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Commissioner Rob Simms,
Chair of the ACCC

Attn: Mr Mark Laybutt via email: mark.laybutt@acc.gov.au

Re: ACCC inquiry into the Dairy Industry

Dear Commissioner,

We thank you for the opportunity to write to you regarding the inquiry into the Dairy Industry.

This submission will attend to several issues that relate to the dairy industry and the ACCC's relationship to it. The essence of this submission will respectfully argue that the ACCC is an organisation that is granted by its charter to police fairness of the commercial environment and that in a deregulated environment that role should be more aggressively pursued.

Deregulation does not mean an absence of law. What it means is that there are less laws in the commercial environment. The laws that are left are laws that have a more criminal, as opposed to regulatory, flavor and therefore the regulator should in part see their role as a policeman. If the intent of Government was to leave the commercial environment exclusively to the courts, then Government would never have enacted the Trade Practices Act back in the 1970s or subsequent Governments would have repealed the legislation. This has not occurred. What has occurred is the creation of the ACCC. But if the ACCC isn't a court, then what is it. The answer is of course, it is a police officer. The inquiry being undertaken is a part of an investigation by that police officer and should they discover anything that is possibly a crime the ACCC will refer it to a court for a determination as any police officer would.

Moreover, the legislation is crafted in many ways to be a shield in the market place to protect the minnows from the sharks. This submission will identify a number of areas where the ACCC should not only see its role as the bearer of that shield but as an organisation that will urge the ACCC to also unsheathe its sword to protect the smaller players against breaches and even potential breaches of the legislation in a timely fashion. A police officer is allowed to counsel or caution a person they think may be about to break the law as well as arrest them afterward should a law be broken.

Farmgate prices

Much of the recent activity by the Parliament and the Government in inquiring into the Dairy Industry has been driven by the awful results for farmers at the farm gate. Many farmers have reported that the cost of production has outstripped the prices being paid. Depending on who is arguing the case there are a number of reasons being given as to why this has occurred. In truth, there has been a perfect storm in the Dairy market particularly for Australian producers.

The perfect storm has been an amalgam of European quotas being lifted and Russia's self-imposed sanctions. However, commercial decisions by Murray Goulburn and Fonterra have also

amplified the impact on Australian farmers, not least of which, those farmers who work in South Australia. Being able to point at European quotas or Russian sanctions does not automatically absolve processors or retailers from culpability and unfair trade practices.

We are mindful that the ACCC is limited to the operation of Australian Consumer Law (formerly the Trade Practices Act), and how that law reflects on the operation of business in this country. Nevertheless, it is clear from submissions to the Senate Economics Committee inquiry into the Dairy industry that there is a deep concern and disillusionment harboured by many producers about the supply chain and how vulnerable producers are to the arrangements that are being made by processors and subsequent clients. The relationship between Murray Goulburn and Coles being the leading example. Such arrangements quickly lead many people to believe that collusive or other anti-competitive conduct has or is occurring. There can be little doubt that these sorts of arrangements have a deep impact on the confidence that many producers have in the market place. This sort of conduct is precisely why the ACCC exists.

One of the matters that the ACCC must turn its mind to are the relative bargaining positions that exist between the producers and processors. What must be accepted is that relationship imbalance has existed for a long time and has been known about for many years. In good times that imbalance isn't particularly corrosive however, in times of stress that imbalance leads to pronounced public concern manifest in protests, Senate Inquiries, political noise and numerous other expressions of disquiet. From a dairy perspective, but likely in a number of other industries in the primary sector at least, the ACCC is in an excellent position to be more proactive or assertive than it historically has been. Like many policing activities it the ACCC often responds to complaint. Nevertheless, there are circumstances where various regulatory bodies will preemptively move to police a law, ostensibly becoming the beat cop on the street corner in a tough neighbourhood. Again, it is this notion of the ACCC taking up its functions as the bearer of a sword as well as a shield.

With the greatest of respect to the ACCC (and for that matter ASIC), if they had been more assertive in their policing roles in the industry environment two years ago, SA Dairyfarmers Association Inc. (SADA) suggests its presence may have made the difference between an investigation into what has already occurred and better management practices by corporations before they made potentially criminal decisions. Players such as Murray Goulburn and Fonterra, which are now under investigation for conduct already completed. As these investigations are not complete SADA offers no public opinion as to the culpability or otherwise of these firms. However, if the firms had been pressed by the police officer earlier in the time line there may never have been the conduct that attracted the investigation in the first instance.

Simply expressed, the mere existence of a legislative instrument is often not enough to ensure compliance. There needs to be a presence that is part coercive and part cautionary.

Loss Leading

The practice of Loss Leading by Supermarkets is an area that deserves scrutiny across a number of products. Milk is an essential staple. The cost of milk on the shelf, when a supermarket seeks to loss lead, can cost less than bottled water at room temperature. This is a practice that needs to be closely monitored by the ACCC. If a retailer chooses to sell a product at a loss that is essentially a matter for them.

However, a major supermarket chain does have leverage over the processor and it is still in the interest of the supermarket to minimise the loss as much as possible on behalf of their business and shareholders. A processor negotiating with a supermarket will enjoy economies of scale when supplying large amounts of milk to a single consumer. As processors are businesses like any other they will seek to retain savings for themselves. Because of the nature of the milk supply contracts between producers and processors, producers are often locked into supplying milk for a

price obtained by the processor. The price is then set primarily by the processor who passes that price onto the producer. The 'step up' or worse 'step down', pricing practices flows through the system and gives the producer little capacity to respond subsequently.

Of course, the primary example of the effect of the 'step down' arrangement are the events that have led to the ACCC investigation, particularly the conduct of Murray Goulburn who were continuing to overstate the price of milk long after most in the industry were aware that Murray Goulburn's projections were unsupportable. Nevertheless, they kept on purchasing the milk with the reasonable expectation that they would be able to claw back losses through the step-down process. Whether this amounts to a fraud or unconscionable conduct will be a matter for a court to determine should such a court ever be asked to do so.

What the system does highlight is the vulnerability of producers to decisions and conduct of others which is far beyond the producer's control, particularly given the disparity between producers, processors and the retail giants that operate in this space.

Contractual Oversight

Because of the relative size of the producers and processors there are several other mechanisms that need to be considered when the ACCC considers the conscionability of conduct.

Producers essentially fly blind in the market place when it comes to prices being offered by processors. Producers will be aware of the milk price generally the presence of confidentially clauses in contract makes price comparison more difficult. The added leverage brought to bear by producers through the mechanism of loyalty payments has a tendency to cause producers to become trapped into specific arrangements. Moreover, the recent aggressive enforcement by Murray Goulburn coupled with legal threats to producers is causing disquiet among producers.

SADA welcomes the announcement by the ACCC in November 2016 of greater contractual oversight. Nevertheless, the focus appears to be on the nature of standard form contracts. There are other contractual arrangements that also deserve review with regard to the conduct of the parties. While SADA appreciates that there are clear business imperatives on the part of Murray Goulburn to shore up their supply chain their conduct in the past two years mean that their demands of integrity amongst those who are contracted to them, when compared to their own conduct, jars the sensibilities of many of producers in the market place.

As stated SADA appreciates the pro-active steps that are being taken by the ACCC to oversee the contractual conduct between parties and this is indicative of what can be achieved by the ACCC in relation to taking a greater prophylactic role in the dairy environment in particular.

Collective Bargaining

Whilst at first blush anticompetitive in nature Australian Consumer Law does embrace the notion that commodity producers may engage in collective bargaining agreements. This may be done by either application or notification in certain limited circumstances.

Again, there is a role here for the ACCC to create a more assertive presence. The approach by the ACCC in this space is by attraction rather than promotion. SADA suggests that in industries, such as the dairy industry, there is an immediate and obvious bargaining disparity between two producers and processors. Nevertheless, the ACCC being the keeper of the commercial playing field generally remains quiet about what steps are available until there is a complaint.

The ACCC should consider a policy based on active conduct and promotion of the right to collectively bargain rather than the mere presentation of the possibility by way of attraction. Again, these observations are about the way the ACCC chooses to position itself in the environment that it oversees.

SADA accepts that the primary industry sector does not easily come together for collective bargaining purposes but that does not absolve government agencies of their duty to inform industries of the possibility.

Get Ready to Police the Effects Test

The issue that we as an organisation seek to impress upon you is a simple matter. Our primary area of concern is the potential for a deleterious effect on the Dairy Industry arising out of the branded/unbranded dollar per litre milk offer by the major supermarkets. While we do appreciate that there are also other forces at work relating to the gate price, the activate price war between the major supermarkets is inflicting pronounced collateral damage to milk producers on the farm in South Australia.

We express our great gratitude to the many consumers who have chosen branded products in support of producers, however there is no doubt that the conduct of the major supermarket chains has inflicted hardship upon those in the industry.

The Commonwealth Government has acknowledged this reality by introducing proposed amendments to Australian Consumer Law by introducing amendments to Section 46 of the ACL changing the legislation to introduce an “effects” test. Essentially, the test removes the burden of intent or knowledge from the legislation and replaces it with a burden of proving a negative outcome to the industry effected by the conduct. There is no doubt that these proposed changes to the ACL are a direct consequence of the events surrounding the Dairy Industry and the major players in the supermarket price wars.

Consequently, there is little to add to the conversation save for a response that has less to do with the legislation but rather more to do with its implementation.

With regard to the operation of the ACL, there is a capacity under certain circumstances for the ACCC to issue an infringement notice under the legislation. Such a notice cannot be issued for a matter arising out of the operation of the soon to be amended Section 46, however the existence of the notice suggests that the original framers of the legislation intended the law to operate, at least in part, as a sword in the hands of the ACCC to protect consumers.

At SADA would prefer it the ACL could be amended to accommodate the notion that such an infringement notice or some form of injunctive restraint could be ordered by the Commission itself in circumstances where there were sufficient grounds to order a halt to conduct by a corporation. Such an injunction would only be possible where, on the balance of probabilities the corporation was engaged in conduct that amounts to a breach of Section 46, and naturally such a decision could be appealed to a competent authority such as a Court or Administrative Appeals Tribunal.

Nevertheless, we appreciate that the opportunity to recommend such amendments has passed by and can only be considered in the next round of changes, whenever they occur.

Having said that, legislatively speaking at least, is possible for the ACCC to involve itself in breaches of Section 46 through administrative conduct. By way of example, speaking with the participants in the possible breach and cautioning them to alter their conduct. This approach doesn't require a full and comprehensive investigation as would be required for a court action. In fact, a mere suspicion of such conduct would be sufficient for the ACCC to open a line of communication with the corporation engaged in suspect conduct. In such circumstances the communication could be collaborative as well as suggestive of alteration of conduct. Only if the behavior continues does a court action become more likely.

This approach is actually a description of what should occur now.

What SADA wishes to impress upon the ACCC is that there is an expectation of timeliness in the response by the ACCC. Currently, the supermarkets are committing no offence. If the law changes, there is little doubt that the supermarkets will be on the wrong side of the 'effects' test. Should that occur rather than waiting for a slow investigative process SADA would hope for and expect an expedited response from the ACCC to what will be anti-competitive behavior from the supermarkets. Bureaucracy moves too slowly when responding to potential breaches of the ACL, include on top of that a slow passage of any action through the courts by the time that a mischief is attended to years may have passed and in the commercial world the players have moved on.

If the ACCC was ready to commence its response on the expectation that the legislation was going to incorporate the 'effects' test, then on the day of assent then SADA would be satisfied that the ACCC was moving to protect the interests of its members immediately.

Deregulation demands a stronger police presence

In any environment that is deregulated there will sadly be those organisations which will seek to bend and break the rules. As a regulated market demands regulatory oversight a deregulated market demands even stronger scrutiny of the fewer rules that remain. The essence of this submission is that the ACCC should be more assertive in its role of being the police officer in their corner of a tough neighbourhood.

If you have any questions regarding this matter, please do not hesitate to contact me.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'John Hunt', written in a cursive style.

John Hunt,
President SA Dairyfarmers Association Inc. (SADA)