



**Australian
Competition &
Consumer
Commission**

Determination

Application for Authorisation

lodged by

Premium Milk Ltd

in respect of the

**collective negotiation of farm-gate milk prices and
milk quality standards with Pauls Limited**

Date: 12 December 2001

**Application: A90745
File: C2000/1335**

Commissioners:

**Cousins
Martin
Bhojani
Jones**

Summary

On 25 August 2000, Premium Milk Supply Pty Ltd (Premium) lodged an application for authorisation (A90745) with the Australian Competition and Consumer Commission (the Commission). The application was made under subsection 88(1) of the *Trade Practices Act 1974* (the Act) for authorisation to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.

The application relates to a proposal by Premium to collectively bargain farm-gate prices and milk standards in negotiations with Pauls Limited. Specifically, Premium proposes to negotiate supply volumes, delivery requirements, quality standards and prices that will apply for six monthly periods (or such longer periods as may be agreed).

The 580 Queensland producers currently selling milk to Pauls Limited through six co-operatives will be offered membership of Premium. These co-operatives are 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.

Under the proposal, a Milk Management Committee, consisting of three Premium representatives and three representatives from Pauls will facilitate collective negotiations. Neither Pauls nor member producers are bound to buy or sell at any particular price established by the Milk Management Committee. Member producers may enter into individual supply arrangements with Pauls, or any other processor, by first giving Premium six months notice.

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.

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.

In addition, competitive pressures at both the processing and retail sectors are likely to limit the likelihood that any higher prices negotiated by Premium will be passed on to consumers.

The Commission considers that there is a benefit to the public flowing from the proposed arrangements. In particular, the Commission considers there is public benefit as a result of the efficiency gains from transaction costs savings, and smoothing the transition from a regulated to a deregulated market.

On balance, the Commission is satisfied that the proposed arrangements the subject of the application are likely to result in a benefit to the public, which is sufficient to outweigh any likely anti-competitive detriment.

Accordingly the Commission grants authorisation to the arrangements in respect of application for authorisation A90745 until 1 July 2005.

The authorisation granted by the Commission applies to, or in relation to, current producers and those who become parties to the proposed arrangements at a time after the authorisation is granted.

At the time the Commission issued its draft determination in relation to this application the Commission granted interim authorisation in respect of the proposed arrangements, effective until the date of the Commission's final determination, or until the Commission decides to revoke interim authorisation. The Commission confirms that interim authorisation will remain in place until this final determination comes into effect.

The Commission delayed its consideration of the final determination to allow Premium to provide it with the rules agreed between Premium and Pauls under which collective bargaining will occur. As a result the Commission considers that the conditions proposed in the draft determination have already been met and there is no need to maintain the conditions in the final determination.

Contents

Summary.....	ii
Contents.....	iv
1. Introduction	1
Premium Milk Ltd (Premium).....	1
Pauls Limited (Pauls)	2
2. Background	4
The Australian Dairy Industry.....	4
Farm sector	4
Manufacturing/processing sector.....	6
Dairy in Queensland.....	7
Industry regulation.....	8
The Dairy Industry Adjustment Package	9
2001 report by ABARE ‘The Australian dairy industry - impact of an open market in fluid milk supply’	10
Commission’s milk monitoring role.....	11
3. The application	15
Milk Supply Agreement	15
Milk Management Committee – establishment and purpose	15
Supply of milk	16
Milk prices.....	16
Pricing information.....	18
Milk collection and payment.....	18
Field advisory services	19
Dispute resolution.....	19
ACCC authorisation	20

Constitution	20
4. Submission by the applicant.....	23
Countervailing power	24
Investment in new technology.....	25
Efficiency improvements.....	25
Smooth transition to deregulation	26
5. Submissions by interested parties.....	27
6. Statutory test.....	35
7. Commission consideration	36
Effect on competition	37
Summary of anti-competitive effects	41
Public benefits	41
Easing the transition to a deregulated market.....	41
Increased countervailing/bargaining power	43
Transaction cost savings.....	44
Investment in new technology.....	45
Other efficiency improvements	45
Summary of public benefits.....	46
Conclusion on anti-competitive effects and public benefits.....	46
8 Determination.....	48

1. Introduction

1.1 Organisations who engage, or propose to engage, in certain anti-competitive business arrangements or conduct that could breach the Trade Practices Act (the Act), may apply to the Australian Competition and Consumer Commission (the Commission) for authorisation of such arrangements or conduct. When an application for authorisation is made, the Commission is required under the Act to make a determination in writing either granting or dismissing the application. It is also required to take into account any submission made to it in relation to the application. The Commission is first required to issue a draft determination in writing. The applicant or any interested party dissatisfied with the draft may request that the Commission hold a conference with the applicant and interested parties. At the conference parties can discuss the operation and effect of the draft determination. After any such conference the Commission reconsiders the application taking into account the comments made and further submissions received and publishes its final determination.

1.2 The Commission may grant authorisation where the public benefit of the subject arrangements or conduct outweighs the public detriment, including the anti-competitive detriment. If granted, an authorisation provides immunity from legal proceedings under the Act in respect of the arrangements or conduct. This protection extends only from the time the authorisation is granted. Consequently, an organisation would not be protected from legal action under the Act in respect of any business arrangements or conduct engaged in prior to the granting of authorisation of such arrangements or conduct.

1.3 On 25 August 2000, an application for authorisation (A90745) was lodged with the Commission by Premium Milk Ltd. The application was made under subsection 88(1) of the Act for authorisation to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.

1.4 The conduct for which authorisation has been sought relates to the collective bargaining of farm-gate prices and milk standards through a representative body, Premium Milk Ltd, in negotiations with Pauls Limited.

1.5 Premium Milk Ltd seeks authorisation for current producers and producers who may participate in the proposed arrangements in the future.

Premium Milk Ltd (Premium)

1.6 Premium is a company limited by guarantee. The 580 producers currently selling milk to Pauls Limited through six co-operatives will be offered membership of Premium. The company will operate on a not-for-profit basis and consequently there will be no right to dividends.

1.7 Premium will represent the collective interests of its members in direct negotiations with Pauls on issues of milk supply including quality, prices and volumes required.

1.8 The six supply co-operatives who currently supply Pauls are:

- 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.

1.9 However, the Commission understands that Port Curtis Milk Suppliers Co-operative has not yet formally joined Premium. Although recent media reports indicate that some individual Port Curtis farmers have applied for membership to Premium.¹

Pauls Limited (Pauls)

1.10 Pauls specialises in the production of branded milk and dairy products and is one of the major manufacturers of milk, yoghurt and fresh dairy products in Australia. Pauls hold approximately 22 per cent of the Australian milk market and is the largest milk processor in Queensland.

1.11 Pauls is a wholly owned subsidiary of the Italian based global dairy company, Parmalat Finanziaria SpA, after being acquired by public takeover in August 1998. Parmalat maintained the existing management and operating structure of Pauls and established Queensland as its Asia Pacific headquarters.

1.12 In Queensland, Pauls operates plants at Labrador, Warwick, South Brisbane, Nambour, Rockhampton, Monto and Mackay. Pauls' dairy farmer producers currently supply 340 million litres of raw milk per annum to these plants. In 1999 Pauls processed and sold approximately 200 million litres of fresh milk throughout Queensland.

1.13 Pauls expanded its market milk and dairy products operations to Victoria in the early 1990s largely through acquisitions of existing operations. Currently Pauls' intake of raw milk from direct suppliers in Victoria is in excess of 100 million litres. In 1999 Pauls processed approximately 200 million litres of fresh milk through its plants in Bendigo and Rowville.

1.14 The Pauls Group is actively involved in exporting products, particularly throughout south-east Asia and the Pacific, and in 1999 export sales of milk, dairy products and juice exceeded \$35 million.

¹ Interview on ABC Tropical North with Pat Rowley, Chairman Australian Dairy Farmers' Federation, 20 November 2001

1.15 The table below outlines the major stages of the Commission's assessment of the application for authorisation.

Table 1.1: Chronology of Commission's assessment of application

Date	Action
25 August 2000	Application for Authorisation A90745 lodged with the Commission for the collective bargaining of milk prices and standards through a representative body (Premium Milk Ltd) in direct negotiations with Pauls Limited.
31 August 2000	Letter seeking submissions from interested parties.
22 September 2000	Closing date for submissions from interested parties.
9 November 2000	The Commission sought further information from Premium.
17 November 2000	Further information provided by Premium.
20 December 2000	Following an indication by the applicant of a proposal to extend the conduct for which authorisation was being sought, the Commission requested formal clarification of the conduct.
10 January 2001	Premium advised that the authorisation should extend to allow it to negotiate collectively with other processors if an agreement can not be reached with Pauls.
16 January 2001	Premium advised that it did not wish to extend the application for authorisation, contrary to indications in its letter dated 10 January 2001.
23 January 2001	Letter seeking further information from Pauls Limited.
8 February 2001	Further information obtained from Pauls Limited
14 February 2001	Draft determination issued by the Commission proposing to grant authorisation. Interim authorisation granted.
3 September 2001	Premium provided the Milk Supply Agreement as negotiated by Premium and Pauls Limited for which final authorisation is sought.
12 December 2001	Final determination issued by the Commission granting authorisation.

2. Background

The Australian Dairy Industry²

2.1 The dairy industry is Australia's third largest rural industry behind beef and wheat. Approximately 10.8 billion litres of milk is produced annually, of which approximately 19 per cent is consumed as drinking milk and the rest is used in manufacturing dairy products such as cheese, skim milk powder, yoghurt, butter and cream. The gross value of production at the farm-gate is estimated to be approximately \$3 billion, with the ex-factory output about \$7.3 billion.

2.2 Industry estimates for the year ended 30 June 2000, showed that approximately one third of total retail milk sales were through supermarkets, while the remaining two thirds were sold through corner stores and service stations. The recent price discounting by supermarkets is likely to increase their share of total retail sales.

2.3 Australia exports around 50 per cent of its annual milk production, and more than 60 per cent of manufactured products are exported. While Australia accounts for less than two per cent of world milk production, it is the third largest exporter of dairy products behind the European Community and New Zealand. The major Australian export markets are Japan and South East Asia.

Farm sector

2.4 The majority of Australian dairy farms are family owned and operated. The total number of dairy farms has declined over the last 20 years, from over 30,000 in 1975 to approximately 12, 500 currently. Industry rationalisation has largely been a consequence of the reduction in government regulation over this period and as a result dairy farms of today are generally larger and more efficient.

2.5 The Australian dairy industry is predominantly pasture-based, and as a result production patterns are mainly seasonal in accordance with feed availability. Milk production based on seasonal pastures is more cost effective than producing all year round through supplementary feeding. On-farm productivity has also been increased by improved pasture, feed and herd management techniques. Indeed, Australian (and New Zealand) farmers are recognised as the lowest cost producers in the world.

2.6 In Australia, milk production is concentrated in the coastal areas, where there is high rainfall, or inland where there is ready access to irrigation sources. Table 2.1 shows the number of farms and proportion of milk produced in each State for 1998-99. Victoria was the largest milk producer in Australia, accounting for approximately 63 per cent of total whole milk followed by NSW and Queensland with about 13 per cent and 8 per cent respectively. Preliminary figures in the recent report from the Australian

² Unless otherwise stated, much of the information in this chapter is sourced from facts and figures provided in the Australian dairy industry's website www.dairy.com.au and in the Australian Dairy Corporation's publication "Australian Dairy Industry in Focus '99" (see www.dairycorp.com.au).

Bureau of Agricultural Resource Economics (ABARE) indicate the relative proportions of milk production remain similar.

2.7 Victoria dominates the dairy industry in Australia and is the lowest cost producer in Australia. The industry primarily produces milk for manufacturing purposes with over 90 per cent of its production going to manufactured products and over 65 per cent of this is exported.

2.8 The Victorian industry has comparative advantages for milk production. Its temperate climate and natural resources enable year round grazing of quality pastures grown using relatively low cost irrigation water or rainfall.

Table 2.1: Number of farms and proportion of milk produced in each State, 1998-99

State	Number of farms	Percentage of total milk production
Victoria	8,215 <i>7806*</i>	62.9
NSW	2,052 <i>1725</i>	12.6
Queensland	1,732 <i>1545</i>	8.4
South Australia	816 <i>667</i>	6.2
Tasmania	740 <i>734</i>	5.9
Western Australia	448 <i>411</i>	3.9

Source: ABARE submission dated 21 September 2000

*Figures in italics represent the preliminary estimate of the number of registered dairy farms in each State, 2000, from the ABARE Report on the Impact on the Dairy Industry of an Open Market in Fluid Milk Supply, January 2001, page 10.

2.9 It appears accepted in the industry that dairy farmers are in a weak bargaining position in relation to the disposal of their product – they are price takers. For example, the Commission understands that currently Pauls sets the prices payable to all producers that supply it with milk. These prices are established with some consultation with producers. However, there is little negotiation or right of veto if processors are dissatisfied with the levels set by Pauls. This is the result of a combination of factors including the fact that market milk has a short shelf-life that must conform to rigid public health standards. Further, long lead times are required to develop and alter production patterns.

2.10 In an attempt to address these issues, dairy farmers have tended to form co-operatives that guarantee supply for their product and to provide a floor price for the payment of their milk. Dairy co-operatives in Australia are generally structured with supplier shareholders controlling the voting shares of the co-operative. Returns to supplier shareholders are largely based on payment for the milk supplied and dividends on the shares they own/capital invested. Some co-operatives take the milk from their supplier members and process it into drinking milk or manufactured products. Others, such as the six co-operatives that currently supply Pauls, do not own processing

facilities and instead enter into supply contracts with another co-operative or proprietary company to process the milk.

2.11 Dairy co-operatives receive approximately 80 per cent of Australia's total milk production and they operate in all states. Murray Goulburn, Bonlac Foods and Dairy Farmers Group are the three largest co-operatives receiving approximately 65 per cent of the nation's milk.

Manufacturing/processing sector

2.12 As in the farm sector, the milk processing sector has also experienced change and rationalisation. Larger operations have allowed improvements in efficiency and economies of scale. Rationalisation has been facilitated by improvements to transport, storage and handling processes, which have reduced the need for the production and processing of milk close to markets. There are approximately 18 major milk manufacturing/processing firms in Australia, most of which are producer owned co-operatives.³

2.13 The largest milk processors are the national-international proprietary companies, National Foods and Pauls/Parmalat. National Foods accounts for about 40 per cent of Australian milk production and Pauls a further 34 per cent. These processors are supplied mostly by co-operatives or other processors, although they also purchase milk directly from farmers at spot prices.

2.14 Traditionally, a distinction has been made between milk used for liquid milk consumption (market milk) and that used for manufacturing purposes (manufacturing milk). Market milk is processed for immediate fresh consumption as whole milk, low fat and modified milks, flavoured milk and UHT (ultra heat treated) milk. In recent years less than 20 per cent of Australia's milk production has been used for the domestic fresh milk market. For instance, in Victoria, prior to industry deregulation, market milk accounted for approximately 6-7 per cent of production, however, its contribution to farm income is approximately 15 per cent.

2.15 Nationally, the market milk industry is dominated by three companies – Pauls/Parmalat, National Foods and Dairy Farmers' Co-operative – which together account for over 90 per cent of packaged milk sales in Australia.

2.16 Manufacturing milk is used in the production of a range of dairy products including butter, cheese, milk powders and other dairy products such as yoghurts, ice cream and dairy desserts. With expanding milk output, market milk's share of production has been declining while milk used for manufacturing dairy products has been increasing.

2.17 The manufacturing milk sector is dominated by two co-operatives located in Victoria – Murray-Goulburn and Bonlac – which together process more than 65 per cent of the milk used for manufacturing purposes in Australia. In particular, Murray-

³ Report of the Senate Rural and Regional Affairs and Transport References Committee, *Deregulation of the Australian Dairy Industry*, October 1999, page 10.

Goulburn collects about 28 per cent of the national intake of milk from its suppliers. It has approximately 3300 farmers/shareholder suppliers predominantly located in Victoria although there are some small supply bases in southern NSW and south-east South Australia. About 90 per cent of Murray-Goulburn's intake is for the manufacture of dairy products, of which 65 per cent is exported. Bonlac has approximately 3000 farmer suppliers located in Victoria and Tasmania. Bonlac is currently an unlisted public company although it has a co-operative heritage. A trans-Tasman alliance between Bonlac and the New Zealand Dairy Board was established in May 2001.

2.18 The distinction between market milk and manufacturing milk has largely resulted from State and Commonwealth Government legislation that regulated the supply and farm-gate price of milk according to the end use of the milk.

Dairy in Queensland

2.19 Queensland is the third largest producer of milk in Australia behind Victoria and NSW. At 30 June 2000 there were 1,545 producers in Queensland which decreased from about 4,600 in 1975. A recent report by ABARE (see paragraphs 2.38 – 2.45) found that approximately 110 farmers have left the industry in Queensland in the six month period following deregulation on 1 July 2000. Tables 2.2 – 2.4 show farmgate milk prices, the changes in farmgate prices following deregulation and farm cash income and profit for Queensland and the other milk producing states. The industry accounts for a gross value ex-farm-gate of \$319 million. The contribution of ex-factory output to gross State product is valued at about \$720 million.⁴

2.20 There are three main dairy production areas in Queensland – the Atherton Tableland in the north, the Central Queensland areas around Mackay, Rockhampton, Gladstone, Biggenden and Monto and the south east Queensland areas centred around Gympie/Maryborough, Caboolture and Toowoomba/Warwick on the Darling Downs.

2.21 The Queensland industry is currently geared to producing market milk on a year round basis to ensure supply to the Queensland liquid milk market. A high percentage of total milk production is used to service the fresh milk market requiring more consistent production than manufactured milk products throughout the year. Herd management practices ensure year round calving and require supplementary feeding. As a result production costs significantly increase, particularly in the winter months.

2.22 There are three main processors operating in Queensland – Pauls, Dairy Farmers' Co-operative and National Foods. National Foods only recently commenced processing operations in Queensland. Currently, National Foods obtains supply of milk for processing under contract from Pauls, rather than directly from producers. The largest processors are Dairy Farmers Co-operative, which represents approximately 900 producers, and Pauls, which currently purchases milk from six supply co-operatives representing approximately 580 producers operating in various regions throughout the State. There are also a number of small microprocessors that process and bottle milk and sell to local markets under private labels.

⁴ National Competition Policy Review of the Dairy Industry Act 1993 (July 1998), Chapter 3.

Industry regulation⁵

2.23 Historically, different regulatory arrangements have applied to the market milk and manufacturing milk sectors. The main form of regulation that has applied in recent times to manufacturing milk was the Domestic Market Support Scheme (DMSS) which commenced in July 1995 under Commonwealth legislation. This continued the assistance provided under the Kerin Plan introduced in 1986 and the Crean Plan introduced in 1992.

2.24 Under the DMSS two levies were imposed on domestic milk production. The first was a levy payable by farmers on milk produced for consumption as domestic liquid milk. The second levy applied to milk used in the manufacture of products for domestic sale and was payable by manufacturers. Milk used in production of exported products was exempt from the levy. The money raised by the levies was used by the Australian Dairy Corporation to make direct payments to all dairy farmers in Australia on the basis of the volume of manufacturing milk they produced each month. The DMSS ended on 30 June 2000.

2.25 All states have, at some time, regulated most aspects of the market milk sector from production to final consumption. State regulatory arrangements covered pricing, supply, health and safety and promotion of market milk. Such arrangements were administered by the relevant State Dairy Authority and were designed to guarantee an all year round supply of fresh milk to domestic markets. During the 1990s all States abolished controls on most aspects of milk distribution and pricing beyond the farm-gate. However, farm-gate pricing and other regulation remained until 30 June 2000.

2.26 Farm-gate regulation ensured that the price for market milk was significantly higher (typically double) than that for manufacturing milk. Interstate trade in milk was also limited by regulations that ensured that milk sold interstate for drinking was sold at the regulated farm-gate price. This prevented interstate manufacturing milk being sourced for market milk thereby undermining the state based market milk arrangements.

2.27 In NSW, Queensland and Western Australia – where the majority of farm revenue was derived from milk sold as drinking milk – quotas or entitlements were used to determine farmers' rights to supply the higher returning fresh milk market. For non-quota milk the price received was the prevailing manufacturing milk price, which generally varied in response to movements in the prices of dairy products on world markets. In Victoria, South Australia and Tasmania the majority of dairy farm revenue was based on manufacturing milk sales, with prices determined by international movements, and was hence more variable. In these states, pooling arrangements operated whereby a proportion of each individual farm's production was paid at the market milk premium price.

⁵ The information contained in this section largely comes from the Report of the Senate Rural and Regional Affairs and Transport References Committee, "Deregulation of the Australian Dairy Industry" October 1999.

2.28 On 1 July 2000 the dairy industry in Australia was fully deregulated. This means that there are no longer any formal quantitative controls on the supply or price of milk sold for drinking. In the deregulated market the differential in the farm-gate prices for market and manufacturing milk is likely to largely disappear, with prices varying according to quality or timing rather than end use.

The Dairy Industry Adjustment Package

2.29 In recognition of the potential impact of deregulation on producers the Commonwealth Government introduced a structural adjustment package. The transitional package consists of three main elements:

- the Dairy Structural Adjustment Program (DSAP);
- the Dairy Exit Program (DEP); and
- the Dairy Regional Assistance Program (DRAP).

2.30 The total cost of the package is estimated to be \$1.78 billion and is funded by a Commonwealth levy on sales of drinking milk applied at the retail level and collected at the wholesale level. The levy of 11 cents per litre on retail sales of drinking milk (including wholemilk, modified milk, UHT milk and flavoured milk) commenced on 8 July 2000. The levy will apply for approximately eight years.

2.31 The Commission has been given a direction under the *Prices Surveillance Act* 1983 (PS Act) to monitor the prices, costs and profits relating to the supply of leviable milk products by persons involved in the production and supply of dairy products.

2.32 Under the DSAP eligible dairy farmers will receive payments calculated on deliveries of manufacturing and market milk in the base year 1998/99. Payments will be made in quarterly instalments over eight years.

2.33 As an alternative to receiving the structural adjustment payments, eligible dairy farmers may choose to exit agriculture and obtain an exit payment of up to \$45,000 tax free. Dairy farmers initially choosing structural adjustment may switch to exit within the two year timeframe of the DEP, with the tax-free exit payment net of payments already received under structural adjustment.

2.34 DRAP commenced on 1 July 2000 and has funds of \$45 million (\$15 million per year) over the next three years to fund DRAP projects in eligible dairy regions throughout Australia. The program will assist dairy-dependent communities affected by deregulation to generate employment solutions and deal with any social dislocation that may be caused by the changes. DRAP will help these communities by supporting business investment, community infrastructure development and provide community access to training and counselling services. Funding is available to both not-for-profit and private sector organisations.

2.35 On 21 May 2001 the Commonwealth Government announced an additional \$140 million of federal assistance measures for those dairy farmers and dairy communities who had been most affected by deregulation. The Government announced this package in response to a report by the Australian Bureau of Agricultural and Resource Economics (ABARE) on the Impact of an Open Market on Fluid Milk Supply in January 2001, which found that some dairy regions, particularly those in

New South Wales, Queensland and Western Australia, have been severely affected by deregulation.

2.36 This package comprises:

- an additional \$20 million to be made available for DRAP, with priorities for funding to focus on those regions most adversely affected by deregulation as identified in the ABARE report;
- \$100 million for targeted increases in adjustment payments to producers who had a heavy dependence on market milk and who have experienced significant losses in income; and
- \$20 million for discretionary payments to deal more equitably with people whom the Government accepts have been inappropriately excluded, or had unreasonably low entitlements under DSAP.

2.37 The existing dairy adjustment levy will be extended to fund the additional package.

2001 report by ABARE 'The Australian dairy industry - impact of an open market in fluid milk supply'

2.38 On 30 January 2001, the Federal Minister for Agriculture, Fisheries and Forestry released a report by ABARE into the impact of dairy deregulation.⁶

2.39 The primary focus of the report was the impact of deregulation at the farm level. It provides updated forecasts on changes in farm-gate milk prices, production costs and farm incomes for the 2000-01 production season.

2.40 In general, ABARE found that the speed and scope of change resulting from deregulation has been faster and more extensive than many industry stakeholders anticipated. ABARE notes that the process of adjustment is proving challenging for many dairy farmers, particularly those in areas where a large proportion of milk production was traditionally sold to the fluid or market milk sector. However, ABARE also considers that the removal of farm-gate price controls for milk is largely inevitable given the dynamics of the commercial forces operating both domestically and internationally.

2.41 ABARE notes that while it is too early to estimate the exact size of the aggregate gain to consumers from an open market in milk, preliminary survey information by the Commission and anecdotal evidence suggests that retail milk prices have fallen. In particular, non-branded products and supermarket brands have become more prevalent and are competing strongly for market share. This has pushed the price of branded milk products down.

Farm-gate prices

2.42 Following deregulation the average farm-gate price of milk has fallen in all states. For example, in Queensland the average farm-gate price paid for milk is forecast to be 30.0 cents per litre in 2000-01, compared with an average price of 39.3 cents per litre in 1999-00 (a 24 per cent reduction). Large decreases were also forecast for Western Australia (30 per cent) and New South Wales (29 per cent).

Farm numbers

2.43 ABARE notes that deregulation appears to have brought forward the decision of many farmers to exit the industry. Preliminary information suggests that around 110 Queensland and 200 New South Wales farmers exited the industry from July to December 2000. This compares to reductions of 44 and 46 dairy farmers respectively in each of these states for the 12 months to 30 June 2000. A further study of farmers' intentions by ABARE indicates that 30 per cent of dairy farmers expect to exit the industry within the next five years.

Changes in Farm Incomes

2.44 ABARE considers that reductions in dairy farm incomes in 2000-01 are expected to be consistent with changes in the average farm-gate price of milk. Thus the largest reductions in dairy farm incomes are expected in New South Wales, Queensland and Western Australia, where market milk accounts for nearly half of all milk produced. States such as Victoria, South Australia and Tasmania, where a much smaller proportion of total milk production is channelled into market milk, will be less affected by deregulation. In fact, Victorian farm cash income is estimated to rise slightly in 2000-01 on the back of strong international prices for dairy commodities, although recent dry weather may lead to forecasts being revised downwards due to lower production levels.

2.45 ABARE considers that assistance to farmers under DSAP will partly offset the impact of lower farm-gate prices in 2000-01. Dairy farmers in Queensland are expected to receive DSAP payments of around \$15,869 per farm, on average, in 2000-01. Over the next eight years this represents a total of \$126,900 per farm. It is important to note that payments will differ significantly between farms as they are directly related to each eligible farm's production in the base year of 1998-99.

Commission's milk monitoring role

2.46 In April 2000, the Commonwealth Government directed the Commission to formally monitor 'prices, costs and profits relating to the supply of leviable milk products by persons involved in the production and supply of dairy products'. Monitoring covered the period before deregulation (April to June) and ended six months following deregulation.

2.47 The Commission released its monitoring report on the Impact of Farmgate Deregulation on the Australian Milk Industry ('the Monitoring Report') in April 2001. The Monitoring Report provides an analysis of the Commission's findings from its program of monitoring prices, costs and profits of businesses dealing in leviable milk products for the nine months to 8 January 2001. The Monitoring Report made the following findings in relation to the impact of deregulation on dairy farms.

Farm Gate Prices

2.48 As a consequence of Government intervention in the fresh milk market, farmgate prices for market milk were estimated to average 47.2 cents per litre in 1999 – 2000 compared to an average per litre price of 20.9 cents for manufacturing milk. Due to differing splits between market and manufacturing milk in each State, the average bundled price at the farmgate of a litre of milk has historically differed considerably between States. Farmgate prices for manufacturing and market milk in 1998, 1999 and 2000 are outlined in Table 2.2 below.

Table 2.2: Farmgate milk prices by State – manufacturing and market milk

State	1998		1999		2000 (p)	
	Man. Milk (c/l)	Market Milk (c/l)	Man. Milk (c/l)	Market Milk (c/l)	Man. Milk (c/l)	Market Milk (c/l)
New South Wales	25.1	49.6	25.3	47.0	21.8	47.7
Victoria	22.7	43.1	23.0	43.4	20.7	42.7
Queensland	24.0	55.3	23.7	55.7	21.9	54.9
South Australia	21.8	43.8	23.1	44.2	22.2	44.6
Western Australia	25.6	45.1	24.7	44.4	24.6	45.5
Tasmania	20.4	45.0	21.8	45.7	18.9	44.3
Australia	22.9	47.9	23.2	47.4	20.9	47.2

Note: (p) Preliminary estimates for year to 30 June 2001. Domestic market support payments not included in manufacturing milk prices. Market milk prices adjusted for freight charges and farmer contributions to state dairy authorities. Commonwealth levies not deducted from market or manufacturing milk prices.

Source: ADC, 2001 – extracted from the Commission's Monitoring Report, p.30

2.49 Following the removal of farmgate price controls from 1 July 2000, raw milk prices are now commercially determined. Farmgate milk prices were anticipated to fall in 2000-01 in all States with high proportions of market milk production. However, milk prices in Victoria were expected to fall by only 3 per cent in 2000-01 due to higher export prices for dairy commodities and a low reliance on market milk premiums under regulated farmgate pricing. It was expected that average milk prices should exhibit less interstate variability in a deregulated market. The estimated changes in farmgate milk prices following deregulation by State are outlined in table 2.3.

Table 2.3: Farmgate Milk Prices by State – all milk

State	Farmgate Prices		Estimated post-deregulation change (%)
	1999-2000(p) (c/l)	2000-01(s) (c/l)	
New South Wales	36.0	25.4	-29
Victoria	26.0	25.1	-3
Queensland	39.3	30.0	-24
South Australia	28.0	24.2	-14
Western Australia	36.0	25.0	-30
Tasmania	25.9	24.0	-7
Australia (a)	28.8	25.4	-12

Note: (p) Projections based on information provided by farmers and major dairy companies in November 2000. (a) estimated prices are not adjusted for State and Commonwealth levies including adjustments related to the Domestic Market support Scheme which terminated on 30/6/0 2000.

Source: ABARE and ACCC, 2001 – extracted from the Commission's Monitoring Report, p.31.

Changes in Farm Incomes

2.50 In its Monitoring Report the Commission found that decreases in average farmgate milk prices were expected to result in reduced dairy farm incomes for 2000-01 in all States except Victoria, where it was expected that strong international prices for dairy commodities should translate into slightly higher farm cash incomes.

2.51 The Commission considered that New South Wales, Queensland and Western Australia, where market milk accounts for nearly half of all milk produced, will experience the largest reduction in dairy farm incomes following deregulation. Farm business profit, which adjusts farm cash income for changes in trading stocks, depreciation and operator and family labour, was forecast to be negative in 2000-01 for all States except Tasmania. It expected that the full impact of dairy industry deregulation would depend on the extent to which an individual farm's average milk price at the farmgate has fallen and the size of the DSAP payments. At the time that the Monitoring Report was published, farmers would receive 42.63 cents per litre for market milk produced in the 1998-99 base year and 8.96 cents per litre for manufacturing milk under the DSAP. Annual DSAP payments will range from nearly \$31,000 in Western Australia to just under \$9000 in Tasmania with payments made quarterly over an eight year period.

2.52 Table 2.4 estimates the average farm cash income and business profit (including DSAP payments) for Australian dairy farms by State.

Table 2.4: Estimates of average farm cash income, business profit and DSAP payments for Australia dairy farms by State

State	1999-2000(p)		2000-01(s)		
	Farm Cash Income (a) (\$)	Farm business profit (b) (\$)	Farm Cash Income (a) (\$)	Farm business profit (b) (\$)	Annual DSAP payment (\$)
New South Wales	81 942	19 614	37 264	-30 533	20 319
Victoria	57 148	1290	57 789	-2123	12 338
Queensland	80 350	10 845	47 517	- 31 899	15 869
South Australia	75 322	15 700	57 515	- 15 760	18 165
Western Australia	127 185	50 735	55 823	-31 321	30 926
Tasmania	91 158	20 257	68 187	+1117	8947

Note: (a) Farm cash income represents the difference between total cash costs and total cash receipts excluding DMSP payments. (b) Farm business profit represents farm cash income, excluding DSAP payments, adjusted for changes in trading stocks, depreciation and operator and family labour. (p) Preliminary estimate. (s) Provisional estimate based on phone survey carried out by ABARE in October 2000. DSAP Dairy Structural Adjustment Program – payments are made quarterly for an eight year period commencing 2000-01. Figures weighed according to farm numbers in each State at 30 June 2001.

Source: ABARE and ACCC, 2000 – extracted from the Commission's Monitoring Report, p.35

3. The application

3.1 Premium is a not-for-profit organisation that will offer membership to the 580 producers currently selling milk to Pauls through six co-operatives. The Commission understands that five of the co-operatives will participate, with Port Curtis Dairy Co-operative electing not to take part in the proposal. Instead, it will maintain the current contractual arrangements already in place with Pauls.

3.2 The conduct for which authorisation has been sought relates to the collective bargaining of farm-gate prices and milk standards through a representative body – Premium – in direct negotiations with Pauls Limited.

3.3 Premium seeks authorisation to cover other persons who may participate in the proposed arrangements as producers in the future.

3.4 Collective negotiations will be facilitated through a Milk Management Committee. 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.

3.5 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.

Milk Supply Agreement

3.6 On 3 September 2001 Premium provided the Commission with a copy of the Milk Supply Agreement that was negotiated by Premium and Pauls for the purpose of enabling:

- Premium to secure a long term dependable outlet for milk produced by producers and a competitive price for milk for producers; and
- Pauls to secure a long term source of milk at a competitive price and a reasonable control over the quality of milk supplied from producers.

Milk Management Committee – establishment and purpose

3.7 The establishment and purpose of the Milk Management Committee is governed by clause 3 of the Agreement. Under clause 3.1 both Pauls and Premium

shall each nominate three representatives to sit on the Committee. These representatives will then elect a chairman. The quorum for a meeting of the Committee shall be the six representatives. The Chairman does not have a second or casting vote. In addition to the elected representatives, Premium may invite up to three of its producers to attend meetings of the Committee but these producers will not have a vote.

3.8 Clause 3.2 provides that the Milk Management Committee will meet not later than one month prior to the commencement of each supply period, and at such other time as the members of the Committee determine, for the purposes of:

- determining relevant milk quality standards for milk to be purchased from producers by Pauls;
- negotiating the prices to be paid by Pauls to producers for market milk and manufacture milk; and
- determining volumes of market milk and manufacture milk required from the producers for the following period specified by the Committee.

Supply of milk

3.9 Pursuant to clause 4.1 Premium shall use its best endeavours to ensure that its producers are aware of the quality standards and volumes required by Pauls from time to time, with a view to enabling those producers to offer for sale milk of the relevant standards and in the relevant volumes required by Pauls.

3.10 Under clause 4.2 Pauls agrees to purchase milk directly from the producers at the prices and in the volumes set by the Milk Management Committee.

Milk prices

3.11 Milk pricing issues are set out in clause 5 of the Agreement. Pauls maintains a market milk access scheme which is designed to ensure supply to Pauls of a year round supply of fresh milk for consumption in Queensland. Pauls recognises that the commitment undertaken by producers to supply fresh milk on a daily basis involves a cost to producers above the cost of supplying milk solely for manufacturing purposes. For this reason, under clause 5.1.3, Pauls and Premium are, unless otherwise agreed in writing, committed to a two tier milk pricing system which provides to producers a premium for market milk above the prices negotiated from time to time for milk for manufacturing purposes.

3.12 Clause 5.1.4 provides that the Milk Management Committee in negotiating milk prices (and the expert in determining milk prices pursuant to the dispute resolution procedures in clause 12) shall ensure that the prices payable by Pauls for both market and manufacture milk shall not cause Pauls to:

- be uncompetitive or disadvantaged in relation to the cost of raw milk for processing and sale as market milk in Queensland, as against its competitors in that market; and

- be uncompetitive or disadvantaged in relation to the cost of raw milk for the manufacture of fresh dairy products (yoghurts, desserts etc) for sale in the Australian market and for processing and sale as UHT long life milk in the Australian (other than Queensland) and export markets, as against Australian competitors in those markets.

3.13 The prices for market milk and manufacture milk will be the market prices determined by the Milk Management Committee from time to time.

3.14 Clause 5.2.3 provides that if Pauls reasonably determines that milk of a different specification, composition or quality, or produced in a particular region can be sold by it in a processed form more profitably or at a higher price, it may require Premium to negotiate, as a separate item from any other category of milk, a price for milk for that different specification, composition, quality or produced in a particular region.

3.15 Under clause 5.2.4 the parties acknowledge that there may be a pricing structure for market milk and manufacture milk:

- consisting of two or more levels to reflect from time to time under or over production at farm level, any significant change to dairy commodity markets or milk of a superior or inferior quality, specification or composition; and
- that has regard to who bears the cost of cartage and handling the milk.

3.16 Price negotiations are conducted pursuant to clause 5.4. Not later than one month prior to the commencement of the each supply period the Milk Management Committee shall meet to negotiate in good faith the price payable by Pauls to producers for market and manufacture milk for the next supply period. If the Committee has not agreed on the prices prior to the commencement of the relevant supply period:

- there shall be deemed to have occurred a dispute in relation to such of the prices which are not agreed and the provisions of clause 12 shall apply; and
- each party shall in good faith immediately commence and pursue the procedures in clause 12 so that the dispute is determined as soon as possible.

3.17 Pending the determination of the prices pursuant to clause 12, Pauls shall continue to pay to producers the current price adjusted as appropriate for changes (if any) in seasonal prices.

3.18 If at any time circumstances occur which in the opinion of Pauls or Premium could reasonably be expected to materially impact or materially influence the price of milk, either party may by notice (renegotiation notice) to the other party request renegotiation of the prices. However, each Pauls and Premium may give a renegotiation notice only once in any supply period. If the Milk Management Committee is unable to agree on a renegotiated price there shall be deemed to be a dispute and the provisions of clause 12 shall apply. The current price adjusted as appropriate for changes in seasonal prices shall apply pending the determination of the dispute.

Pricing information

3.19 Clause 5.6.1 provides that in negotiating the prices for market and manufacture milk the parties will confidentially disclose information to each other through their representatives on the Milk Management Committee, and will take into account all relevant factors, including:

- any information known to them which may materially affect the prices of milk;
- the need to maintain a year round continuing source of milk of the quality and quantity reasonably required by Pauls;
- the effective prices for market milk and manufacture milk payable to farmers who supply milk in the relevant geographic regions to other processors having regard to the freight and cartage arrangements of those processors;
- all factors which materially influence the prices of milk and dairy products sold by Pauls;
- the cost of transporting and handling the milk;
- the composition of the milk in relation to butterfat and protein percentages;
- the cost of Pauls paying producers directly;
- any bonuses payable in relation to the quality or composition of the milk; and
- Pauls' quality standards and control procedures in relation to total bacterial plate count, bulk milk cell count, freezing point, iodine count and such other quality standards and control procedures as may be in place from time to time.

3.20 Whenever prices are announced to its producers, Premium will, where possible, disclose to its producers prices for milk being paid by other comparable processors.

Milk collection and payment

3.21 Under clause 6.1 Pauls will collect the milk which is offered for sale to Pauls by producers from the dairy farms of the producers. Clause 6.3 provides that Pauls and Premium shall determine who bears the cartage costs. Unless otherwise agreed, cartage costs in each geographic area shall be charged at a cost to recover the direct cost of cartage for their geographic area, recognising the current concessional arrangements implemented by Pauls in relation to factory closures.

3.22 According to clause 6.5 Pauls must comply with all laws relating to the collection, cartage, testing and grading of milk.

3.23 Under clause 7.1 Pauls shall pay direct to the producers for all milk purchased by Pauls from the producers on the 15th day of each month following the month of supply.

Field advisory services

3.24 Clause 8.1 provides that Pauls shall at its cost provide reasonable field advisory services to Premium's producers to assist them in:

- producing high quality milk and increasing milk volumes;
- planning and implementing dairy improvements;
- maintaining or improving quality standards for milk and milking herds; and
- maintaining or improving the cost efficiency of dairy operations including technical matters.

3.25 The level of field advisory services provided by Pauls shall take into account the:

- level of field services provided by Pauls' competitors;
- number of farms from which milk is supplied;
- commercial benefit derived by Pauls; and
- reduction after the commencement date in any similar or like services provided by an authority.

Dispute resolution

3.26 The dispute resolution procedures are set out in clause 12 of the Agreement. Clause 12.1 provides that, subject to clause 12.7, if a dispute or disagreement arises out of, or under, clauses 5 (milk pricing) and 6 (milk collection) the dispute or disagreement shall be submitted to an expert for expert determination. The parties may agree on the expert which will make the expert determination. However, if they have not agreed on the expert within 14 days the expert shall be appointed by the Australian Commercial Disputes Centre (ACDC) in accordance with the ACDC's guidelines or rules.

3.27 Clause 12.7 provides that clause 12.1 does not restrain a party from at any time commencing urgent interlocutory proceedings for injunctive relief in connection with an alleged breach of the Agreement.

3.28 Under clause 12.3 the parties shall accept the determination of the expert as final and binding. The expert shall act as an expert and not as an arbitrator.

3.29 Unless contrary to ACDC's guidelines or rules, the expert shall:

- proceed in a manner which the expert thinks fit without being bound to follow the rules of natural justice or the rules of evidence;
- take into account all documents, information and other written and oral material that the parties may place before the expert, including documents, information and

material relating to the matters in dispute and arguments and submissions upon such matters;

- determine the dispute or disagreement in a manner which has regard to and is consistent with the terms of this Agreement;
- where the dispute or disagreement relates to the prices payable by Pauls for milk, determine the dispute or disagreement in a manner which has regard to and is consistent with the provisions of this Agreement which relate to the prices payable by Pauls for milk including clauses 5 and 6; and
- promptly provide the parties with written notification of his/her determination and a summary of the reasons for such determination.

3.30 Under clause 12.6 the costs incurred by the expert in the determination shall be borne equally by the parties unless otherwise determined by the expert.

ACCC authorisation

3.31 Under clause 13.3, the Agreement will terminate:

- on the date the ACCC advises Premium or Pauls that it will not grant authorisation;
- if the authorisation is issued for the proposed four year period, or any other period, on the date that period expires; or
- if the authorisation is issued for the proposed four year period, or any other period and such period is extended by the ACCC, on the date any or all such extensions expire.

Constitution

3.32 The applicant provided a copy of its proposed constitution as background information and to illustrate how Directors of Premium will be appointed. The applicant has not applied for authorisation in respect of its Constitution. An outline of the proposed constitution is set out below.

3.33 Members will elect a Board that will initially consist of 11 Directors, reducing to eight over a two year period. Directors are responsible for the management of the business of Premium including:

- borrowing, raising or securing the payment or repayment of money;
- charging, mortgaging or otherwise encumbering the undertakings, property, assets or business of Premium;
- issuing notes, bonds, debentures or any other securities or giving any guarantee for any debt liability or obligation of Premium.

3.34 Under the Constitution membership of Premium is open to milk producers and applications for membership are accepted or rejected by a meeting of Directors. Any applicant who receives a majority of votes of the directors present at the first meeting