

- the possibility of disclosure of confidential information of processors and retailers.
- 7.14 Dairy Farmers submits that the detriment to consumers as a result of the anti-competitive impact of collective boycotts cannot be justified in any circumstances; it submits that the collective bargaining arrangements proposed have the potential to detrimentally affect the participating dairy farmers by restricting their freedom to negotiate individually direct with processors.
- 7.15 Woolworths submits that no entity should be allowed to:
- artificially construct a monopoly or near monopoly supply of commodity goods which are of vital public interest;
 - engage in anti-competitive conduct that is clearly not intended to result in a greater choice for consumers in price, quality and service;
 - obtain authorisation to engage in a boycott of processors and/or a secondary boycott of processors and retailers arising from negotiations between an individual retailer or processor and a dairy farmer.
- 7.16 CML submits that the applications for authorisation do not recognise the need to ensure that any collective negotiations between farmers do not significantly affect the price consumers pay for milk.
- 7.17 A number of dairy farmers, in their confidential submissions, submit that they have made substantial capital investments in their businesses following deregulation which have resulted in productivity gains and increased efficiencies. They submit that they are now beginning to earn a return on investments and any external market shock, would cause extreme detriment to the industry and put their investments and livelihoods at risk.
- 7.18 Other dairy farmers in confidential submissions submitted that, should the proposed milk negotiating agency be authorised, recent large capital investment in the industry would be placed in jeopardy and future new investment and projected interstate and international development plans would be threatened
- 7.19 Several dairy farmers submit that should the proposed milk negotiating agency be authorised, there is potential for further exits from the industry; however, those exiting will be the efficient dairy farmers who have driven recent productivity improvements in the industry in Western Australia.

ACCC assessment of anti-competitive detriment

- 7.20 In assessing the potential anti-competitive detriment of the proposed milk negotiating agency, the ACCC proposes to consider the following anti-competitive effects:
1. reduced economic efficiency;
 2. creation of barriers to entry and exit;
 3. increased potential for collective activity beyond that authorised.

Potential for reduced economic efficiency

- 7.21 A major feature of most collectively negotiated arrangements are agreements or understandings as to the price members of the collective will receive for the supply of their goods or services.
- 7.22 Competition between buyers or sellers ordinarily directs resources to their most efficient or productive use. Where buyers or sellers collude on the terms or conditions of acquisition or supply, competition can be distorted and resources directed to less efficient uses. This distortion in competition can often result in increased prices to consumers, less choice, lower quality products or services and increased costs of inputs for producers.
- 7.23 This is the foundation of the principles of competition and, as such, Parliament has deemed agreements between competitors as to price to substantially lessen competition in breach of the TPA.
- 7.24 Aside from price, businesses compete on factors such as quality, service and other terms of trade. Just as price agreements stifle competition on price, non-price agreements can stifle competition in areas such as quality and service.
- 7.25 In its past consideration of collective bargaining arrangements the ACCC has accepted that where collective bargaining results in higher prices, less choice, or lower quality of products, this could constitute an anti-competitive detriment.
- 7.26 The extent of the detriment and the impact on competition of the collective agreement will depend upon the specific circumstances. There are a number of features of the proposed arrangements that should be considered in assessing the extent of detriment likely to arise, namely:
- the scope of the proposed arrangements;
 - limitations on the voluntary nature of the arrangements;
 - the effect on existing levels of competition;
 - the extent to which the arrangements interfere with current relationships; and
 - the proposed use of boycotts.

The scope of the proposed arrangements

- 7.27 The ACCC considers where the size and scope of bargaining groups is restricted, any anti-competitive effect is likely to be smaller having regard to the smaller area of trade directly affected and the maintenance of competitive discipline by those competitors outside the group.
- 7.28 The ACCC generally considers that the potential for a collective bargaining arrangement to generate anti-competitive detriment would be greatly increased where arrangements have the effect of setting a common price for goods or services on an industry-wide or market-wide basis.

- 7.29 Arrangements giving rise to a monopoly market situation have the potential to set prices higher than the competitive market price and to restrict output levels. This may allow parties to extract monopoly rent with the likelihood of higher retail prices to consumers.
- 7.30 It is not entirely clear what level of coverage the milk negotiation agency would have, although some submissions have referred to the arrangements as amounting to a 'single desk'. Dairy WA has however submitted that the arrangements are not 'single desk' arrangements but rather reflect voluntary participation by growers (rather than a legislative requirement to participate).
- 7.31 The ACCC is concerned that a number of features of the proposed agency may resemble some of the characteristics of a single desk marketing body in that:
- the agency will have monopoly selling powers;
 - the extent to which raw milk supplied by the agency will be differentiated is unclear. Milk marketed under the arrangement may be treated as a broadly homogenous product;
 - dairy farmers will not have a direct relationship with processors;
 - the agency will reimburse dairy farmers in accordance with an (undisclosed) pricing model; and
 - negotiations with downstream industry participants will be carried out by the agency.
- 7.32 In its submission of 11 May 2005, Dairy WA advised that it would aspire to have a 70% minimum by volume of Western Australian milk supplied through the milk negotiation agency.
- 7.33 However, at a meeting of dairy farmers in September 2004²², Dairy WA representatives advised that under the proposed agency arrangements, dairy farmers would be in a monopoly position and that the ultimate aim is to turn the world upside down. In response to a question as to whether 100% of farmers were required to go forward, farmers were advised 'yes'. The representative noted that if farmers were to move outside the agency, the ability to bargain as a monopoly group would be lost.
- 7.34 It is possible that Dairy WA has altered its position since September 2004. At worst, however, Dairy WA will aim to hold a monopoly position; at best, it would seek to represent in excess of 70% of dairy farmers. In either case, it is clear that the breadth of the group carries significant anti-competitive consequences.
- 7.35 Despite making enquiries of Dairy WA, the ACCC is unclear as to the pricing methodology to be used by the milk negotiating agency to price the milk supplied through it and thereafter distribute payments to dairy farmers.

²² Video provided by Dairy WA in March 2005.

- 7.36 In the event that Dairy WA were to adopt a pooling and/or an equalisation arrangement (under which revenues would be divided according to raw milk volumes supplied by each dairy farmer) or a pricing model based on average sales to various markets, the effect would be to standardise prices paid to dairy farmers in Western Australia. Such arrangements unavoidably create 'winners and losers' amongst dairy farmers, with the losers being efficient dairy farmers.
- 7.37 In any event, given the proposal for common representation by the milk negotiating agency across all processors, the ACCC is concerned that the potential exists for the development of an industry wide price.²³
- 7.38 The ACCC is concerned that under these circumstances the milk negotiating agency is likely to significantly depress competitive activity.

Limitations on the voluntary nature of the arrangements

- 7.39 The ACCC takes the view that where participation in collective bargaining arrangements are voluntary for members of the collective and the counterparty, the anti-competitive effects of the arrangements are likely to be lower.
- 7.40 In the case of participants, where they consider they can better compete outside the collective and are able to opt out, this provides a competitive constraint on the group.
- 7.41 Dairy WA submits that it proposes to enter into written agreements with dairy farmers in Western Australia to collectively negotiate supply contracts for their milk with processors. Supply contracts will be individually negotiated with each processor and the term of the agency agreement, including provisions for renewal and termination, will be matched off with total processor contracts.²⁴
- 7.42 Under the proposed arrangements, farmers must obtain the consent of the milk negotiating agency before being released from the collective. Despite requests for advice as to the circumstances in which dairy farmers would be released, Dairy WA has simply advised that it would be a matter for contractual negotiations with the farmer.
- 7.43 In the case of processors, where they are able to choose whether or not to deal with the collective bargaining group, there is less risk of being forced to accept inefficient terms or conditions. Dairy WA submits that dairy farmers who have authorised it to negotiate on their behalf will be prevented from negotiating directly or entering directly into contracts with processors or retailers. Non-compliance will result in collective boycott of the processor or retailer by other dairy farmers contracted to Dairy WA.

²³ S.45A of the *Trade Practices Act 1974* declares price fixing arrangements to be a per se breach.

²⁴ Dairy WA: 11 May 2005; response to ACCC' schedule of questions.

- 7.44 Should the milk negotiating agency attract over 70% of Western Australia dairy farmers, it is clear that processors will have little choice but to deal with the milk negotiating agency. Further, under the proposed arrangements processors are prevented, under the threat of a collective boycott, from negotiating directly, without the consent of Dairy WA, with individual farmers who are participating members of the milk negotiating agency.

The effect on existing levels of competition

- 7.45 Generally, the ACCC considers that collective bargaining arrangements will lessen competition relative to a situation where no such arrangements exist. The extent of any anti-competitive detriment caused by this lessening of competition will depend on the pre-existing level of competition between members of the bargaining group.
- 7.46 The ACCC notes that there are four milk processors in Western Australia offering prices in the range of 24¢ - 32¢ per litre and dairy farmers are free, subject to the termination provisions of their contracts, to transfer their supply from one processor to another. A number of farmers supply a proportion of their milk to one processor and supply their growth milk to a second processor. In this respect, dairy farmers compete with each other.
- 7.47 Dairy WA submits that the level of competition between dairy farmers for the supply of milk to processors is low because processors offer contracts on a 'take it or leave it' basis and dairy farmers are locked into a single processor.
- 7.48 Peters & Brownes submits that its dairy farmer suppliers, who are members of a collective bargaining group formed under the ADF authorisation, compete for the quality premium paid to farmers whose milk surpasses the set quality threshold. Peters & Brownes submits that this competition on quality factors will be eliminated if all the milk output of all dairy farmers is pooled into one agency.
- 7.49 Peters & Brownes and NFML submit that their dairy farmer suppliers currently participate in collective bargaining groups, which negotiate on behalf of dairy farmers with the processors.
- 7.50 Should the proposed milk negotiating agency not receive authorisation, it is likely that Western Australian dairy farmers will continue to collectively negotiate with a single processor, as they currently do under the terms of the ADF authorisation.
- 7.51 The ACCC notes the price differential and the various terms and conditions, offered by the different processors lead to a degree of competition between the collective bargaining groups. This level of competition contributes to the attainment of more efficient outcomes. The ACCC considers that the proposed milk negotiating agency has the potential to restrict or limit the current level of competition existing between collective bargaining groups.

- 7.52 Western Australia processors have submitted that the establishment of a milk negotiating agency has the potential to reverse the productivity and efficiency improvements that have occurred as a result of deregulation (and the competition that followed) and that the proposal will create an inefficient structure that will lead to dairy farmers being worse off.
- 7.53 A number of dairy farmers expressed concern regarding the commercial viability of the proposed agency and contend that the dairy industry in Western Australia is now turning the corner after 4-5 very difficult years. They submit that the establishment of a proposed agency could negate the benefits achieved at considerable pain during the transition years²⁵.
- 7.54 Consequently, the ACCC considers that the proposed milk negotiating agency arrangements are likely to reduce the level of competition that currently exists between bargaining groups and are likely to have a detrimental effect on competition in the market for the supply of raw milk to processors.
- 7.55 The ACCC considers that the proposed milk negotiating agency arrangements have the potential to impact negatively on the productivity gains achieved in the Western Australian dairy industry since deregulation. The ACCC is concerned that the potential anti-competitive detriment of the proposed arrangements is likely to stifle further productivity improvements and suppress innovation which will affect the ability of Western Australian dairy products to compete in domestic and international markets.

Extent to which the arrangements interfere with current relationships

- 7.56 The ACCC is concerned the proposed agency arrangements may have a potentially adverse impact on current commercial arrangements in the Western Australian dairy industry, for example the arrangements:
- are likely to limit the input of dairy farmers into contracts with processors;
 - seek to sever the existing commercial relationships between dairy farmers and processors;
 - may reduce certainty and stability of income for dairy farmers;
 - may have a negative impact upon surplus milk arrangements; and
 - may have a detrimental impact upon Challenge.
- 7.57 One of the benefits the ACCC often finds flowing from collective bargaining arrangements is the efficiency gains that can be generated by improving the ability of small businesses to have input into contracts rather than the use of 'take-it-or-leave-it' standard form contracts. Where small businesses are provided with opportunity for input, issues that are common between the businesses can be put on the table and improved strategies for transacting business can be developed.

²⁵ Dairy farmers' confidential telephone submissions, April 2005.

- 7.58 The issue of increased input into contracts is discussed further at Section 8 of this draft determination. The flip side of the coin in this application however is the extent to which the collective bargaining arrangements proposed by Dairy WA lead to reduced input from dairy farmers in their dealings with processors and consequently result in anti-competitive detriment.
- 7.59 Dairy WA has advised that the milk negotiating agency will be the party contracting with processors and that it is not intended that there will be a direct relationship between the dairy farmer and the processor. Dairy WA further advises that dairy farmers will not directly participate in matters to be negotiated with processors but rather provide feedback through a liaison committee.
- 7.60 Dairy WA also indicates that its preference is that processors are not made aware of the amounts paid to farmers and that processors should not be made aware of the identity of the dairy farmers supplying their milk.
- 7.61 It is unclear how these propositions fit with the principle that ownership of the milk would reside with the farmer until supplied to the processor. It is clear however, that Dairy WA seeks to sever the direct relationships that currently exist between dairy farmers and processors. In their September 2004 presentation to dairy farmers, Dairy WA advised that dairy farmers would no longer be a Peters and Brownes supplier, a National Foods supplier or a Harvey Fresh supplier.
- 7.62 The severing of direct relationships between dairy farmers and processors has a number of detriments. First, it limits the opportunities for dairy farmers to sit down with their processor and provide input into issues specific to their commercial relationship.
- 7.63 It will also remove the ability for processors to work with growers to improve productivity and address quality concerns. For example, a number of processors gave examples of discussions with farmers resulting in agreed strategies for milk quality and productivity improvements. This was supported by dairy farmers referring to processors' advisory services.
- 7.64 The ACCC considers the proposed severing of direct relationships will lead to significant anti-competitive detriment by decreasing the opportunity for dairy farmers to have input into the supply arrangements negotiated with processors.
- 7.65 The severing of direct relationships between dairy farmers and processors also has the potential to significantly remove the certainty currently provided by existing contractual relationships.
- 7.66 The ACCC understands that supply contracts with processors currently provide for certainty in the acceptance of milk from contracted farmers. This provides dairy farmers with a level of income security. Milk supplied surplus to fresh milk requirements is used in processing products.

- 7.67 Under the Dairy WA proposal, it is not guaranteed that processors will contract the same volumes of milk. Some processors advised that given the severing of direct relationships with farmers they may well choose to contract lower volumes of milk and scale back lower margin products.
- 7.68 Dairy WA disputes the claim that processors may choose to contract less volume and leave farmers exposed to surplus milk. They also refer to the potential for Dairy WA to contract with processors in interstate or overseas markets or through local spot markets.
- 7.69 The ACCC considers that there remains strong concern that under the proposed arrangements processors could reduce the volume of contracted milk leaving dairy farmers exposed to significant uncertainty. While there may exist some scope for Dairy WA to find alternative customers, the ACCC is not convinced that it would have the ability to deal with significant volumes of surplus milk given the ACCC's earlier assessment that the transport of raw milk outside Western Australia is limited at this time.
- 7.70 The potential for farmers to be exposed to surplus milk and the lack of certainty this provides would lead to under-investment by dairy farmers. The ACCC considers this would constitute a significant anti-competitive detriment.
- 7.71 Finally, it is also worth noting the potential impact of the proposed arrangements on Challenge. Challenge operates on the basis of dairy farmer ownership of delivery rights units (DRU) – see Section 2. Submissions received note the importance of Challenge in providing certainty for dairy farmers as a customer of last resort. Dairy WA submits that it would be able to design its contracts with dairy farmers so as not to interfere with DRUs and the operation of Challenge.
- 7.72 While it would be pleased to receive further information from Dairy WA on this point, the ACCC is not confident that the Dairy WA proposal could accommodate the Challenge co-operative arrangements. DRUs involve a direct contract between the co-operative and the dairy farmer. As noted above, the Dairy WA proposal seeks to sever the link between farmer and processor.
- 7.73 Accordingly, the ACCC is concerned that the proposed arrangements are likely to significantly impact on the operation of Challenge, and to adversely affect the certainty it provides dairy farmers and the competitive dynamic it brings to the Western Australian dairy industry. The ACCC considers this would constitute a significant detriment.

Boycott activity

- 7.74 Parties engaging in collective negotiations may also seek to jointly agree not to acquire goods or services from, or jointly agree not to supply goods or services to a business with whom they are negotiating, unless that business accepts the terms and conditions of acquisition or sale offered by the group. This conduct is

referred to as a 'collective boycott' and is prohibited under section 4D of the TPA.

- 7.75 Section 45 of the TPA declares it a per se breach of the TPA to enter into a contract containing an exclusionary provision or to give effect to such a provision.
- 7.76 While there are circumstances when the ability to boycott may generate a net public benefit, more generally, collective boycotts can significantly increase any anti-competitive effects of collective bargaining arrangements. For example, the ability to collectively boycott reduces the voluntary nature of collective bargaining arrangements.
- 7.77 Collective boycotts have the potential to cause serious disruption to industry participants, consumers and the economy in general. The withdrawal, restriction or limiting of supply of any good or service in a market results in consumer detriment (higher prices and restricted choice); adversely affects businesses' ability to fulfil contracts, service debt and meet business projections; and negatively impacts on returns on capital investments suppressing future investment in an industry.
- 7.78 Dairy WA has applied for authorisation (A90961) to allow it to engage, if necessary, in collective boycott activity with regard to those dairy processors and retailers, if there are no current contracts in place or the processor seeks to unilaterally change a pre-existing contract with dairy farmers.²⁶ Dairy WA has noted that the application for authorisation of the collective bargaining arrangements is not subject to the approval of the application for collective boycott.
- 7.79 As noted previously, under the proposed arrangements processors are prevented, under the threat of a collective boycott, from negotiating directly, without the consent of Dairy WA, with individual farmers who are participating members of the milk negotiating agency. Dairy WA submits that consent to negotiate direct would not be unreasonably withheld.
- 7.80 The ACCC notes that Dairy WA has not provided guidelines as to what conditions are required for obtaining Dairy WA's consent to conduct direct negotiations.
- 7.81 The ACCC considers that the withdrawal of supply of raw milk to the market by way of a collective boycott, is likely to result in some restriction of supply of milk and dairy products to consumers and the general community.
- 7.82 Even short term restriction in the supply could potentially result in longer term impact on market participants and consumers, including:
- economic damage on market incumbents including processors and farmers;

²⁶ Dairy WA's submission in support of its applications for authorisation, 16 March 2005

- possible withdrawal from the industry by smaller market players;
 - a loss of consumer confidence in affected brands and transfer of brand loyalties; and
 - long term price increases to Western Australian consumers.
- 7.83 In addition to these considerations associated with the withdrawal of raw milk from the market, there are serious environmental issues in the disposal of raw milk.
- 7.84 The ACCC must assess, whether in all the circumstances, having considered all the detriments, the public benefits are such that the exclusionary provision should be authorised.
- 7.85 Overall, in relation to Dairy WA's application, the ACCC is of the view that the significant public detriments (economic and environmental) that would result from a collective boycott of dairy processors by dairy farmers would have a substantial negative impact on competition in the dairy industry in Western Australia and would seriously impinge on community welfare.

Effect on barriers to entry and exit

- 7.86 One of the features of a competitive market is that potential new businesses are free to enter the market to compete for the rights to undertake the business of existing market participants and that participants in the market are free to exit. New businesses are attracted to industries that experience above average profits. Monopoly profits create incentives for entry of new participants or the creation of new productive capacity.
- 7.87 Barriers to entry to an industry or market have implications for how competition operates and the economic outcomes. Barriers to entry can be natural barriers (natural resource requirement); institutional (market size relative to the size of a business); legal (government restrictions, licensing) or artificial (created by an industry). Collective arrangements resulting in long term contracts on agreed prices, terms and conditions can deter entry to an industry and create an artificial barrier to entry.
- 7.88 Existing dairy farmers have in the past 5 years since deregulation, purchased additional factors of production (land and cattle herds) to increase productive capacity and improve output. In these circumstances and in the absence of natural, legal or institutional impediments, the ACCC notes that existing barriers to entry to the dairy industry in Western Australia are unlikely to be overly high.
- 7.89 Dairy WA submits that dairy farmers may have the power to novate their contracts with the consent of the milk negotiating agency and subject to specified

terms and conditions.²⁷ Further, farmers contracting with Dairy WA will be subject to, as yet undefined, specific termination provisions.

- 7.90 Where dairy farmers are making losses in the long run, it is rational economic behaviour to exit the industry. The restrictive requirement for consent and the application of terms and conditions have the capacity to hamper a dairy farmer's economic decision and to create a barrier to exit from the industry.
- 7.91 The ACCC is also concerned that if prospective or incumbent processors are unable to negotiate a commercially appropriate supply arrangement with the agency, then the existence of the agency (given its potential control of raw milk volume) may create artificial barriers to entry and/or expansion in the raw milk processing sector in Western Australia.
- 7.92 The ACCC considers that the establishment of a milk negotiating agency, with associated monopoly features, and the conditions imposed on exit from the agency arrangements, could considerably increase the barriers to entry and exit for dairy farmers and barriers to entry and expansion for processors.

Increased potential for collective activity beyond that authorised

- 7.93 In considering collective bargaining arrangements in the past, the ACCC has noted concern that the arrangements may increase the potential for collusive anti-competitive conduct beyond that authorised.
- 7.94 In particular the ACCC considers that the potential anti-competitive effects of the proposed arrangements may be increased where the arrangement requires the competitors to meet, share information, discuss pricing and determine future collective strategies.
- 7.95 The arrangements proposed by Dairy WA appear to be a significant move towards replicating the single desk arrangements which existed under the regulated system. Combined with the intention to allow dairy farmers to collectively boycott processors, the ACCC considers this proposal to be an extreme example of collective bargaining arrangements.
- 7.96 The ACCC is concerned in this instance that the potential for collusive activity beyond that authorised is increased, where participants will be meeting to discuss the possibility of a collective boycott, should a dairy farmer and a processor enter independent direct negotiations.

²⁷ Dairy WA, 11 May 2005: Response to schedule of questions and answers

Conclusion on anti-competitive effects of the proposed arrangements

- 7.97 The ACCC considers that the potential anti-competitive detriment likely to arise from the proposed arrangements to be significant.
- 7.98 The ACCC considers that, under either counterfactual identified in Section.6, the proposed milk negotiating agency arrangements have the potential to result in a lessening of competition.
- 7.99 In the event that authorisation is not granted to ADF's application (A90966) the proposed agency arrangements are likely to reduce the level of competition between dairy farmers relative to a situation where dairy farmers negotiate on an individual basis. Under the alternative counterfactual, the ACCC considers that the proposed arrangements are likely to reduce the level of competition existing at present under the currently authorised collective bargaining arrangements.
- 7.100 The ACCC considers that the probable anti-competitive effect of the proposed arrangements, under either counterfactual, is significantly increased by the inclusion of an exclusionary provision permitting collective boycotts in milk supply contracts.
- 7.101 The ACCC considers that a number of features of the arrangements proposed by Dairy WA have the potential to a significant anti-competitive effect, these include:
- the arrangements have the potential to significantly depress competition between dairy farmers on matters such as price;
 - the arrangements have the potential to unduly restrict the ability of dairy farmers to deal directly with processors;
 - the arrangements have the potential to introduce industry-wide pricing agreements;
 - the arrangements are likely to significantly limit the input of dairy farmers into contracts negotiated with processors;
 - the arrangements may have a significantly detrimental impact upon Challenge and existing surplus milk arrangements; and
 - the arrangements are likely to artificially increase barriers to entry and exit for dairy farmers and may also artificially increase barriers to entry and expansion for processors.
- 7.102 Consequently, the ACCC considers that the potential anti-competitive detriment that may result from the proposed milk negotiating agency is likely to be significant.

8 ACCC assessment of the public benefits

- 8.1 In order to grant authorisation to collective bargaining arrangements, the ACCC must be satisfied that those arrangements would result in a benefit to the public that outweighs any detriment to the public constituted by any lessening of competition arising from the arrangements.
- 8.2 There must be a nexus between the claimed public benefits and the proposed arrangements for which authorisation is sought. In other words, the benefit to the public must have a correlation with the proposed arrangements.
- 8.3 Generally when considering the size of any public benefits in an authorisation context the ACCC will, as with the anti-competitive detriments, compare whether the claimed public benefits arise as a result of the collective bargaining arrangement against whether they would exist absent the authorisation.
- 8.4 In this instance, as there are two potential counterfactuals (see Section 6) the size of the public benefits generated may vary depending on which counterfactual is accepted.
- 8.5 The ACCC considers that in the event that ADF's application for revocation and substitution (see Section 2) is granted, this will allow dairy farmers in Western Australia to continue negotiating through their respective collective bargaining groups, as they currently do, irrespective of authorisation of Dairy WA's proposal. The alternative counterfactual would be one where ADF is denied authorisation and Western Australian dairy farmers would negotiate individually with processors for the supply of their milk.

The ACCC's assessment of Dairy WA's claimed public benefits

- 8.6 Dairy WA submits that the proposed milk negotiating agency would have the following public benefits:
- Improved bargaining power*
- 8.7 Previously, the ACCC has considered improved bargaining power as a claimed public benefit. Arguments based on improved bargaining power essentially relate to a change in the power relativities of the parties to the proposed arrangements. An increase in the bargaining power of one party, by definition, means a reduction in the bargaining power of the counter party.
- 8.8 However, the ACCC is not satisfied that a transfer of bargaining power from one negotiating party to another party contributes to increased economic efficiency or public benefit in itself.
- 8.9 The ACCC is concerned with the likely outcomes resulting from any change in the balance of bargaining power as a result of the collective bargaining

arrangement for which authorisation is sought. It is these likely outcomes which are essential to the net public benefit test.

- 8.10 The ACCC considers that such improved outcomes and efficiencies are more likely to arise if both parties to the negotiation (i.e. dairy farmers and processors) have some input into the negotiation process. A public benefit can result from collective bargaining arrangements that increase the effective input of the weaker party to the bargaining process.
- 8.11 Where members of the collective have common issues, there can be significant efficiencies in putting proposed improvements on the table through the collective bargaining process. In the dairy industry context, strategies to improve milk quality or transport arrangements may flow from collective bargaining.
- 8.12 In the current circumstances, the ACCC accepts that there is an imbalance in bargaining power between dairy farmers and processors, which limits the capacity of dairy farmers to have effective input into contract terms and conditions without collective bargaining. Generally, in the context of milk supply contracts, the ACCC accepts that a dairy farmer collective bargaining arrangement may address this inequality.
- 8.13 Dairy WA argues that an improved bargaining position should:
- improve the likelihood of the Western Australian industry surviving;
 - allow dairy farmers to negotiate for a price that more equitably allocates surplus profits; and
 - reduce the likelihood of industry failure and limit the need for higher priced import replacements to consumers.
- 8.14 It is difficult however, for the ACCC to accept that the Dairy WA proposal would facilitate dairy farmer input into contracts with processors. As discussed in Section 7, the proposal seeks to sever the direct relationship between dairy farmers and processors.
- 8.15 In circumstances where the link between dairy farmers and processors is broken, it is hard to see how dairy farmers will gain more input into contracts. In fact, as discussed at Section 7, the reverse is likely to apply.
- 8.16 This concern is heightened by the proposal for the group to bargain with all processors. In these circumstances, issues that are specific between one processor and its farmers would be difficult – if not impossible – to separate and address in such a wide collective.
- 8.17 The ACCC therefore considers that rather than leading to efficient input into contracts, the Dairy WA proposal is more likely to lead to less efficient input into contracts.

- 8.18 This is in contrast to the ADF counterfactual, where dairy farmers continue to have a direct relationship with their processor and through collective bargaining have the potential to put common issues on the table. The ACCC considers that, without the ability to collectively bargain, given the undisclosed terms and conditions of the proposed contracts which will be individually negotiated between dairy farmers and the milk negotiating agency, it is difficult to predict if the proposed arrangements will contribute to an improved bargaining position for Western Australian dairy farmers.

Significant transaction cost saving

- 8.19 In considering previous applications for authorisation, the ACCC has noted that there are transaction costs associated with using the market as a mechanism for trade. The ACCC has considered that transaction cost savings can represent a real resource saving by reducing the cost of supply and potentially reducing costs to consumers.
- 8.20 The ACCC has accepted that transaction costs may be lower in negotiating a collective bargaining agreement involving a single negotiating process than where repeated negotiation occurs with a number of similar businesses. Consequently, to the extent that potential transaction costs savings are realised, and are likely to be passed on to consumers in the form of lower prices or better services, the ACCC has accepted that this could constitute a public benefit.
- 8.21 Dairy WA submits that under the proposed milk negotiating agency arrangements, dairy farmers will benefit from transaction cost savings. The ACCC notes that the only potential transaction cost saving identified by Dairy WA related to transportation costs. The ACCC notes that Dairy WA has not provided any evidence of current expenditure on transport by dairy farmers and how the proposed arrangement would result in a reduction in transportation costs. Consequently, the ACCC is unable to assess the extent to which transport costs would be reduced, giving a transaction cost saving.
- 8.22 To the extent that Dairy WA proposes that the milk negotiating agency would negotiate individually with each dairy farmer on the terms and conditions for the supply of milk, the ACCC is concerned that dairy farmers may incur transaction costs in the form of professional business advice (lawyers and accountants) prior to contracting with the agency. In addition, dairy farmers may incur additional transaction costs in transferring from their current contractual arrangements to the agency arrangements.
- 8.23 The ACCC is further concerned that the establishment, administration and management costs of the proposed milk negotiating agency would be factored into the price negotiated with processors by the agency on behalf of dairy farmers. The ACCC notes that Dairy WA has failed to demonstrate where the claimed cost savings could be achieved and how the agency's ongoing operational costs would be absorbed into the price received by its dairy farmer members.

- 8.24 On balance, the ACCC is not satisfied that the establishment of a milk negotiating agency, with the associated sunk costs and ongoing administration costs, would result in transaction cost savings to industry participants.

The re-distribution of current monopsony profits

- 8.25 Dairy WA submits that dairy processors continue to earn a similar proportion of the retail sales value despite the downward pressure on the price received by dairy farmers and argues that processors use their monopsony position to extract surplus profits.
- 8.26 NFML submits that with the existence of a number of processors in the Western Australian market, it is not possible for any processor to act like a monopolist. NFML argues further that the proposed milk negotiating agency would create a monopoly supplier of milk, allowing it to extract monopoly rents from processors and retailers.
- 8.27 CML submits that if a monopoly negotiating agency extracted better returns to farmers from cost increases rather than productivity/efficiency gains, these would result in increased prices to consumers.
- 8.28 The ACCC is not satisfied that Dairy WA has provided evidence that Western Australian processors are extracting surplus profits and consequently is unable to accept this claimed public benefit.

Easing the transition to industry deregulation

- 8.29 The ACCC has authorised various collective bargaining arrangements in industries, particularly rural industries, following deregulation. In assessing such arrangements the ACCC has accepted arguments that there would be a public benefit in facilitating the adjustment from a regulated to a deregulated environment. The ACCC considers that the requisite restructuring of an industry following deregulation could lead to market disruption and has accepted collective bargaining arrangements as a means to easing the transition.
- 8.30 In 2002 the ADF (now ADF) argued that such a public benefit would flow from allowing dairy farmers to collectively negotiate and assist in the adjustment to the new economic environment. The ACCC accepted this claimed public benefit at that time.
- 8.31 However, consistent with its assessment of Premium's application for revocation and substitution, the ACCC is of the view that sufficient time has passed to allow parties, in particular dairy farmers, the opportunity to adjust to a deregulated environment. Consequently, the ACCC is unable to accept this claimed public benefit.

Improving the viability of small dairy farms

- 8.32 Dairy WA submits that the aim of the milk negotiating agency is to provide a more cohesive and efficient industry which may result in improved stability in the industry in the future.
- 8.33 The ACCC is of the view the viability and prosperity of any sector of the economy would be regarded as a public benefit, provided the ongoing viability is not at the cost of productivity and efficiency gains elsewhere in the sector.
- 8.34 However, where a wealth transfer results in the continued participation by inefficient and uncompetitive businesses, that transfer is likely to lead to economic inefficiency. The ACCC could not accept the promotion of such inefficiency as a public benefit.
- 8.35 Having considered the information before it, the ACCC is not satisfied that Dairy WA has demonstrated that the proposed arrangements would result in this public benefit.

Opening up new marketing opportunities

- 8.36 Generally, the ACCC considers the expansion of markets both domestically and internationally for Australian products to be a public benefit. However, the ACCC notes that these opportunities could be explored without the need to establish a milk negotiating agency.
- 8.37 The ACCC notes that Dairy WA has been in existence for a number of years and has not provided sufficient information to demonstrate that these potential new opportunities have been explored or would be realised with the benefit of the proposed collective bargaining and collective boycott arrangements and, as a consequence, the ACCC does not accept the claimed public benefit.

Conclusion on the public benefit of the collective bargaining arrangements

- 8.38 As a general principle the ACCC considers that collective bargaining between small businesses, such as dairy farmers, has the potential to result in benefits to the public. However the extent and nature of these benefits are contingent upon the nature and effect of the collective bargaining proposal.
- 8.39 In order to grant authorisation to Dairy WA's proposal to establish a milk negotiating agency, the ACCC must be satisfied that the potential public benefits arising from the arrangements would outweigh the potential anti-competitive detriments arising from the arrangements.
- 8.40 As noted in section 6 of this draft determination, the ACCC has identified two possible counterfactual situations. In general, potential public benefits generated by collective bargaining arrangements may vary depending on the accepted counterfactual.

8.41 In this instance, having considered the information provided by Dairy WA and interested parties, the ACCC is of the view that, under either counterfactual, the public benefits likely to arise from Dairy WA's proposal are likely to be minimal.

9 Balance of public benefits and anti-competitive detriments

9.1 As noted previously, for the ACCC to grant authorisation to the Dairy WA proposal, it must be satisfied that:

Collective bargaining

- the contract, arrangement or understanding would be likely to result in a benefit to the public; and
- this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding.

Collective boycott

- in all the circumstances, that the proposed arrangements would have the result, or likely to result, in such a benefit to the public that the arrangements should be allowed.

9.2 In this instance, the ACCC has assessed the claimed public benefits and potential public detriments that may arise from the establishment of the proposed milk negotiating agency based upon the information available to it. The ACCC notes that, despite requests made to Dairy WA, aspects of the material provided by the applicant are lacking in detail which may otherwise have assisted in the assessment of the proposal.

9.3 In considering whether the statutory tests have been met the ACCC must weigh the Dairy WA arrangement against what it considers to be the most likely counterfactual. In the circumstances presented, the ACCC considers that, were it to deny Dairy WA's application but were to grant the ADF application for revocation and substitution (see Section 2), the counterfactual is likely to be one in which the status quo would prevail. That is, Western Australian dairy farmers would be able to engage in collective negotiations under the terms of the ADF authorisation.

9.4 However, in the event that the ACCC does not grant the ADF authorisation to engage in collective bargaining, the likely counterfactual would be a situation where Western Australian dairy farmers would negotiate individually for the supply of raw milk with processors.

9.5 In considering the possible detriments to the public that may result from Dairy WA's proposed arrangements, the ACCC notes the following features as having a potentially significant anti-competitive effect:

- the arrangements have the potential to significantly depress competition between dairy farmers on matters such as price;

- the arrangements have the potential to unduly restrict the ability of dairy farmers to deal directly with processors;
- the arrangements have the potential to introduce industry-wide pricing agreements;
- the arrangements are likely to significantly limit the input of dairy farmers into contracts negotiated with processors;
- the arrangements may have a significantly detrimental impact upon Challenge and existing surplus milk arrangements; and
- the arrangements are likely to artificially increase barriers to entry and exit for dairy farmers and may also artificially increase barriers to entry and expansion for processors.

9.6 Overall, the ACCC considers that public detriments likely to result from the Dairy WA arrangements are likely to be significant.

9.7 As has been noted the ACCC considers that collective bargaining between small businesses, such as dairy farmers, has the potential to result in benefits to the public. However the extent and nature of these benefits are contingent upon the nature and effect of the collective bargaining proposal.

9.8 Having considered the information provided by Dairy WA and interested parties, the ACCC is of the view that the public benefits likely to arise from Dairy WA's proposal are likely to be minimal.

9.9 Following consideration of the arguments advanced by Dairy WA and interested parties, the ACCC cannot be satisfied that the public benefits likely to result from the proposed arrangements are likely to outweigh the potential public detriments of those arrangements. Accordingly the ACCC proposes to deny authorisation to Dairy WA's applications for authorisation.

10 Draft determination

Applications A90961 and A90962

- 10.1 On 16 March 2005 Dairy WA lodged applications for authorisation A90961 and A90962 with the Australian Competition and Consumer Commission (ACCC).
- 10.2 In lodging the applications authorisation has been sought:
- to make and give effect to a contract, arrangement, or understanding a provision of which would be or might be an exclusionary provision within the meaning of section 45 of the Trade Practices Act 1974 (A90961); and
 - to make and give effect to a contract, arrangement, or understanding a provision of which would have the purpose or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the Trade Practices Act 1974 (A90962).
- 10.3 The applications are also expressed as applying to any other person who subsequently becomes a party to the proposed arrangements pursuant to section 88(10) of the Act.

Statutory test

- 10.4 For the reasons outlined in this draft determination, the ACCC is not satisfied that the conduct for which authorisation is sought under subsection 88 (1) of the TPA in respect of provisions which would be or might be exclusionary provisions would be likely to result in such a benefit to the public that it should be allowed to be made and given effect to (A90961).
- 10.5 For the reasons outlined in this draft determination, the ACCC is not satisfied that the conduct for which authorisation is sought under subsection 88 (1) of the TPA in respect of provisions which would have the purpose or would have or might have the effect of substantially lessening competition within the meaning of section 45 TPA would be likely to result in a benefit to the public and that this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding (A90962).

The ACCC therefore proposes, subject to any pre-decision conference requested pursuant to section 90A of the TPA, to deny authorisation to applications A90961 and A90962.