3.40 Table 3.1 represents the number of producers in each zone, by participating supply co-operative.

Table 3.1: Producer numbers in proposed dairy zones, by participating co-operative.

Co-operative	NE Zone	NW Zone	SE Zone	SW Zone	Total
Maryborough Co-operative Dairy Association	0	2	37	0	39
Suncoast Milk Producers Co-operative Association	0	0	3	74	77
Burnett Milk Producers Co-operative Association Limited	0	0	58	0	58
Dairyfields Milk Suppliers Co-operative Limited	75	93	0	0	168
Metropolitan Milk Producers Co-op Association Limited	51	3	6	36	96
Total 2000	**126**	**98**	**104**	**110**	**438**
Total 2001	**105**	**88**	**80**	**85**	**358**

Source: Premium application ("Schedule — Zone Map")

3.41 The producer members within each zone will elect two Directors to represent that zone. The Directors may determine the geographical areas in Queensland which comprise the Zones; they may vary the boundaries and change and amalgamate zones. The applicant advises that the zonal system will take effect in year three of the scheme.

after an applicant has been lodged shall be accepted as a member. There is no right of appeal in respect of rejections of applications and the Directors are not obliged to inform the applicant of the grounds on which an application was rejected (or accepted).

3.35 An application for membership shall provide the details of the terms on which the applicant proposes to supply milk to Premium. Such details include the quantity of milk to be supplied; the intervals at which milk is to be supplied; and the time, place and manner of delivery of milk. Directors may reject or accept a member's proposal to alter the terms on which they supply milk to Premium.

3.36 The Directors may prescribe:

- a minimum quantity of milk which is acceptable for supply to Premium;
- criteria for different levels of quality of milk supplied to Premium;
- prices payable to members for milk supplied to Premium, including different prices for different categories of milk quality; and
- minimum quantities of milk which must be supplied by a member within prescribed timeframes.

3.37 Members must comply with the terms proposed with the member's application or that are subsequently altered in accordance with a proposal accepted by Directors. Where a member does not supply milk in accordance with the regulations, the Directors may give the member a notice specifying details of the breach and giving a reasonable time for the member to remedy the breach. Failure to remedy a breach within the time prescribed is a breach of the member's obligations under the regulations. Where a member supplies milk which not of the minimum quality prescribed by the Directors, Premium may refuse to accept the milk and is not required to pay the prescribed price for the milk.

3.38 Premium advises that while the quality, prices and required volumes of milk to be supplied to Pauls will be determined at the Milk Management Committee level, Premium must have a legally enforceable way of ensuring that these requirements are met by producer members. Premium advises that this is achieved through the Constitution and the powers of Directors.

3.39 Under the proposed arrangements the producers will be divided into four geographical zones having regard to different processing and consequent transport facilities. It is proposed that the zones will encompass the following regions:

- North East Zone, extending along the coast from Maryborough in the north to Brisbane in the south;

- North West Zone, extending from Mundubbera in the west to Toowoomba in the south;

- South East Zone, extending south from Brisbane to the New South Wales Border, and westward to Ipswich and Beaudesert; and

- South West Zone, extending south from Toowoomba to the New South Wales border, including Warwick on the Darling Downs.

- milk producers have significant capital investment in land, livestock and equipment. The nature of land holdings make alternative uses of land economically unviable for most producers; and

- the lead time for investment in major new technology is approximately three years. Consequently, security of demand is essential if producers are to adopt innovative production methods.

4.4 In any event, even assuming that a lessening of competition ensues, Premium claims there are significant public benefits flowing from the proposal including:

- the creation of countervailing bargaining power in favour of member producers;

- collective negotiation of quality and composition standards will create certainty for member producers and thereby allow for investment in new technology, plant and equipment to ensure that quality standards are achieved and improvements are made;

- other efficiency improvements; and

- the proposed arrangements will significantly increase the prospects of a smooth transition from a regulated to a deregulated farm-gate price environment.

Countervailing power

4.5 Premium submits that in the absence of a mechanism such as that being proposed, producers in a deregulated market will have very little bargaining power. There are a number of factors which contribute to this fact, including:

- milk is a highly perishable product that reduces the producer's ability to negotiate. A means by which longer term prices and supply conditions can be determined will overcome the difficulties arising from the nature of the product; and

- the size of most producers in Queensland. Whilst there are a number of large volume producers, the majority of producers (and certainly the majority of those that would be represented by Premium) are smaller producers who do not have the financial capacity or volume to effectively negotiate individually with processors.

4.6 By contrast with the bargaining power of the producers, the processors are large corporate entities with significant financial capacity and the ability to source product from various suppliers.

4.7 In the case of Pauls, whilst it has significant bargaining power, it wishes to participate in the proposal to secure for itself longer term security of supply at appropriate standards of quality and composition. Premium submits that Pauls could not achieve this result by simply negotiating on an individual basis with 580 or more producers or through six independent co-operatives as currently occurs. There are administrative as well as tangible benefits from negotiating such matters through a single body.

4. Submission by the applicant

4.1 Premium submits that the proposal for which authorisation is sought has been developed to reduce the negative impact of deregulation on producers by providing them with a more effective means by which to influence farm-gate pricing, supply arrangements and milk standards. Premium claims that this is done by allowing for collective bargaining of prices and standards through the representative body (Premium) in direct negotiations with Pauls.

4.2 Premium submits that any potential detriment to competition that may result from the proposed collective arrangement is outweighed by the public benefits associated with the proposal. Any anti-competitive elements are diminished because of the lack of any compulsion on member producers to sell, or on Pauls to buy, at any particular price established by the Milk Management Committee. Premium advises that the success of the proposal will be entirely dependent on the effectiveness of the Milk Management Committee in setting reasonable prices and standards, having regard to competitive forces. The lack of any compulsion on members to sell milk at a particular price, subject to the six month notice requirement, to sell or on Pauls to buy milk at a particular price, reinforces this view.

4.3 The following industry characteristics were identified by Premium as being relevant to minimising any effect on competition that is likely to result from the proposed collective arrangement:

- manufacturing milk prices in Australia are influenced by import parity with New Zealand prices which in turn reflect world prices and exchange rates;

- there is a very high volume of manufacturing milk available on the Australian Eastern Seaboard which will compete directly with the supply by Premium members;

- there is significant competition amongst the three major milk processors (Pauls, Dairy Farmers' Co-Operative and National Foods Limited). In turn, the major supermarket chains have a high degree of market power vis-à-vis the processors, and through home brands, are vigorous competitors of processors at retail level;

- Victorian producers account for 64 per cent of Australia's total milk production. Prices paid for milk in Victoria will impact the prices paid in other states;

- in Queensland the Dairy Farmers' Co-Operative represents approximately 900 producers and will exercise significant competitive influence over the prices paid by Pauls, particularly in light of the lack of any compulsion on Premium's members to sell to Pauls;

- while only recently commencing processing operations in Queensland, National Foods is expected to provide a viable alternative buyer of Queensland milk;

4.8 Premium submits that currently Pauls simply offers prices and quality arrangements to the six co-operatives. There is little negotiation of those matters and, in any event, the producers do not have sufficient countervailing market power to negotiate a better price. Since deregulation of the farm-gate price, processors have set the price and producers have been price takers. The six co-operatives have not been successful in having any significant influence on the price for milk paid to producers.

4.9 By aggregating a greater number of producers under the one corporate structure, and by putting in place the Milk Management Committee as a cornerstone of the current proposal, Premium expects that a much more effective voice for producers will be created.

4.10 The applicants also claim that in the absence of the proposed scheme, the 580 producers to be represented by Premium will be at a significant disadvantage in comparison with the 900 members of Dairy Farmers' Co-operative who have a producer Board representing their interests.

Investment in new technology

4.11 Dairy farming has become increasingly capital intensive. Premium claims that there is a direct correlation between the quality of milk produced and the amount invested in technology. On average, major investment in new technology carries a three year lead time.

4.12 In order for dairy farmers to make that capital investment Premium submits that they need security of return in the short to medium term. The current proposal, whilst not guaranteeing any sales of milk to Pauls, gives the relevant producers sufficient certainty to create an incentive to make the necessary investment in technology.

4.13 Premium advises that certainty will result from the proposal because standards of milk production will be determined in advance and published to all members of Premium and, at the same time, the relationship between Premium and Pauls will ensure longer term supply requirements at known pricing levels. These factors will give producers both the incentive (through higher prices for better quality milk) and the security (through longer term supply arrangements being effected) to make the capital investment necessary to improve their technology.

4.14 Premium claims that the incentive to make the necessary levels of investment in the industry is further enhanced by the tangible benefits flowing from attainment of the relevant standards set by the Milk Management Committee.

Efficiency improvements

4.15 Premium advises that while there is no pricing component that directly relates to efficiency, efficiency is indirectly taken into account through the setting of the various quality and composition standards at particular levels. Efficient producers will have the necessary quality procedures in place and investment in equipment to ensure that the milk they produce meets the highest standard possible to achieve higher prices. Premium submits that the efficiency of the producer – as determined by the quality of their procedures and the capital they have invested in state-of-the-art equipment, together with the quality of their herd – will directly and materially influence such matters as butterfat and protein percentage and cell counts.

4.16 Processors such as Pauls, are seeking to improve the quality of the milk it receives from producers as that will impact on its costs of production and quality of output. Premium claims that as a result, it is in the interests of both the producers and the processors to effect a premium for higher quality milk. That is the way in which the factors referred to will impact on prices determined by the Milk Management Committee.

4.17 In addition, the Premium proposal and structure will offer a more consistent approach across Queensland to quality standards and procedures. This should result in an overall improvement in efficiency for that part of the Queensland industry participating in the Premium structure, particularly as it will directly take account of Pauls' requirements through the Milk Management Committee.

Smooth transition to deregulation

4.18 Premium submits that there is a clear benefit in any mechanism which provides for a smooth transition from a regulated industry to a deregulated one. Whilst the current proposal seeks to reduce the adverse effects of complete deregulation of farm-gate prices, the fully negotiable nature of the price at the Committee level, and the lack of any compulsion to sell or buy at the negotiated price, preserves the competition benefits that deregulation seeks to achieve.

4.19 It is also submitted that the countervailing power which the proposal provides in favour of the producers will also add to a smooth transition to a deregulated industry and will provide producers with some encouragement to make investment in technology so that longer term production efficiencies can be achieved and improved.

4.20 Premium claims that the effects of the transition will be most acutely felt in rural communities and the benefit from ensuring a smooth transition, whilst difficult to quantify is nevertheless real and significant.

5. Submissions by interested parties

5.1 The Commission sought submissions from a wide range of interested parties in relation to the application for authorisation and the public benefit and public detriment claims made by Premium. Copies of the non-confidential submissions received by the Commission are on the public register. Set out below are the main points raised in the substantial submissions received from interested parties.

5.2 The **Metropolitan Milk Producers Co-operative Association Limited** (Metropolitan Milk) submits that Queensland has always been a market milk State as distinct from Victoria which is predominantly a manufacturing milk state. In Queensland, processors require fresh milk 365 days of the year to meet their market milk requirements, and farmers have geared their production to cater for these requirements. This has come at an extra cost compared with seasonal production and consequently deregulation has hit Queensland harder than other areas.

5.3 The deregulation of the dairy industry has seen a substantial fall in the farm-gate price to farmers with an income loss of over 25 per cent. Metropolitan Milk has already lost 6 per cent of suppliers because of deregulation and expects to lose 15 per cent in the first year at current farm-gate prices. Should the farm-gate price fall any further, Metropolitan Milk claims the whole viability of the Queensland industry will be threatened with processors forced to import milk from Victoria to service the market milk and short shelf products.

5.4 Metropolitan Milk claims that it was against this background that the formation of all Pauls' suppliers into Premium was seen as desirable to promote the interests of these suppliers. Pauls' suppliers are at a distinct disadvantage to co-operative suppliers who have farmer directors looking after their interests. Metropolitan Milk sees Premium as a means to put these suppliers on a more equal footing.

5.5 Premium would be responsible for the supply, quality and cartage of milk for its members. Metropolitan Milk advises that the object of Premium is to endeavour to stabilise producer numbers and volume of milk produced in order to maintain viable cartage runs and rural communities dependent on their dairy farmers. Metropolitan Milk considers that this can be achieved by liasing with Pauls on supplying them with the volume of high quality milk they require 365 days per year, and on obtaining a milk premium for a guaranteed local supply of fresh quality milk as compared with Pauls sourcing milk from interstate.

5.6 Metropolitan Milk advises that milk prices are highly competitive. The Victorian price for milk, plus freight, sets a benchmark for prices in other States. Metropolitan Milk claims that the formation of Premium will not alter this.

5.7 Metropolitan Milk claims there should be cost savings in the rationalisation of cartage between the co-operatives supplying Pauls, and also in the administration work of Pauls in dealing with one entity rather than six individual ones.

5.8 There will also be public benefit in that milk distributed by Pauls to consumers will be a fresher product as milk will be accessed locally by Pauls on a daily basis.

Metropolitan Milk also claims that anything that can stabilise farmer numbers will be a benefit to the rural towns and communities where falling farmer numbers will have a detrimental effect on business and consequent unemployment.

5.9 The **Burnett Milk Producers' Co-operative association Limited** (Burnett) is one of the six co-operatives that currently supply milk to Pauls. Burnett supports the application for authorisation.

5.10 Burnett submits that in the recently deregulated dairy industry there is an urgent need for the coming together of co-ops to assist in the smooth transition from a regulated to a deregulated industry. The opportunity for Premium to collectively bargain with Pauls on behalf of its 580 producers instead of these producers individually negotiating has a very major public benefit for producers with a flow on benefit to the consuming public at large.

5.11 For example, Burnett claims that the establishment of a Milk Management Committee with equal representation by Pauls and Premium will be a major contributor in several key areas of negotiations. The operation of the Committee will facilitate the setting of policy for the group to ensure long term availability of milk to the public as a fresh product 365 days per year. Premium, through the Committee, will be able to negotiate a fair market price with Pauls who, while they will not be obligated to pay this price, will find this option far superior to negotiating with individual suppliers.

5.12 Burnett claims that the quality of milk, as is the case for all commodities required for human consumption, is of paramount importance to the public at large. The proposed Committee will be in a position to set these standards and then ensure that they are met.

5.13 Burnett advises that the group of suppliers who are represented by Premium are a widely scattered group that extends from Mackay in the north to the Queensland/NSW border and inland to the Darling Downs and Burnett. With such a wide spread of suppliers, cartage of the milk from the farm to the processing plant is of major consideration. Premium, through the Committee, will be able to influence the transport of this product in the most economical way.

5.14 Burnett claims that the proposal will not inhibit competition as their major competitor for market share in Queensland is the Dairy Farmers' Co-operative with over 900 producers.

5.15 Burnett claims that the proposal will be of immense public benefit to the dairy farmers represented as it will assist them in their long term viability. Without long term confidence in the industry the public could be severely disadvantaged by not having milk readily available on supermarket shelves for 365 days per year. In addition the maintenance of quality standards requires constant investment in expensive technology and without confidence in the future this investment will not continue.

5.16 **Pauls Limited** and **Port Curtis Dairy Limited** are supportive of the application.

5.17 In Queensland only Pauls and the Dairy Farmers Co-operative compete for the acquisition of milk directly from processors. The other major processor in Queensland is National Foods it currently obtains supply of milk from Pauls.

5.18 Pauls currently acquires milk from six supply co-operatives in Queensland. All Pauls' producers are paid on a two-price system for manufacturing and market milk, and are responsible for their own freight. Pauls has developed a Milk Payment and Quality Handbook (the Handbook) that sets out the prices paid for manufacturing and market milk purchased from all its suppliers for a particular period. The current market milk price paid by Pauls for fresh milk is 39 cents per litre. Prior to deregulation, the market milk price was set at approximately 58.9 cents per litre.

5.19 In determining the farm-gate prices, Pauls consults with representatives from the six co-operatives in relation to price structure and milk quality standards, but does not negotiate on these issues. There is no ability for the co-operatives to veto or negotiate on these prices.

5.20 Producers have the ability to transfer supply between processors if they are dissatisfied with the price they receive for their product. Pauls stressed the need to remain competitive with Dairy Farmers in order to secure its milk supplies. Over the last five/six years, a number of producers have transferred supply to Pauls from Dairy Farmers and vice versa. Currently Pauls pays its producers about 3 cents more per litre for market milk than the price Dairy Farmers pays its producer members.

5.21 Pauls claims that the Premium proposal may provide producers with a greater ability to influence milk pricing and quality decisions, compared with current arrangements. In addition, member producers under the Premium proposal would be in a stronger position than Dairy Farmers' members who can only influence decisions through the election of Board members.

5.22 Pauls would be concerned if the proposed conduct meant that the price set by the Milk Management Committee would cause Pauls to be uncompetitive. For this reason Pauls considers it may be necessary to include a process of independent arbitration in circumstances where negotiations break down or are at an impasse.

5.23 Pauls claims that the Premium proposal may provide producers with a higher level of certainty which, in turn, may provide them with the confidence to invest in new technology.

5.24 Pauls does not envisage substantial savings to it in dollar terms under the Premium proposal. There may be savings from only dealing with one organisation in negotiations rather than individual supply co-operatives.

5.25 Pauls submits that it is not economically viable for it to acquire milk from some interstate producers due to the high cost of transport and the logistics involved in transporting a perishable product. In particular, it is not viable for Pauls to source milk from Victorian producers. It costs approximately 12-15 cents per litre to transport unprocessed milk from Victoria, and approximately 15-18 cents per litre for the packaged product. As a general rule, Pauls would not be prepared to transport milk more than six hours by road. For example, this would take Pauls as far south as Coffs Harbour in northern New South Wales.

5.26 The **Queensland Dairy Authority** (the QDA) advised that as a result of deregulation and other legislative amendments its principal role is now food safety and quality assurance. The QDA submitted that since deregulation on 1 July 2000 it has been apparent that producers have very little countervailing power as evidenced by the significant decrease in market milk prices (from 58.9 c/l to approximately 43.0 c/l)[7]. The QDA submits that the recent announcement by the three major retailers of substantial decreases in the retail price of milk to consumers will witness further pressure on the returns to producers from market milk processors.

5.27 The QDA supports the application for authorisation as the public benefits arising from the removal of the pricing and supply legislation have been transmitted to consumers. The authorisation sought will provide Premium with the ability to negotiate pricing and composition standards for milk supply with Pauls Ltd.

5.28 The **NSW Dairy Farmers' Association Limited** supports the application by Premium. It strongly believes that farmers are disadvantaged under the operation of the Act. Farmers are ill-equipped to deal with and/or negotiate individually with large processor groups who, in turn, are under the influence of oligopoly supermarket chains.

5.29 The NSW Dairy Farmers' Association submits that the proposed arrangement cannot result in price agreements that are too far away from the market and therefore at best can only help avoid extremes and deliver some stability. Further, it believes that efficiencies are to be gained by both parties through the type of arrangement proposed as a result of the simpler management structure that will be offered between farmers and Premium.

5.30 The **Tasmanian Farmers & Graziers Association** claims farmers are particularly vulnerable at this stage in the evolution of the Australian dairy industry and are individually disadvantaged in negotiations. Collectively there is the real opportunity to negotiate a fair price and conditions to retain viability. There is public benefit from a healthy and viable dairy industry and the ability to collectively bargain is a major factor in this.

5.31 The **United Dairy Farmers of Victoria** (UDV) represents approximately 6,000 dairy farmers. The UDV submits that deregulation of the dairy industry was inevitable primarily due to commercial forces that were poised to tear down state market milk regulations and the national Domestic Market Support Scheme. The UDV recognised this and subsequently worked hard to gain national industry and government support for a transition package to ensure dairy farmers were able to manage deregulation.

5.32 The UDV advises that since deregulation came into effect on 1 July 2000 the market milk price has fallen below the price range predicted by industry pundits more quickly than expected. This has taken many in the industry by surprise and left many dairy farmers wondering what can be done to recover lost ground.

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[7] The Commission notes that these figures include a levy and is the maximum price payable for the highest level of fat and protein.

5.33 Victoria produced 6.9 billion litres of milk in 1999/2000. Of this, only 434 million litres were used for market milk and the balance was converted into manufactured product. Seventy-five per cent of Victoria's milk produced is exported as manufactured products.

5.34 Co-operatives feature predominantly in the development of the Victorian dairy industry. Currently there are four major dairy co-operatives in Victoria. The co-operatives handle over 95 per cent of the milk produced in Victoria – the two largest control 75 per cent.

5.35 The UDV believes Victorian dairy farmers will be less affected by the vagaries of the liquid milk market as a result of the strength and predominant position of Victorian dairy co-operatives. Dairy co-operatives give Victorian dairy farmers an alternative to market milk for their milk. For example, if milk processors in Victoria are not prepared to pay a reasonable price for fresh milk then the UDV would expect co-operatives to put it through their own plant to produce manufactured product. Dairy co-operatives in Victoria give dairy farmers in that state some countervailing power to the dominant position of processors and supermarkets for negotiating prices for fresh milk.

5.36 Most Victorian dairy farmers also have a choice of the company they supply. However, the UDV submits that many dairy farmers in other states have no choice of company they supply. In most dairy regions there will only be one dairy company to whom a farmer can supply. This places the bargaining power squarely in the hands of the company. Dairy farmers either sign the contract supplied by the company or they exit dairy farming.

5.37 The UDV believes that dairy farmers – due to the highly perishable nature of their product, the relatively small size of individual dairy farms and the absence of choice of company they supply – should be allowed to collectively bargain for prices and standards through a representative body such as Premium.

5.38 **Coles Myer Ltd** notes that under the proposal Queensland would be divided into four geographical zones having regard to different processing and consequent transport facilities allowing for prices to vary between these zones. Coles Myer also notes that there is a very high volume of manufacturing milk available on the Australian Eastern Seaboard and the recent start up of National Foods as a viable alternative purchaser of Queensland milk. Coles Myer states that whilst Victorian production may account for 64 per cent of Australia's total milk production, Coles supermarkets presently have supplier agreements for housebrand milk requiring it to be sourced using processors along pre-deregulation intrastate supply lines.

5.39 Coles Myer submits that its supermarkets and their customers depend on the competitive benefits from deregulation flowing through state to state. Coles supermarkets would be concerned if the competitive conditions over the four geographical zones altered. For example, if National Foods did not become an alternative viable buyer of Queensland milk or the Victorian prices (including freight) are not a factor in the price review mechanisms.

5.40 Subject to these countervailing forces on the production and processing side continuing Coles Myer advises it would have no objection to the application.

5.41 The **Minister for Primary Industries and Rural Communities, Queensland Government** considers the proposal to be a commendable initiative. The Minister submits there is a serious imbalance of market power in the dairy industry. This is evidenced by the fact that 1500 dairy farmers in Queensland supply only three fresh milk processors, who in turn make the bulk of their milk sales to the retail trade which is increasingly dominated by the three supermarket chains, namely Woolworths, Coles and Franklins. The collective negotiating arrangement embodied in the Premium proposal will go some way to addressing this imbalance of market power.

5.42 In addition, the Minister suggests the proposal provides a 'levelling of the playing field' for the 580 suppliers to Pauls in comparison with approximately 900 producers who supply to the Dairy Farmers' Co-operative Limited and who have a collective negotiating power exercisable through its Board of Directors.

5.43 The Minister also considers that it is important that the dairy industry be allowed both the time and means to make an orderly transition to a deregulated market place, and is of the view that the application for authorisation is in the interests of the Queensland dairy industry and dairy communities throughout South and Central Queensland.

5.44 The **Department of Agriculture, Fisheries and Forestry – Australia** (AFFA) had no objection to the proposed arrangements. AFFA submits that following the removal of state regulations governing farm-gate market milk pricing, the dairy industry has seen significant falls in prices paid for milk destined for the fresh milk market. The price fall appears to have been particularly acute in the previous quota states where the regulated prices tended to be higher and there is less opportunity in the short term to penetrate other non-fresh milk markets.

5.45 AFFA advises that industry concerns in making a case for a Commonwealth restructuring assistance package stemmed from the fact that farm incomes would be affected by the expected price effects of deregulation and would impinge on the ability of farmers to service new or existing loans. Furthermore, dairy farmers leaving the industry would cause asset values (cows and land) to fall thereby lowering the equity levels for those remaining in the industry. Lower equity levels would affect dairy farmers' capacity to restructure through herd/land expansions. The viability of new infrastructure investments would be affected with flow on effects into the regional economy. An over-reaction to the changes in market returns could jeopardise the gains made by the industry in developing a competitive export industry.

5.46 AFFA advises that the impact of dairy industry deregulation was a primary motivating factor for the Federal Government's decision to make available an industry adjustment package. While the assistance provided by the Federal Government is substantial (the package is valued at $1.78 billion), the magnitude of the falls in prices of milk sold into fresh milk markets indicates that further measures are desirable to assist farmers and surrounding communities work through the short term economic shock. AFFA advises that the number of dairy farmers planning to exit the industry is not yet known but it is clear that the impacts of deregulation have sharply affected many farmers particularly in the quota states of NSW, Queensland and Western Australia. In this context, the application for authorisation by Premium would appear reasonable given the novel circumstances confronting dairy farmers and dairy communities, particularly those in the former quota states such as Queensland.

5.47 Notwithstanding the positive impact of the Commonwealth package, support for the application can be justified on the basis that a greater number of dairy farmers will be forced to leave the industry than would have occurred had the changes taken place over a longer period of time. With little time to prepare financially, there is a risk that the convergence of reduced farm incomes and increased exit numbers may lead to economic impacts that cannot be easily absorbed by farmers remaining in the industry or by regional communities dependent on the industry. AFFA submits that authorisation for collective bargaining may provide farmers with some capacity to mitigate the magnitude and abruptness of the falls in farm returns and farm values thus easing the transition to a deregulated market and providing wider public benefits to regional communities.

5.48 **ABARE** submits that in a deregulated market, the differentials in the farm-gate prices for market and manufacturing milk are likely to eventually disappear, with prices varying for quality or timing rather than end use. The adjustment pressures will likely be greatest for farms whose average milk price falls the most, for example farmers who previously produced relatively large shares of market milk (the prices for which were fixed at an administratively determined level that was higher than the price for manufacturing milk). ABARE claims this is likely to be the situation for producers in NSW, Queensland and Western Australia, where a higher proportion of milk sales were to market milk compared to producers in other states.

5.49 ABARE considers the level of competition between producers in different states is likely to increase since processors are no longer bound to source market milk supplies from quota holders. Furthermore, processors will also be able to sell fresh milk into interstate markets that should also enhance competition at the retail level.

5.50 ABARE notes that the aim of the Premium proposal is for a group of producers to collectively negotiate a higher price for their milk in return for security of supply for the processor. ABARE considers that the proposal is unlikely to have an undue influence on the market because:

- Any higher prices negotiated by the producers are unlikely to be significant, particularly over the longer term, due to competition between suppliers of fresh milk.
  - The milk produced by producers comprising the Premium Milk Supply Group will form a small proportion of total milk supplies in Queensland.
  - Queensland produces only 8 per cent of total Australian milk production.
- Competition between processors, potentially including suppliers from interstate, is expected to limit any effect of negotiated supply contracts on consumers. ABARE is of the view that it would be reasonable to expect supermarkets in Queensland and

other states to continue to source their supplies from processors offering the most competitive prices.

- Members of the group are free to negotiate privately with Pauls or other processors after giving 6 months notice.

5.51 Overall, ABARE is of the view that there do not appear to be any significant public benefits or costs associated with the proposal and it would be unlikely to have a significant effect on competition.

6. Statutory test

6.1 Application A90745 was made under section 88(1) of the Act to make and give effect to a contract, arrangement or understanding containing a provision which may have the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.

6.2 The Act provides that the Commission shall only grant authorisation if the applicant satisfies the relevant test in section 90(6) of the Act. Section 90(6) provides that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:

- the provision of 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.

6.3 In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements, the public benefits arising from the arrangements, and then weigh the two to determine which is the greater. Should the public benefits or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation or grant authorisation subject to conditions.

7. Commission consideration

7.1 The Commission's consideration of the application for authorisation is in accordance with the statutory test set out in section 6 of this determination. As required by the test, the Commission cannot grant authorisation unless it is satisfied that the conduct or arrangement for which authorisation is sought is likely to result in a benefit to the public, and that benefit is sufficient to outweigh any detriment to the public constituted by any lessening of competition that is likely to result from the conduct or arrangement.

7.2 The conduct for which authorisation has been sought relates to the collective bargaining by dairy producers of farm-gate milk prices and standards through a representative body — Premium — in direct negotiations with Pauls Limited. Collective negotiations of the producers will be facilitated through a Milk Management Committee.

7.3 In the draft determination issued on 14 February 2001 the Commission proposed as conditions of authorisation that:

- only the rules relating to the formation and operation of the Milk Management Committee are to be authorised;

- the rules relating to the formation and operation of the Milk Management Committee reflect the features as advised by Premium; and

- the rules relating to the formation and operation of the Milk Management Committee be reduced to writing and a copy provided to the Commission within three months of the date of the final determination.

7.4 Premium advised that it wished to provide the rules relating to the formation and operation of the Milk Management Committee to the Commission prior to the issuing of the final determination.

7.5 On 3 September 2001 Premium provided the Commission with a copy of the Milk Supply Agreement that was negotiated by Premium and Pauls. An outline of the Milk Supply Agreement, that provides for the establishment and operation of the Milk Management Committee is contained in section 3 of this determination.

7.6 The Commission did not receive any further submissions from Premium or interested parties following the release of the Commission's draft determination. The submission received from Premium and interested parties prior to the release of the draft determination are outlined in sections 4 and 5 of this determination. The Commission did not receive any submissions opposing the application for authorisation.

Effect on competition

7.7 Arrangements that provide for agreements in respect of price, are deemed by the Act to substantially lessen competition. By its very nature, a collective bargaining arrangement, such as the one proposed by Premium — which sets uniform rates of payment to independent producers participating in the proposed arrangement — is likely to lessen competition relative to a situation where each of the producers individually negotiates their own rates of payment.

7.8 While collective arrangements might be regarded as *a priori* causing a reduction in competition in the relevant market, any anti-competitive detriment, particularly in the form of higher retail prices for consumers, will partly depend on the terms and conditions of the arrangement. For instance, if price is to be collectively negotiated, the associated anti-competitive detriment may be reduced if there is, for example, provision for individuals to opt out and negotiate outside the collective arrangements. In addition, while competition between members of a collective group will be lessened the extent to which competition between other suppliers is maintained or enhanced is also a relevant consideration for the Commission.

7.9 In order to assess the competitive impact of the proposed arrangements it is necessary to identify the relevant market features. In the draft determination in relation to this application the Commission noted that the main features are:

- There are currently approximately 1500 milk producers in Queensland, the majority of which are family owned and operated farms.

- Dairy farmers have significant amounts of capital tied up in land, livestock and equipment.

- There are currently three major processors operating in Queensland. Pauls and Dairy Farmers' Co-operative are the major processors. National Foods Limited acquires milk for processing from Pauls rather than directly from producers. There are a number of small microprocessors also supplying milk locally under private labels.

- The three major processors in Queensland are national processors and have access to milk from other milk producing states in Australia (at least in the medium to long term, although transport costs may limit this). However, transport costs and the fact that milk is a perishable product, to some extent, provide a natural barrier to milk being sourced from interstate.

- Pauls has processing plants in Central and South East Queensland (see paragraph 1.12 for locations). Pauls currently acquires milk from six co-operatives that together represent approximately 580 dairy farmers in Queensland.

- National Foods has a plant located at Crestmead in Brisbane (encompassing the South East Queensland Region). Pauls currently supplies National Foods with raw milk for processing.

- The Dairy Farmers Co-operative has plants located at Booval and Malanda in the South East Queensland Region and the North Queensland Region respectively. Dairy Farmers' Co-operative currently represents approximately 900 dairy farmers in Queensland.

- Producers are generally located in close proximity to the plant they supply. The processing and farm sectors generally developed concurrently in regions that had a competitive advantage in dairying. Improvements in transport, storage and distribution now allow dairy processors to have wider coverage of supply. However, as cartage is a considerable component of the cost of producing milk, and the fact that raw milk requires processing within two days, there is still a reasonably close geographical nexus between processors and producers although packaged milk is now transported greater distances.

- Milk produced in Queensland represents approximately 8 per cent of total Australian milk production.

7.10 The existence of co-operative supply arrangements in the dairy industry may suggest that competition between individual processors is limited. Some competition may occur between co-operatives. For example, there are six co-operatives that compete with each other to supply unprocessed milk to Pauls, namely:

- Metropolitan Milk Producers Co-op Association Limited;
- Suncoast Milk Producers Co-operative Association;
- The Burnett Milk Producers Co-operative Association Limited;
- The Maryborough Co-operative Dairy Association Limited;
- Dairyfields Milk Suppliers Co-operative Limited; and
- Port Curtis Milk Suppliers Co-operative Association Limited.

7.11 The applicant advises that none of the above co-operatives have their own processing plants and do not carry on any processing activities. The milk is collected directly from farmers and delivered to the nearest processing plant.

7.12 Under the proposed arrangements, instead of the six co-operatives negotiating supply terms and conditions on an individual basis with Pauls, Premium will negotiate a single agreement that will apply to each participating co-operative (the Commission understands that currently five of the co-operatives have formally agreed to participate although media reports indicate that Port Curtis is currently considering joining the group). As a consequence, the scope for competition between the co-operatives for supply to Pauls is potentially reduced. This may have the effect of increasing the prices producers can obtain, compared to the situation where prices are negotiated by individual co-operatives.

7.13 Clause 5.6.1 of the Agreement provides a list of information the Milk Management Committee will take into account in negotiating milk prices, including quality standards and milk composition. The applicant submits that in setting these standards, efficiency factors will be taken into account. Efficient producers will have the necessary quality procedures in place and investment in equipment to ensure that the milk they produce meets the highest standards to achieve higher prices. Bonuses will be payable in relation to the quality and composition of the milk.

7.14 The Commission would be concerned if the prices set by the Milk Management Committee were set at such a level that Pauls' ability to compete with other processors was impeded. However, the Commission notes that Clause 5.1.4 expressly provides that the Milk Management Committee, and dispute resolution expert, shall ensure that prices payable by Pauls shall not cause it to be uncompetitive or disadvantaged in the cost of raw milk. Further, the Commission considers that if prices are too far above the market, Pauls may source milk from elsewhere. Under the arrangements for which authorisation is sought, Pauls will not be bound by any exclusivity agreement with Premium and is able to purchase milk from any member of Premium, or any other producer, at the same or different price than that negotiated under the collective arrangements. In particular, producer members of Premium are able to opt out of the collective arrangements and negotiate their own supply arrangements with Pauls (or another processor).

7.15 On the producer side, a member who wishes to opt out of the collective process must first give Premium six-months notice, the Commission understands that this period is designed to ensure continuity of supply to Pauls. To the extent that some producers choose to negotiate individually, this will increase the scope for competition over rates of payment and other contract terms.

7.16 The Commission considers there are also a number of structural features in the market that are likely to limit the anti-competitive detriment resulting from the proposed arrangements.

7.20 Currently there are approximately 1500 dairy producers in Queensland, generally located in the Atherton Tableland in the north; the Central Queensland areas around Mackay, Rockhampton, Gladstone, Biggenden and Monto; and South east Queensland areas centred around Gympie/Maryborough, Caboolture and Toowoomba/Warwick on the Darling Downs. At the time the application was lodged Premium estimated 438 producers (out of the 580 that supplied Pauls) were likely to participate in the proposal. Premium estimated that this figure will fall to approximately 358 throughout 2001. The Commission understands that the Port Curtis Milk Suppliers Co-operative is currently assessing whether to formally participate in the Premium proposal or whether to continue to operate under the existing long term contract it has in place with Pauls.

7.21 Premium producers face potentially strong competition from other producers for supply to Pauls both within Queensland and nationally. In particular, approximately 900 dairy farmers in Queensland are members of the Dairy Farmers' Co-operative. It may be possible for individual producers to negotiate supply arrangements with Pauls (although they may have to leave the Dairy Farmers' Co-operative depending on the rules of the Co-operative). Pauls advises that producers can, and do, transfer between supplying Pauls and the Dairy Farmers Co-operative.

7.22 In addition, the Dairy Farmers' Co-operative (and other companies) may supply any surplus milk to Pauls. The Commission understands that the co-operative structure of many dairy companies means that they are required to take supply of all milk produced by their members even where it is surplus to processing and manufacturing requirements. In this situation, surplus milk could be supplied to Pauls for example, rather than allowing the milk to spoil or be channelled into inefficient production lines.

7.23 Another feature of the market that is likely to limit any higher prices negotiated by Premium, particularly over the longer term, is the ability for Pauls to source milk from interstate (although this is subject to transport costs and availability of sufficient low cost producers to meet local needs). The Commission notes the comments by ABARE that, in a deregulated market, competition between producers in different states is likely to increase since processors are no longer bound to source market milk supplies from quota holders. Queensland produces only 8 per cent of total Australian milk production and the availability of interstate milk (at least in the medium to long term) is likely to impact on the farm-gate prices of Queensland producers, especially those in South East Queensland, including Premium. It is relevant to note, however, that dairy farmers in northern NSW and Queensland may be afforded a significant degree of natural market protection for drinking milk based on the cost of freighting milk from Victoria and any year-round supply premium. For example, Pauls advises that the cost of transporting raw milk from Victoria to Queensland is approximately 12-15 cents per litre. As a general rule, it is not efficient to transport raw milk further than a six hour radius, by road, to a processing plant. In addition, milk is fresher if it is locally sourced as freighting milk over long distances reduces storage life and lowers milk quality.

7.24 Deregulation is also likely to result in the phasing out of the differentials in the farm-gate prices for market and manufacturing milk. Currently the price for manufacturing milk in Australia is greatly influenced by the Victorian market, which is influenced by import parity with New Zealand prices, which in turn reflects world prices and exchange rates. The price of all Australian milk is expected to eventually move towards the import parity price of New Zealand manufacturing milk with a small premium for any drinking milk produced out of season when cows are normally not producing large quantities. Although, as already noted, there is a degree of natural market protection due to the costs of transporting milk over long distances and the subsequent reduction in quality that will occur.

7.25 In addition, the Commission considers that Pauls faces strong competition from other large processors both in Queensland and nationally. For example, in Queensland Pauls competes with the Dairy Farmers Co-operative, both in terms of securing supply from producers, and selling processed milk and manufactured products at the retail level. The need to remain competitive with the Dairy Farmers Co-operative should limit Pauls' ability to pay prices that are too far above competitive levels. Deregulation has enabled processors to sell fresh milk into interstate markets which has resulted in enhanced competition at the retail level.

7.26 While retail milk prices have recently increased[8], competitive tendering for house brand contracts amongst processors in August of last year placed downward pressure on the retail prices of the branded milk products controlled by milk processors. In the draft determination in relation to Premium's application for authorisation the Commission noted that the entry of discount supermarkets to the Australian supermarket industry was also likely to continue the downward pressure on retail milk prices as commodities such as milk are often discounted to drive store traffic.

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[8] See for example, The Herald Sun 16 August, *Milk Prices to Rise* and the Sunday Mail 27 August 2001, *Milk Price to Jump 20C a Litre.*

7.27 The Commission considers that processors face competitive influences from the supermarket chains that are likely to impose further limits on their capacity to pay high prices for raw milk.

Summary of anti-competitive effects

7.28 The Commission considers that there are a number of features both within the proposed arrangements and in the market that will limit the anti-competitive effects that may result and that will prevent any higher prices negotiated by Premium from being passed on to consumers.

Public benefits

7.29 As outlined in section 4, Premium claims that a number of public benefits will result from the proposal. In particular:

- the creation of countervailing bargaining power in favour of member producers;
- the creation of certainty for member producers allowing for investment in new technology, plant and equipment that will ensure that quality standards are achieved and improvements are made;
- other efficiency improvements; and
- a significant increase in the prospects of a smooth transition from a regulated to a deregulated farm-gate price environment.

Easing the transition to a deregulated market

7.30 The Commission has authorised various schemes in rural industries following deregulation. In assessing such schemes, the Commission has accepted that there could be a public benefit in mechanisms that facilitate the transition from a regulated to a more competitive environment. The mechanisms may help to avoid a dislocation in the functioning in a market that would be caused by too sudden a movement in such transition. The Commission nevertheless requires that industries demonstrate a clear commitment and movement towards operating in a more competitive market.

7.31 As discussed in section 2, the Australian dairy industry is currently in the process of adjusting to major changes to its regulatory environment. The Australian dairy industry has traditionally been highly regulated and many producers have limited experience in commercial contract negotiation.

7.32 Previously, regulation artificially set the farm-gate price for drinking milk (typically well above the average price paid for the non-regulated manufacturing milk). The Commission recognises that dairy farmers, particularly in states such as Queensland that produce large quantities of market milk – where the price was previously administratively fixed – may experience particular difficulty in adjusting to the new environment where prices are no longer regulated. In a more competitive environment, producers must take more account of market information including supply and demand requirements and national and international movements in price.

Many producers, including co-operatives, may not have the requisite experience to engage in effective negotiation.

7.33 The Commission notes that the introduction of the structural adjustment package by the Commonwealth Government was in recognition of the potential impact of deregulation on producers, dairy communities and the industry as a whole. AFFA submits that the assistance provided by the Federal Government is substantial (valued at $1.78 billion). However, AFFA notes that the magnitude of the falls in prices of milk sold into fresh milk markets indicates that further measures are desirable to assist farmers and surrounding communities work through the short term economic shock.

7.34 In its report, ABARE forecast large decreases in the average farm-gate price of milk for Queensland farmers in 2000-01. ABARE considered that assistance to dairy farmers by the Commonwealth Government will only partly offset the impact of lower farm gate prices, particularly in states such as Queensland where market milk forms a high component of producer income.

7.35 The Commission notes the comments by AFFA that a sharp decrease in prices paid to farmers following deregulation would impinge on the ability of farmers to service new or existing loans. Furthermore, dairy farmers leaving the industry would cause asset values (cows and land) to fall, thereby lowering the equity levels for those remaining in the industry. Lower equity levels would affect dairy farmers' capacity to restructure through herd/land expansions. The viability of new infrastructure investments would be affected with flow on effects into the regional economy. On an Australia-wide basis an over-reaction to the changes in market returns could jeopardise the gains made by the industry in developing a competitive export industry.

7.36 The Commission notes that around 110 Queensland dairy farmers have already left the market since farm-gate price deregulation and ABARE anticipates further reductions. It is important that efficient producers are able to remain in the industry during the transition period to prevent a major dislocation of the market with a consequent impact on price and supply. The Commission accepts that producers on an aggregate basis, as proposed, will be in a better position to match supply and demand considerations in order to reach the longer-term equilibrium farm-gate price for milk. The discovery of the long term farm-gate price for milk will also enable producers to be in a more informed position about whether to exit the industry or whether to remain and even expand and consolidate.

7.37 The Commission considers that there is detriment to the operation of the industry if efficient producers have difficulty in assessing long term viability because they do not have access to market information or lack the requisite experience to engage in effective negotiation. The Commission is of the view that there is public benefit resulting from collective bargaining under the Agreement particularly as it will facilitate the adjustment by diary farmers to deregulation and provide them with the opportunity to gain experience and access to information to assist them in conducting efficient and effective negotiations so that they can successfully operate in a deregulated environment. This will help minimise the adjustment costs that could result from too precipitous change from regulation.

Increased countervailing/bargaining power

7.38 Premium submits that without the proposed conduct, producers in the deregulated market have very little bargaining power. Furthermore, since deregulation of the farm-gate milk price, processors have set the price and producers have been price takers. Premium claims that the six co-operatives that supply Pauls are not currently able to significantly influence the price of milk paid to producers. Premium submits that by aggregating a greater number of producers under the one corporate structure, and by putting in place the Milk Management Committee as a cornerstone of the current proposal a much more effective voice for producers will be created.

7.39 The Commission has considered a number of previous applications which involve primary producers collectively negotiating terms and conditions of supply with their processor where an increase in countervailing power is claimed as a public benefit.

7.40 Arguments based on increasing countervailing power essentially relate to a change in the power relativities of the parties to a proposed agreement. An increase in countervailing power, raised in the authorisation context, typically involves one party attempting to improve its bargaining position relative to another, for example through a collective arrangement. The Commission does not accept that a mere change in the amount of countervailing power is necessarily, in itself, a public benefit. Rather, the Commission will focus on the likely outcomes resulting from the change in bargaining position flowing from the proposed arrangement for which authorisation is sought. It is these likely outcomes which are essential to the net public benefit test. Generally, the Commission would accept an argument about increasing countervailing power as a public benefit where it is satisfied that enhancing the bargaining power of the applicant would benefit the broader community, for example, if a likely result of increasing a particular party's bargaining power was the lowering of prices for consumers.

7.41 The Commission has previously stated that the balance of negotiating power – and possible public benefits from addressing any imbalance – will depend on the circumstances involved. The Commission is of the view that generally individual dairy farmers are in a weak bargaining position vis-à-vis processors. This imbalance is exacerbated by the fact that:

- milk is a perishable product that reduces the producer's ability to negotiate in relation to the disposal of their product;
- fresh milk must comply with rigid public health standards making it difficult for dairy farmers to sell their product directly to consumers;
- the costs of transporting milk to processors may limit supply alternatives for producers;
- many processors are large corporate entities with significant financial capacity and the ability to source product from various producers; and
- prior to deregulation the price paid to producers was regulated and as such many dairy farmers may not have the necessary negotiating skills and experience.

7.42 The Commission notes that an aim of the proposed arrangements may be to increase prices to producers above those that would otherwise apply. The Commission would be concerned if this outcome was to the detriment of consumers or competition in linked markets. The Commission considers that the proposed arrangements may provide producers with a stronger bargaining position relative to a situation where they deal individually with Pauls or even where they continue the current co-operative arrangements. However, in this instance, as previously discussed, the Commission does not consider that the proposed arrangements will enable Premium to negotiate significantly higher prices with Pauls over the long term that would be likely to have a detrimental impact on competition or end consumers. It is relevant to note that Pauls is not bound to purchase milk at the price determined by the Milk Management Committee. Pauls will continue to be able to source milk from other producers in Queensland or interstate. In addition, the conduct for which authorisation is sought does not provide for any collective action by way of a group boycott.

7.43 There may be an argument that if an upstream buyer of a product (that is, a processor and/or retailer) has substantial market power, they could use that power to set producer prices below the competitive market level. In the short term, where producers have significant sunk costs, it is possible that prices could be driven below efficient average cost levels. While the Commission accepts the prices paid to dairy farmers for raw milk have fallen significantly since deregulation (see tables 2.2 – 2.4), the Commission has not received evidence to support such an argument in this case. No conclusion is therefore reached as to the market power of processors or retailers in the industry, or the relation between current price levels and efficient supply costs.

7.44 The Commission is not satisfied that, in these circumstances, the proposed conduct will provide countervailing power to the producers that will result in a net public benefit in itself. However as already noted, the Commission considers that providing farmers with greater time and opportunity to gain the experience and knowledge to negotiate supply contracts will enhance their ability to negotiate with processors efficiently and effectively. This is likely to increase the confidence of individual dairy farmers in their commercial dealings and enhance the individual bargaining power of farmers relative to processors. However, other public benefits are likely to result from the proposed collective arrangements, particularly associated with easing the transition from a regulated to a deregulated market, as discussed, and efficiency gains from transaction cost savings.

Transaction cost savings

7.45 Premium claims there are administrative as well as tangible benefits from negotiating through a single body. Savings on transaction costs are an outcome generally associated with collective negotiations. Collective arrangements may reduce the number and cost of agreements that need to be negotiated. However, as the current application relates to a collective selling arrangement, it is possible that the main beneficiary will be Pauls. Pauls advises that there may be a small level of savings resulting from the need to conduct one negotiation/consultation process with Premium, replacing the need for Pauls to consult with the individual co-operatives. This may result in cost savings in terms of time and labour. There may be similar cost savings for the participating co-operatives who can centralise contract negotiations through Premium and the Milk Management Committee.

7.46 The Commission is of the view that if savings are aggregated in competitive markets, these savings are likely to be passed on to the final consumers. The Commission accepts that a small public benefit is likely to arise from transaction cost savings in this instance.

Investment in new technology

7.47 Premium claims that in order for dairy farmers to make the necessary investment in capital they need security of return in the short to medium term. Premium claims that the proposal, whilst not guaranteeing any sales of milk to Pauls, gives producers sufficient certainty in the form of longer term supply arrangements which creates an incentive for producers to make the necessary investment in technology. Similarly, the Commission notes producer certainty may be created under the proposal as standards of milk will be determined in advance and publicised to all members of Premium.

7.48 The Commission notes the claims by Premium that the dairy industry has become increasingly capital intensive, and that there is a correlation between the quality of milk produced and the capital invested in technology. The Commission notes that investment decisions of producers are influenced by the perceived security of supply with processors. The Commission considers that parties acting collectively may give producers the incentive and security such that they are encouraged to invest more in infrastructure to remain in the industry.

7.49 However, the Commission has not been provided with sufficient information to demonstrate how the collective negotiations will create more certainty for member producers – such that they will continue to invest in technology – than is the case through the existing co-operative supply arrangements. The Commission notes that there is no obligation on Pauls to accept the milk produced by Premium's members at the price determined by the Milk Management Committee.

Other efficiency improvements

7.50 Premium claims that efficiency improvements will result from the pricing methodology taken into account by the Milk Management Committee. In particular, the efficiency of the producer – as determined by the quality of their procedures and the capital they have invested in state-of-the-art equipment, together with the quality of their herd – will directly and materially influence such matters as butterfat and protein percentage and cell counts.

7.51 In addition, Premium claims that the proposal will offer a more consistent approach across Queensland to quality standards and procedures. This should result in an overall improvement in efficiency for that part of the Queensland industry participating in the Premium arrangements, particularly as it will directly take account of Pauls' requirements through the Milk Management Committee. The Commission notes that Pauls currently consults with each of its supply co-operatives in setting milk quality standards. Current policy at Pauls includes quality bonuses paid to producers for milk supplied within established standards, and producer penalties for supplying milk below established standards. The Commission also notes that the QDA also has a role in the regulation of food safety and quality assurance.

7.52 The Commission is not satisfied that Premium has sufficiently demonstrated how the proposed arrangements will result in other efficiency improvements than those already discussed.

Summary of public benefits

7.53 In summary, the Commission considers there is likely to be some benefit to the public as a result of the efficiency gains from transaction cost savings and smoothing the transition from a regulated to a deregulated market.

Conclusion on anti-competitive effects and public benefits

7.54 The Commission considers that the collective negotiation of milk prices and quality standards – as provided by the arrangements for which authorisation is sought – involves a lessening of competition relative to a situation where the independent co-operatives negotiate individually with Pauls or where producers negotiate on an individual basis. However, the Commission considers that the nature of the proposed arrangements as well as a number of structural features in the market are likely to limit the anti-competitive effects, and that the resulting anti-competitive detriment is likely to be minimal.

7.55 In particular, Pauls is not bound by any exclusivity agreement with Premium and may purchase milk outside the collective arrangements. Similarly, producer members of Premium are able to opt out of the collective arrangements and negotiate their own supply arrangements with Pauls or another processor. To the extent that some producers have the option to choose to negotiate individually, the scope for potential competition over rates of payment and other contract terms is increased.

7.56 The Commission considers there is public benefit as a result of efficiency gains from, particularly, smoothing the transition from a regulated to a deregulated market and transaction cost savings. However, the Commission has concluded that the public benefits as demonstrated by the applicants are not likely to be substantial. Nonetheless, the Commission is satisfied that there is sufficient public benefit to outweigh the minimal detriment to competition resulting from the proposed arrangements.

7.57 The Commission considers that an aim of the proposed arrangements may be to increase prices paid to producers by giving them countervailing power in negotiations with Pauls. The Commission does not consider that an increase in the price of milk to consumers above the competitive level would constitute a public benefit. However, the Commission considers that competitive pressures at both the processing and retail sectors will limit the likelihood that any higher prices negotiated by Premium will be passed on to consumers.

7.58 The Commission therefore grants authorisation to the arrangements the subject of application A90745 until 1 July 2005. The Commission considers that the dairy industry has undergone significant regulatory reform and is currently in the process of adapting to these changes. This represents a period of five years from the date of industry deregulation on 1 July 2000 and means that the arrangements the subject of this application will have had the benefit of authorisation immunity for over four years (interim authorisation was granted on 14 February 2001). If at the end of this time period, the applicants wish to retain the benefits of authorisation (ie immunity from prosecution under the Act) in respect of the collective negotiations they would need to lodge a fresh application for authorisation to be considered by the Commission.

7.59 As outlined in paragraph 7.3, in its draft determination the Commission proposed as conditions of authorisation a number of conditions. As Premium provided the Commission with a written copy of the rules of the Milk Management Committee following the draft determination the Commission is of the view that the conditions have already been met and there is no need to maintain the conditions in the final determination.

7.60 At the time the Commission issued its draft determination proposing to grant authorisation, the Commission also decided to grant interim authorisation in respect of the proposed arrangements until the Commission's final determination in this matter takes effect, or until the Commission decides to revoke interim authorisation. Under the Act, the Commission is able to grant interim authorisation that enables the parties to engage in the proposed conduct prior to the Commission issuing its final determination. The Commission confirms its decision that interim authorisation will remain in place until the final determination takes effect.

8 Determination

8.1 For the reasons set out in Section 7 of this decision, the Commission is satisfied that the proposed arrangements for which authorisation is sought:

- are likely to result in a benefit to the public, and
- that benefit is sufficient to outweigh the detriment to the public constituted by any lessening of competition resulting from the proposed arrangements.

8.2 The Commission therefore grants authorisation to Premium in respect of the proposed arrangements the subject of application A90745.

8.3 The authorisation also applies to, or in relation to, producers who become parties to the proposed arrangements at a time after authorisation is granted.

8.4 This determination is made on 12 December 2001. If no application for review of the determination is made to the Australian Competition Tribunal, it will come into force on 3 January 2002. If an application is made to the Tribunal, the determination will come into force:

- where the application is not withdrawn – on the day on which the Tribunal makes a determination on the review; or
- where the application is withdrawn – on the day on which the application for review is withdrawn.

8.5 The authorisation the Commission grants is in respect of application A90745 will remain in force until 1 July 2005.