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Dear Mr Hatfield

Supplementary submission in relation to application for Authorisation A91364

We refer to our telephone discussion on 7 May 2013 in respect of the application for revocation of authorisation A91089 and substitution with authorisation A91364 lodged with the Australian Competition and Consumer Commission (ACCC) on 8 March 2013 (**Authorisation Application**).

Defined terms used in this supplementary submission have the same meaning as in the Authorisation Application.

During our telephone discussion you requested that DFMC confirm certain arrangements in respect of the MSA between DFMC and Lion, as well as provide further information demonstrating the public benefits of the authorised conduct. In particular, you requested that DFMC:

- confirm whether the version of the MSA contained in Confidential Annexure 1 of the Authorisation Application is the latest version of the MSA;
- confirm whether the terms of clause 5.6 of the MSA are also included in the terms of clause 4.4 of the MSA; and
- provide examples of how the authorisation of the Back to Back Arrangements has resulted in public benefits.

MSA

DFMC confirms that the MSA contained at Confidential Annexure 1 of the Authorisation Application is the latest version of the MSA.

The terms in clause 5.6 of the MSA are a subset of the terms of clause 4.4 of the MSA

As you are aware:

- clause 4.4 of the MSA requires DFMC to adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members as Lion applies to its purchase of milk from DFMC; and
- clause 5.6 of the MSA requires DFMC to adopt the same milk price in relation to the purchase of milk by DFMC from its members as DFMC receives from Lion for the milk it sells to Lion.

DFMC considers that the terms of clause 5.6 of the MSA are a subset of the terms of clause 4.4. Clause 5.6 simply further clarifies that DFMC must pay members the same price for their milk as it receives from Lion.

Public benefits accruing from the Back to Back Arrangements

As set out in the Authorisation Application, authorisation of the Back to Back Arrangements via the grant of Authorisation A91089 has provided the conditions necessary for DFMC, DFMC members and Lion to realise public benefits including:

- certainty of milk off-take for members, certainty of supply for Lion;
- transaction cost savings; and
- greater farmer input into milk pricing and milk policies.

Certainty of supply

As detailed in the Authorisation Application, the MSA effectively requires Lion to buy all of the milk produced by DFMC members. Moreover, the farmer contracts between DFMC and members, and the Back to Back Arrangements effectively give farmers the option to contract to supply Lion via DFMC for 1, 2 or 3 years.

The concurrent ability of individual members to freely select the duration of their supply contract, and the guarantee that all of a member's milk will be acquired for the period of their supply contract, has resulted in increased farmer efficiency. In particular, members have provided DFMC with feedback that the ability to select a 3 year supply contract in the knowledge that all their milk will be acquired has provided them with increased certainty to make the necessary significant capital and other investments to improve their production processes and increase their long-term efficiency as a milk producer contributing to dynamic efficiency.

Meanwhile, for other members, the ability to select a relatively short-term contract (e.g. 1 year) knowing that all their milk will be acquired, has enabled them to maximise their production of milk whilst maintaining the flexibility to switch to supplying an alternate processor, should the alternate processor offer more attractive commercial terms. This has contributed to farmers allocating the maximum volume of milk to processors and applications that most demand their milk.

Lion's loss of significant private label contracts in 2010 and 2011 could have led to the exit of numerous farmers, as well as the loss of a large volume of reliable milk supplies to Lion despite no change in the underlying demand for drinking milk. However, Lion's concurrent obligation to acquire all the milk from DFMC members, and Lion's ability to offer a "tier 2" price for milk in excess of its anticipated full demand, prevented inefficient exit and re-entry of farmers (or inefficient transfers) and enabled Lion to more quickly adapt its operations. In particular, the guarantee that all their milk would be acquired meant that farmers could maintain milk production levels, albeit not necessary all at a "tier 1" price, providing a buffer until they could switch to an alternate milk processor. Lion too, could allocate greater volumes of milk to alternate dairy products and thereby take advantage of its own manufacturing efficiencies more quickly.

Transaction cost savings and greater input into contracts

The Authorisation has reduced the requirements for individual farmers to conduct their own information gathering on milk prices and reduced total administrative costs that would be incurred by hundreds of farmers individually seeking legal and business advice on the merits of entering into a supply contract with Lion. Lion too, is able to negotiate and determine pricing and supply terms with a single party.

In respect of greater input into farmer contracts, DFMC notes that it provides numerous services to its members that have led to greater farmer input, as well as higher levels of farmer engagement and understanding of milk pricing, milk standards and supply terms. For example, DFMC holds multiple member meetings each year in every region. During member meetings, DFMC both provides information to members, and garners feedback from members on numerous topics including desired amendments to standard supply terms as well as milk pricing. Increased input into contracts has led to more efficient outcomes including better farm practices, greater compliance with milk standards and pricing that is likely to more closely correspond to efficient pricing of raw milk prices.

Please contact myself or Fadi Metanios on (02) 8915 1061 if you have any questions regarding this letter.

Yours sincerely



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