



TELEPHONE +61 2 8915 1000
FACSIMILE +61 2 8916 2000

Level 12

60 Carrington Street
Sydney NSW Australia
GPO Box 1433 Sydney
NSW 2001 Australia
DX 262 Sydney
ABN 55 365 334 124

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Our Ref: KXE:DA1695/22
Your Ref: C2008/850

Dr R Chadwick
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Dear Dr Chadwick

**Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited (DFMC)
and Australian Cooperative Foods Limited (ACF)**

This letter responds on behalf of DFMC and ACF to queries raised by Joanne Palisi and Monica Bourke in their conversation with Graham Maher of this office on 3 July 2008.

Defined terms used in this letter have the same meaning as used in the submission accompanying the application for authorisation, unless otherwise stated.

1 Are clauses 4.4 and 5.6 of the Milk Supply Agreement (MSA), the only provisions of the MSA in respect of which authorisation is sought?

There are three clauses of the MSA which, pursuant to clause 20.1 of the MSA, will cease to bind DFMC and ACF once related party status between them is lost. They are clauses 4.4, 5.6 and 9, which deal, respectively with the adoption and implementation of back to back milk purchasing policies, the adoption and implementation of back to back milk prices and a restraint on ACF from purchasing raw milk from parties other than DFMC, except in limited circumstances. Clause 3.8 also ceases to apply in accordance with clause 3.8(f).

Of these clauses, DFMC and ACF only seek authorisation for amendment of the MSA now to allow for the continuation of clauses 4.4 and 5.6 in the event that related party status between DFMC and ACF is lost. They do not seek authorisation for the continuation of the restraint provision in clause 9. Therefore, following the loss of related party status, ACF will not be restrained in any way from acquiring milk directly from farmers, including members of DFMC. No other provisions of the MSA require authorisation.

2 Is pricing determined in accordance with the Milk Policy Guide which is referred to in section 4.6 of the submission accompanying the application for authorisation?

Pricing is determined by negotiation between DFMC and ACF in accordance with the terms of the MSA. The Milk Policy Guide is not a pricing document, although a number of matters referred to in it are relevant to price. They include matters such as:

- a description of the different types of supply agreements between farmers and DFMC;
- a definition of "new milk";
- details of "gates charges" (ie freight and cartage costs); and
- an explanation of the Quality Payment System.

Other matters included in the Milk Policy Guide relate to issues such as sampling of milk, animal feedstuffs, animal health, and minimum volumes and pick up arrangements. A confidential copy of the current Milk Policy Guide is attached to this letter. The guide is provided to farmers to provide them with information relevant to their obligations when supplying milk to DFMC for on sale to ACF.

3 In the event that authorisation is granted, is there anything which would prevent DFMC from growing its membership to such an extent as to cause an imbalance in bargaining power between DFMC and ACF?

As we understand it, the Commission has raised the possibility that ACF's obligation to purchase all qualifying milk from DFMC may operate to make DFMC so attractive to farmers that it causes DFMC to have an inequitable degree of bargaining power in its relationship with ACF. DFMC and ACF submit that this has not occurred in the 4 years since the MSA was first entered into and will not occur in the future. There are 2 reasons for this:

1. ACF is only obliged to purchase milk which is produced at a farm from which ACF collected milk in the 8 week period prior to the commencement of the MSA. ACF may elect, but is not obliged, to take milk produced at any other farm.
2. ACF is free, following the loss of related party status, to acquire milk directly from persons other than DFMC including DFMC's members.

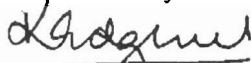
We set out below a brief explanation.

- ACF is only obliged to purchase "all of the qualifying farmer member's milk" purchased by DFMC from its members (clause 3.3(a) of the MSA). The expression "qualifying farmer member's milk" is defined in clause 1.1 of the MSA as either:
 - milk which is produced by a member of DFMC at a farm from which ACF collected milk at any time in the 8 weeks prior to commencement of the MSA on 1 July 2004; or
 - milk which is deemed to be qualifying farmer member's milk pursuant to clause 3.7(b) of the MSA.

Clause 3.7 deals with new farmer members. ACF is not obliged to acquire milk from DFMC if the milk was produced at a farm from which ACF did not collect milk at any time in the 8 weeks prior to 1 July 2004 (clause 3.7(a) of the MSA). It is only if ACF elects to purchase that milk, that the milk is deemed to be qualifying farmer member's milk (clause 3.7(b) of the MSA). If ACF does not elect to acquire that milk, DFMC may sell or supply the milk to another person.

- ACF may purchase other milk from DFMC (including milk which DFMC purchases pursuant to a Milk Receival Supply Contract), but only where ACF approves or agrees (clauses 3.3(b) and 3.3(c) of the MSA). Where the milk is purchased by DFMC under a Milk Receival Supply Contract, ACF cannot unreasonably withhold its approval. A Milk Receival Supply Contract is a contract between DFMC and either The Bega Co-operative Society Limited, The Berry Rural Co-operative Society Limited or any other person who owns or occupies a milk receival depot and who was a member of DFMC on the commencement date.
- Another important constraint on DFMC's ability to gain bargaining power is that, following the loss of related party status, ACF will not be restrained either contractually or commercially from acquiring milk directly from farmers, including DFMC's members. Therefore, it may also be possible for ACF to seek to maintain its bargaining power by dealing with farmers directly.

Yours faithfully



Kathryn Edghill
Partner

Direct Line: (02) 8915 1057

Direct Fax: (02) 8916 2057

Email: kathryn.edghill@addisonslawyers.com.au

cc: By email to: Monica Bourke and Joanne Palisi - ACCC Canberra