

Senator Chris Ketter
Chair
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600
November 9, 2016



Dear Chair,

Submission by the United Dairyfarmers of Victoria (UDV) to the Senate Economics References Committee Inquiry into the Dairy Industry

United Dairyfarmers of Victoria (UDV) is the Victorian advocacy body, representing dairy farmers across Victoria spread into three key regions.

Dairy farmers have had a tough past season and it is pleasing to note that the outlook for dairy in the future is more positive with a rebalancing of supply and demand fundamentals globally taking place.

Dairy farmers have a limited capacity to manage the market price so it is important to always focus on what can be managed, remain aware of industry risks and maintain a low cost production system so the farm business is in a better position to weather any storms.

Unfortunately, last year's sustained dry seasonal conditions and very late season milk price downgrades is a set circumstances even the most flexible businesses will struggle to withstand.

Late 2015, early 2016 presented considerable challenges for most Victorian dairy farmers. Dry seasonal conditions limited the availability of home grown fodder in many dryland areas, and temporary water prices were hovering around \$300 per mega litre limited farmers in irrigation areas. Even domestic water was an issue with South Gippsland and parts of Western Victoria where farmers were forced to truck stock and domestic water as their usual water reserves had run dry. In isolation, these were difficult circumstances.

At the same time, these some businesses faced a farmgate milk price down-grade from ~\$5.60 KgMS to just \$1.91 KgMS for May and June. Industry forecasts prior to this time, consistently indicated a final year end price of at least \$5.60.

Autumn calving suppliers were hit the hardest as they produce most of their milk this time of year and in some cases this left more than \$100,000 budget shortfall, in a year when they already carried higher than average input costs because of the dry season. Autumn calving suppliers were hit the hardest as they produce most of their milk in this time of year and in some cases this left more than \$100,000 budget shortfall, in a year when they already carried higher than average input costs because of the dry season.

Public comments after the price changes announced by Murray Goulburn and Fonterra from late April & May 2016 speak to the concerns:

- “To push debt across to the supplier base, that’s fundamentally wrong ... you could assume it’s opportunistic,” Adam Jenkins, United Dairyfarmers of Victoria
- “Given there is an ongoing drought, there couldn’t be a worse time for this to happen,” Agriculture Minister Jaala Pulford said
- Murray Dairy chair Rick Cross said “it could feel like the whole world is closing in on you” given the Murray Goulburn announcement and the dry season.

These are not circumstances a business can plan for. These are circumstances that some cannot withstand. Both market and seasonal volatility is here to stay and the UDV recognise it is important our industry is structured to allow farmer profitability through this volatility over the long term.

UDV will continue to advocate ensuring that the events of earlier this year are never repeated. That has been our stance from day one and we will continue to work with other state and national dairy farmer organisations, the milk processors, the state and federal governments, regulators including the ACCC and ASIC.

ACCC Investigation of Conduct

The ACCC is continuing its investigation of the conduct of Murray Goulburn and Fonterra Australia on whether:

- Murray Goulburn has engaged in false, misleading or deceptive and / or unconscionable conduct in connection with its decision to ‘step down’ its Farmgate Milk Price in its Southern Milk Region late in the 2015-16 season, and ‘claw back’ what it considered to be overpayments made to suppliers since the beginning of the season.
- Fonterra Australia has engaged in unconscionable conduct in connection with its decision to step down its Farmgate Milk Price late in the 2015-016 season, disproportionately affecting those farmers supplying in May and June.

We cannot comment on the potential outcomes of these independent investigations other than recognising that we welcome the investigations and will continue to support where possible.

UDV are working closely with our national representative body Australian Dairy Farmers (ADF) to resolve issues across the value chain, in particular in the development of a Voluntary Industry Code of Conduct which is expected to prevent conduct of this nature in the future.

Voluntary Industry Code of Conduct & Unfair Contract Terms

The industry has long recognised that it is important that farmers and processors work together collaboratively to address both domestic and international challenges to the profitability of the industry.

The dairy industry is co-operative in nature. For most of Australian dairy history, farmers have put their trust in co-operative structures and processors that have truly sought benefit for their suppliers. These are the values that Australian dairy has been built on, and this is why the resolution to the events of 2016 is being led by farmers.

UDV attended an ADF convened meeting between dairy farmers and processors on 27th September 2016 to begin the process of improving the contractual arrangements with farmers and balance risk along the supply chain. This follows on from milk price structure work done by UDV in recent years.

Processors and dairy farmers engaged in a constructive discussion of the points raised in the draft discussion paper whilst considerate of the specific needs of different industry players and regional differences.

Two key outcomes from the workshop were:

- Agreed importance of transparency and prescribing the mechanisms for milk pricing in the proposed draft Code and importance of allowing flexibility.
- Agreed no retrospectivity regarding pricing and pricing mechanisms.

Voluntary Industry Codes offer opportunity for greater compliance with the *Competition and Consumer Act 2010* (Cth) and offers a range of benefits in preference of a mandatory code:

- Greater transparency of the industry to which signatories to the code belong
- Greater stakeholder or investor confidence in the industry/business
- Ensuring compliance with the Act to significantly minimise breaches
- A competitive marketing advantage.

Other reasons for developing a Voluntary Industry Code include:

- It is more flexible than government legislation and can be amended more efficiently to keep abreast of changes in industries' needs
- It is less intrusive than government regulation
- Industry participants have a greater sense of ownership of the Code leading to a stronger commitment to comply with the Act
- The Code acts as a quality control within an industry
- Complaint handling procedures under the Code are generally more cost effective, time efficient and user friendly in resolving complaints than government bodies.¹

A Voluntary Industry Code of Conduct is supported by the introduction of changes to unfair contract laws for small business. From 12th November 2016 a new law will protect farmers and small businesses from unfair terms in standard form contracts. The law aims to address some of the power imbalances existing in business-to-business transactions.

Milk Prices

We need to ensure that our industry is returning the market value of milk back to the farm gate. This may see some changes going forward with those having more exposure to the domestic market and those prominently export commodity focused. Whilst we enjoy the competitive farm gate competition for milk, we must all acknowledge that we have not increased the volume outputs and profitability that has been touted for our industry for some time.

¹ 'Guidelines for developing effective voluntary industry codes of conduct' *Competition and Consumer Commission* (July, 2011) 3.

In April 2014, UDV released a discussion paper into milk pricing structures and their impact on the productivity of Australian dairy.² In assessing current milk pricing systems and long term impacts, the report recognised distorted pricing signals:

Distorted price signals have potentially contributed to less milk in the industry via a distortion of any alignment between payment systems and farm profitability. This is potentially leading to a less competitive and less resilient industry, through an increasing farmer cost of production, with a weakness in export competitiveness and an increased reliance on a domestic market that does not require all the milk produced in the industry.

Dairy farmers respond to processor pricing signals, these signals are not achieving the desired outcomes. For example, weighted average pricing causes confusion amongst suppliers.

Following the 2016/17 milk price announcement in June, UDV president Adam Jenkins said “The UDV are now very concerned for those on a net price, not a weighted average price, because we tend to know that it is 20 cents a kilogram of milk solids less than the weighted average price. I bet there will be a lot of people on \$4.10-\$4.15kg/MS.”

The ACCC Dairy Industry Inquiry will be far-reaching and UDV look forward to having input into review of milk pricing structures and agreements.

In past discussions, the environment has not allowed for collaborative discussion nor a catalyst for change. The interest from the Federal Government and industry investigative tools available to the ACCC has catalysed willingness for change and the UDV is seeking to grasp this opportunity for farmers.

Market Power

There has been significant ongoing discussion since 2011 regarding \$1 per litre milk and the impact this marketing strategy has on farmers.

Devaluation of milk is not confined to drinking milk. This devaluation has spread throughout the dairy supply chain to products such as yogurt and cheese. This means less value for dairy products across the industry.

Research commissioned by Dairy Australia in June 2016, confirms that consumers share concerns about the fairness of liquid milk prices and the inherent value of milk. Some key themes to emerge were:

1. The price of milk is too low (Around 70% agree that milk should cost more than \$1 a litre, and that it should cost more than a bottle of water);
2. Farmers are struggling and the future of the industry is uncertain (Around 90% agreed that farmers are struggling because of low prices); and
3. Farmers aren't being treated fairly, particularly by supermarkets (74% felt that supermarkets were not treating farmers fairly).

² 'A Comparison of Complex Milk Price Structures and Suggested Components of a Better Milk Pricing System', *United Dairyfarmers of Victoria* (April, 2014).

These consumer attitudes have also been borne out of the very sudden and large shift in consumer behavior following the price step down in April 2016, with consumers switching to branded milk in favour of private label milk.

UDV have long held concerns regarding market power of the major supermarkets. In 2009, UDV/VFF submitted to the *Senate Standing Committee on Economics on Competition and pricing in the Australian dairy industry* 'The UDV/VFF has concerns about the level market power held by the supermarket duopoly in the food sector, and how this feeds back into prices for dairy farmers.'

Conclusion

The systems in Australian dairy industry are damaged but not broken. UDV says there are significant issues with processor milk pricing and structures and market power of supermarkets. UDV have strongly advocated for change in the past, and we welcome the unparalleled regulatory support with ACCC, ASIC and the supportive changes through unfair contract terms extended to reach dairy supply agreements.

This is a strong environment for change and through the ACCC inquiry, unfair contract term extension and voluntary industry code we are confident the circumstances of 2016 will not re-occur.

At the meetings we have attended with the dairy industry, there is a clear appetite for the industry to examine and improve its practices. There is also recognition that the industry has a history of working collaboratively to resolve issues and it recognises that it is better for the industry to address its own issues rather than have government intervene with a solution.

The industry has recognized that this means improving the way it operates within the current structures and moving to improve the way it operates at a more strategic level. We can see that the development of a Code of Best Practice on Contractual Relationships and addressing strategic issues are key to the way forward.

If you require any further information or wish to discuss these matters, please do not hesitate to contact me.

Yours Sincerely,

Adam Jenkins,
President United Dairyfarmers of Victoria