



Australian
Competition &
Consumer
Commission

Draft Determination

Application for revocation and substitution of authorisation

lodged by

Dairy Farmers Milk Co-operative Limited (DFMC)

in respect of

Milk supply arrangements between DFMC and Lion Pty Ltd

Date: 5 June 2013

Authorisation number: A91364

Commissioners: **Sims**
 Rickard
 Cifuentes
 Court
 Dimasi
 Walker

Summary

The Australian Competition and Consumer Commission (ACCC) proposes to re-authorise milk supply arrangements between Dairy Farmers Milk Co-operative Limited, its members, and Dairy Farmers Pty Ltd for ten years.

The ACCC will now seek further submissions in relation to this draft determination before making its final decision.

Introduction

1. On 8 March 2013, the Dairy Farmers Milk Co-operative Limited (DFMC), lodged an application for the revocation of authorisation A91089 and the substitution of a new authorisation A91364 with the ACCC under section 91C (1) of the *Competition and Consumer Act 2010* (the Act) (re-authorisation).
2. DFMC seeks re-authorisation to make and give effect to back to back milk purchasing policies and milk pricing arrangements between DFMC, DFMC members and Dairy Farmers Pty Ltd (Lion)¹ by virtue of a Milk Supply Agreement (MSA)² between DFMC and Lion. The MSA sets out the terms whereby DFMC's acquisition of milk from its approximate 600 members is on the same terms as Lion's acquisition of milk from DFMC.
3. The clauses of the MSA are given further effect to by virtue of the agreements DFMC has entered into, and will enter into in the future, with its members to obtain milk supply.
4. The relevant clauses of the proposed MSA between DFMC and Lion are identical to those considered by the ACCC in 2008³ except that the term of the MSA is extended to 2019. The key effects of the clauses are:

Clause 4.4 - DFMC must 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

Clause 4.6.2 - DFMC must sell milk it acquires from members to Lion on the same terms and conditions relating to payment, pricing collection and quality as contained in its farmer contracts, and

Clause 5.6 - DFMC must adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk as DFMC received from Lion for the milk it sells to Lion.

¹ Formerly known as Australian Co-operative Foods Limited (ACF) and now a wholly owned subsidiary of Lion Pty Ltd.

² A copy of the Milk Supply Agreement has been provided to the ACCC on a confidential basis.

³ On 22 October 2008, the ACCC granted Authorisation A91089 until 13 November 2013, to make and give effect to the back to back arrangements between DFMC, DFMC members and Australian Co-operative Foods Limited ((ACF) now Lion)³ (2008 Authorisation).

<http://transition.accc.gov.au/content/index.phtml/itemId/829411/fromItemId/401858>

5. DFMC seeks re-authorisation to make and give effect to the MSA which may be regarded as conduct:
 - a. fixing, controlling or maintaining the price for goods and the terms of supply of goods by DFMC members, DFMC and Lion, in contravention of the cartel conduct provisions of the Act, or
 - b. in contravention of sections 45 (2)(a)(ii) and 45 (2)(b)(ii) of the Act.
6. DFMC seeks re-authorisation for ten years, however if the ACCC is not minded to grant authorisation for this length of time, DFMC seeks authorisation until the expiry of the MSA on 30 June 2019.
7. The ACCC can authorise anti-competitive conduct such as cartel conduct if it is satisfied that the likely public benefits of the conduct will outweigh the likely public detriment constituted by any lessening of competition.⁴ Further details regarding DFMC's application for re-authorisation can be found on the ACCC's Public Register.⁵

DFMC

8. DFMC is a trading co-operative and commenced trading following a restructure of Australian Co-operative Foods Ltd (ACF) on 29 June 2004. DFMC's principal activity is the acquisition of milk from members (pursuant to supply contracts with its members) and the sale of all such milk to Lion (pursuant to the MSA). DFMC is the owner of the milk it sells to Lion. It does not have any infrastructure for milk collection and storage and is dependent on Lion for the collection and storage of the milk which DFMC acquires from its members and on sells to Lion.
9. DFMC submits that membership of DFMC is voluntary and members join and leave regularly. DFMC submits that as at 30 June 2012 there were approximately 600 DFMC members across Australia, located in the relevant dairy regions, see paragraph 15(d) below.⁶
10. DFMC submits that the following changes have occurred since 2008:
 - a. entry of Parmalat Australia Limited (Parmalat) in Central New South Wales
 - b. a reduction in the number of, and volumes of milk supplied by, DFMC members
 - c. the introduction of contracts between DFMC and farmer suppliers with shorter terms and shorter notice periods to exit
 - d. heightened countervailing power of retailers as opposed to milk processors, and

⁴ The ACCC's *Guide to Authorisation* (available from the ACCC website) has more details regarding the ACCC's authorisation process.

⁵ <http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039>

⁶ This is compared to 800 members as at 30 June 2008.

- e. factory consolidation by milk processors.⁷
11. DFMC submits that these factors, when combined, mean that the impact of the milk supply arrangements on the sale of end dairy products is arguably even less significant than it was when the 2008 Authorisation was granted.

Public Consultation

12. On 18 March 2013 the ACCC invited submissions on the application for re-authorisation from 33 potentially interested parties, including competitors such as Parmalat, industry representative bodies and dairy associations, and various state Government departments.
13. The ACCC received submissions from the three parties listed below. All submissions were supportive of the application:⁸
- a. Australian Dairy Farmers Ltd
 - b. Queensland Dairy Farmers' Organisation, and
 - c. Queensland Department of Agriculture, Fisheries and Forestry.

ACCC evaluation

14. The ACCC's evaluation of the milk supply arrangements is in accordance with the relevant net public benefit tests⁹ contained in the Act. In broad terms, under the relevant tests the ACCC shall not grant authorisation unless it is satisfied that the likely benefit to the public would outweigh the detriment to the public, including the detriment constituted by any lessening of competition that would be likely to result.
15. In its evaluation of this application, the ACCC has taken into account:
- a. Information received from DFMC and interested party submissions. In particular, the ACCC notes that there were no objections to the re-authorisation.
 - b. Information available to the ACCC regarding the 2008 Authorisation.
 - c. The likely alternative future without the conduct the subject of the authorisation. The ACCC accepts that the future without the conduct would be that DFMC unilaterally negotiates milk supply prices with dairy farmers and Lion, creating greater uncertainty and increasing transaction and administrative costs. Alternatively, DFMC farmers may consider

⁷ The complete submission can be viewed on the ACCC Public Register at: <http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039/display/application>

⁸ All submissions can be viewed on the ACCC's Public Register, including a list of parties consulted - <http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039>

⁹ Subsections 90(5A), 90(5B), 90(6), 90(7) and 91C(7) of the Act. The relevant tests are set out in Attachment A.

- entering into collective bargaining arrangements consistent with those already operating in the dairy industry under an ACCC authorisation.¹⁰
- d. The relevant areas of competition likely to be affected by the milk supply arrangements. The ACCC agrees with DFMC that the milk supply arrangements will directly impact the acquisition of raw milk by milk processors in the following areas:
 - North Queensland
 - South East Queensland and Northern New South Wales
 - New South Wales
 - Riverina/Northern Victoria (Gippsland), and
 - Western Victoria/South Australia
 - e. The ACCC considers some downstream markets may also be relevant such as the markets for the wholesale supply of fresh and flavoured milk and the markets for the wholesale supply of other manufactured dairy products.
 - f. These areas of competition were considered relevant in the 2008 Authorisation and are supported by DFMC.
 - g. The ten year authorisation period requested.

Public Benefits

16. In line with the 2008 Authorisation, DFMC submits that the milk supply arrangements have led, and will continue to lead to the following public benefits:
 - a. certainty of supply for DFMC, Lion and DFMC members through continuation of existing milk supply arrangements
 - b. transaction cost savings and greater input into supply contracts for DFMC members and Lion; and
 - c. greater farmer input into milk pricing and milk policies.

Certainty of supply

17. DFMC submits that 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.
18. For example, DFMC notes that it has received member 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, 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

¹⁰ In 2011, the ACCC granted authorisation A91263 for ten years, with conditions, to allow dairy farmers to collectively bargain the terms and conditions of their supply contacts with milk processors.

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.

Transaction cost savings

19. DFMC submits that the 2008 Authorisation has reduced the need for individual farmers to gather their own information on milk prices and has 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.

Greater farmer input

20. DFMC submits that since the 2008 Authorisation, it has provided numerous services to its members that have led to greater farmer input in contract negotiations with Lion, as well as higher levels of farmer engagement and understanding of milk pricing, milk standards and supply terms. For example, DFMC notes that it 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.

21. DFMC submits that 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 raw milk prices.

ACCC view on public benefits

22. The ACCC accepts that the milk supply arrangements have, and are likely to continue, to provide substantial transaction cost savings for DFMC members, DFMC and Lion. The ACCC is of the view that transaction cost savings in undertaking a single negotiation process, rather than a series of individual contractual negotiations between the parties, would not be captured without the proposed milk supply arrangements. The ACCC notes that as of June 2012, there were approximately 600 DFMC members across Australia.

23. The ACCC also accepts DFMC's submission that its role in representing DFMC farmers extends beyond negotiating milk supply arrangements and extends to the comprehensive gathering of information on trends and pricing for dairy products both in the Australian market and the world market. The ACCC is of the view that DFMC members are likely to benefit from DFMC undertaking this information gathering and market research in preparation for negotiations on their behalf with Lion. This is also likely to further improve the transparency and reduce information asymmetry for DFMC farmers regarding market conditions.

24. Further, the ACCC is of the view that negotiations between DFMC and Lion, on behalf of DFMC farmers, are likely to improve the level of input DFMC farmers have in contractual negotiations by addressing common contractual

issues, such as pricing, terms and conditions, timing and delivery, in a more efficient and effective manner.

25. The ACCC considers that the milk supply arrangements are likely to continue to result in public benefit through providing certainty for DFMC, DFMC farmers and Lion in terms of their rights and obligations in respect to the supply chain. This in turn allows all parties to make better informed decisions and provides certainty over the life of the supply agreements entered into.

Public Detriments

26. DFMC submits that the milk supply arrangements result in no significant public detriments. In relation to the potential effect on competition, DFMC submits:

- a. Factors identified in the 2008 Authorisation¹¹ continue to constrain the prices negotiated for milk.
- a. DFMC's pricing has been in line with prevailing market prices since the 2008 Authorisation was granted.
- b. Although exports as a proportion of milk production have fallen from approximately 45% to 38%, exports continue to represent a significant proportion of milk production, and world milk prices have a significant impact on Australian milk prices, including those negotiated between Lion and DFMC.
- c. Even with the milk supply arrangements in place between Lion and DFMC, DFMC farmer members continue to be in a position to move their supply freely, either to third party processors or directly to Lion. Therefore, DFMC is not in a position to lock up a significant section of the farmer base or raise barriers to entry by expansion to other processors.
- d. DFMC represents fewer members and less milk volume than it did when applying for the 2008 Authorisation and DFMC covers a smaller proportion of the farmer base than it did when the 2008 Authorisation was granted.

ACCC view on public detriments

27. The ACCC considers that agreements between competitors which influence the pricing decisions of market participants have the potential to result in allocative inefficiencies. That is, they can move prices away from levels that would be set in a competitive market. In this case, public detriment may arise if the prices negotiated were artificially higher or lower than they otherwise would be in the absence of the milk supply arrangements.

28. Public detriments may also arise if a horizontal agreement creates or enhances the potential for coordinated (rather than competitive) conduct on

¹¹ Authorisation A91089 Final Determination paragraph 6.43.

other matters that are beyond the scope of the agreement, as well as across the market more generally.

29. However, in this instance, and consistent with the 2008 Authorisation, the ACCC considers that the proposed milk supply arrangements, have resulted, and are likely to continue to result, in little public detriment.
30. The ACCC notes that even with the milk supply arrangements in place, Lion can still acquire additional milk from entities other than DFMC, and/or directly from DFMC members. Further, the ACCC accepts that due to changes to farmers' contracts since 2008, farmers can now more easily terminate their contracts with DFMC by giving at least three months written notice.¹² Farmers coming off contract have had the option to enter into new farmer contracts with DFMC for 1, 2, or 3 years. Shorter farmer contracts and more flexible conditions make it easier for farmers to supply other processors, or to seek to supply Lion directly should they prefer. Finally, the ACCC notes that since 2008, the ACCC has not received any submissions raising competition concerns from industry participants or competitors of DFMC with respect to the 2008 Authorisation.

Balance of benefits and detriments

31. For the reasons outlined in this draft determination, the ACCC considers that in all the circumstances the conduct for which authorisation is sought is likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the conduct in accordance with tests found in sections 90(6), 90(7), 90(5A) and 90(5B) of the Act.

Length of authorisation

32. The ACCC considers it is appropriate to grant re-authorisation for the period requested, that is ten years.
33. Authorisation A91089 expires on 13 November 2013 which was when the MSA was initially due to expire. However, following a letter of extension between DFMC and Lion the MSA now expires on 30 June 2019, and could potentially be extended further. The ACCC is of the view that granting authorisation for a period of ten years is consistent with similar authorisations granted recently in the dairy industry. Further, the ACCC notes that the milk supply arrangements have been operating since 2008 without concerns being raised with the ACCC.
34. The ACCC notes that it may review an authorisation prior to its expiry if, among other things, there has been a material change in circumstances since the authorisation was granted.

¹² Previously 6 months notice in writing was required, except in limited circumstances.

Draft determination

The application

35. On 8 March 2013, the Dairy Farmers Milk Co-operative Limited (DFMC), lodged an application for the revocation of authorisation A91089 and the substitution of a new authorisation A91364 with the ACCC under section 91C (1) of the Act (re-authorisation).
36. In order for the ACCC to re-authorise the milk supply arrangements, the ACCC must consider the application for re-authorisation under the same statutory tests as if it was a new application for authorisation under section 88 of the Act. The relevant sections are:
- section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.
 - section 88(1A) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

Draft determination

37. For the reasons set out in this draft determination, the ACCC is satisfied that the tests in sections 90(5A), 90(5B), 90(6), 90(7) and 91C(7) of the Act are met.¹³
38. Accordingly, the ACCC proposes to revoke authorisation A91089 and grant a new authorisation A91364 in substitution. The proposed substitute authorisation is to Dairy Farmers Milk Co-operative Limited (DFMC) to make and give effect to back to back milk purchasing policies and back to back milk pricing arrangements, under the Milk Supply Agreement between DFMC, DFMC members and Dairy Farmers Pty Ltd (Lion). The ACCC proposes to grant the substitute authorisation for ten years.
39. This draft determination is made on 5 June 2013.

Further submissions

40. The ACCC will now seek further submissions from interested parties. In addition, DFMC or any other interested party may request that the ACCC hold a conference to discuss the draft determination, pursuant to section 90A of the Act.

¹³ See Attachment A.

Attachment A

Competition and Consumer Act 2010

Section 90—Determination of applications for authorisations

Section 90 (5A) states that the Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a proposed contract, arrangement or understanding that would be, or might be, a cartel provision, unless the Commission is satisfied in all the circumstances:

- (a) that the provision would result, or be likely to result, in a benefit to the public; and
- (b) that the benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:
 - (i) the proposed contract or arrangement were made, or the proposed understanding were arrived at; and
 - (ii) the provision were given effect to.

Section 90 (5B) states that the Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a contract, arrangement or understanding that is or may be a cartel provision, unless the Commission is satisfied in all the circumstances:

- (a) that the provision has resulted, or is likely to result, in a benefit to the public; and
- (b) that the benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision.

Sections 90(6) and 90(7) state that the Commission shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:

- the provision of the proposed contract, arrangement or understanding in the case of section 90(6) would result, or be likely to result, or in the case of section 90(7) has resulted or is likely to result, in a benefit to the public; and
- that benefit, in the case of section 90(6) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision was given effect to, or in the case of section 90(7) has resulted or is likely to result from giving effect to the provision.

Section 91C(7) requires the Commission, in making a determination to revoke an authorisation and substitute another authorisation, to apply the tests in section 90(5A), (5B), (6), (7) (8), (8A), (8B), or (9) (as applicable) as if the authorisation were a new authorisation sought under section 88.