Parliament of Australia

Senate Economics Committee

Inquiry into the impacts of supermarket price decisions on the dairy industry

Submission
by

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UNDERSTANDING THE IMPACT OF SUPERMARKET MILK PRICING DECISIONS

The recent announcements by the major supermarket chains regarding the price of home brand milk raises a number of important questions:

(i) Is home brand milk being sold below cost?

(ii) Who is currently funding the reduced price of home brand milk?

(iii) Who will be funding the reduced price of home brand milk over time?

(iv) Is the lower price on home brand milk being offset by higher prices on other grocery products?

(v) What impact is the lower price on home brand milk having on the price and demand for branded milk?

(vi) What would happen if the demand for branded milk fell significantly?

In dealing with these questions it is clear that there is a real lack of transparency as to the pricing behavior of the major supermarket chains. This lack of transparency means there are considerable questions and concerns surrounding the pricing behavior of the major supermarket chains. These concerns mean that there are real questions as to whether the pricing behavior of the major supermarket chains is detrimental to competition and consumers.

In dealing with the central issues raised by the recent reductions in the price of home brand milk by the major supermarket chains, it is essential to look well beyond a simplistic analysis of a well publicized price reduction on a single product range. It is critical to resist the temptation to merely take the view that a price reduction on a single product range is “obviously” a “good” thing. Such a relatively unsophisticated approach of a price reduction on a single product range runs the clear risk of failing to identify potentially more sinister or adverse impacts on competition and consumers.

The key point to note is that the pricing decisions of the major supermarket chains should not be considered in isolation from one another. The major supermarket chains can be very sophisticated in their pricing decisions for simple reason that poor pricing decisions can dramatically impact on profitability. Inevitably, the major supermarket chains will carefully assess the impact of each pricing decision on their overall business model.

In practice this means that Coles, for example, would have carefully considered how a reduction in the price of home brand milk would have impacted on the sales of home brand milk and other products in their supermarkets, as well as the sales of petrol sold through Coles Express petrol stations. Given that Coles did reduce the price of home brand milk it could reasonably be inferred that it formed the view that a reduction in price of home brand milk would potentially lead to an increase in the sales of home brand milk and, possibly of other products. That's the theory, but the reality may not be so straightforward.

There are a number of potential problem areas for Coles in this scenario. First, while the reduction in the price of home brand milk will boost sales of home brand milk it will also reduce profit margins on those sales of home brand milk. The price reductions on home brand milk will also lead to a fall in the sales of branded milk as consumers will increasingly switch from branded milk to home brand milk.

So, when taken in isolation the reduction in the price of home brand milk will initially have a double whammy negative effect on Coles as the reduction in the price of home brand milk will reduce the profit margins on the sales of home brand milk and a reduction in the sales of branded milk will reduce profits on branded milk. This double whammy negative effect at the retail level is also ultimately very likely to have a knock on negative effect on milk processors, the farm gate price of milk and the financial viability of dairy farmers.

Second, in order for Coles to offset the falls in profit margins on home brand milk Coles could do one or a combination of possibly three things;

(i) Coles can seek to offset falls in profit margins on home brand milk by seeking to reduce the price it pays to milk processors for home brand and/or branded milk. This, in turn, opens up the very real prospect of milk processors seeking to reduce the farm price they pay to dairy farmers for fresh milk. It is a common strategy of the major supermarket chains to maintain or grow their profit margins on products by requiring suppliers to reduce the price at which they sell the product to the major supermarket chain. The danger of this strategy in the case of fresh milk is that the farm gate price for milk paid to dairy farmers will be further eroded over time such that the financial viability of the farmers is also further eroded. As the financial viability of dairy farmers is eroded, dairy farmers will either switch to other types of farming or simply leave farming altogether. That would be bad news for consumers as the supply of fresh milk would fall and, the price of fresh milk would rise over time. As the price of fresh milk moved upwards consumers would either accept being gouged or they would switch to alternatives, including long life (UHT) milk. Under this scenario, consumers over time would ordinarily pay much more for fresh milk than they would have otherwise paid if there was a sustainable dairy farming sector; and/or

(ii) Coles can seek to increase the price of and/or profit margins on non-milk products. While Coles has publicly indicated that it has reduced the price of upwards of 5,000 or more products, Coles has been silent on what has happened to the price of the upwards of 15,000 other products typically stocked in a Coles supermarket. In the absence of full price transparency from Coles, consumers are simply unable to determine if they are paying more for other grocery products to offset the reduction in the price of home brand milk. Again, consumers would be worse off to the extent that the increases in the upwards of 15,000 or more non-milk products were greater than the reduction in the price of home brand milk; and/or

(iii) Coles could reduce the frequency and size of discounting patterns across the supermarket product range. In this regard, supermarkets have traditionally engaged in regular patterns of discounting where they would offer "deep" discounts on a rotating group of products. If Coles reduced the frequency and size of those "deep" discounts, then the benefit of those discounts to consumers would clearly be reduced as compared to past discounting patterns. Thus, the smaller the discounting patterns on selected products over time, the smaller the savings that consumers will be able to make on those individual products when they are included in the discounting round. Naturally, there is also the possibility that Coles may reduce the number of products that are included in the discounting round. If fewer products are included in the discounting round, then consumers would be worse off as a result of being denied the opportunity to obtain a saving on products that were previously included in the discounting round. Significantly, Coles would increase its overall profitability to the extent that it reduced the frequency, level and scope of "deep" discounting across the supermarket product range. In short, Coles could more than offset the reduction in the price of home brand milk by simply reducing the frequency, level and scope of discounting it may over time engage in on other products.

Of course, Coles could restore the profit margins on home brand milk by simply raising the price of home brand milk in future, but given its extensive advertising campaign that prices are "staying down" Coles would suffer considerable damage to its reputation if consumers felt misled by the Coles advertising campaign. In practice, Coles has backed itself into a corner on the price reductions on home brand milk and it will obviously be mindful of not letting that price reduction adversely affect the overall profitability of its supermarket business model.

Accordingly, the price reductions on home brand milk should not be seen in isolation and must instead be considered in perspective having regard to the real possibility that consumers may not be better off overall and may even be worse off, particularly where the price reductions on home brand milk could be more than offset either by higher prices on non-milk products or through altered discounting patterns that disadvantage consumers across the full supermarket product range.

Questions to be resolved

Whether or not consumers are better or worse off overall from the price reductions on home brand milk by Coles ultimately depends upon answers to following questions:

Is home brand milk being sold below cost?

The first question be resolved is whether Coles is selling home brand milk below cost. This is an issue given that under section 46(1AA) of the *Competition and Consumer Act* (otherwise known as the Birdsville Amendment) anti-competitive below cost pricing or predatory pricing is prohibited. The Birdsville Amendment provides:

> (1AA) A corporation that has a substantial share of a market must not supply, or offer to supply, goods or services for a sustained period at a price that is less than the relevant cost to the corporation of supplying such goods or services, for the purpose of:
>
> > (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market; or
> > (b) preventing the entry of a person into that or any other market; or
> > (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

Anti-competitive below cost pricing or predatory pricing is illegal for the simple reason that such conduct distorts and undermines competition by artificially pricing a product in a deliberately sustained manner aimed at trying to drive out competitors.

Here it is important to distinguish between temporary and sustained below cost pricing. While below cost pricing for a temporary period may be rational behavior designed to meet a transitory competitive threat or to assist in establishing or growing sales of a particular product or the business, below cost pricing for a sustained period is generally not rational behavior for a business. Indeed, ongoing losses on a product mean that it is obviously not profitable for the business to sell the product and, accordingly, the business would be better off discontinuing the sale of the product and diverting its resources to the sale of other profitable products.

In relation to the Coles decision to reduce the price of home brand milk, the question of whether or not there is below cost pricing is much more significant given that Coles has publicly stated that the price of home brand milk is "staying down." Such public statements would clearly suggest that the pricing strategy by Coles in relation to home brand milk will be a sustained one. Thus, if Coles is in fact selling home brand milk below cost, then there would be serious issues to be considered under the Birdsville Amendment.

In short, from a competition law point of view it needs to be established whether or not Coles is selling home brand milk below cost. If Coles is not selling home brand milk below cost, then that is the end of the matter under the Birdsille Amendment. If, however, Coles is selling home brand milk below cost then there may be possible breaches of the Birdsville Amendment that would need to be investigated by the ACCC.

Who is currently funding the reduced price of home brand milk?

The question of who is currently funding the reduced cost of home brand milk is a key issue in relation to consumers. In particular, the question arises as to whether the reduced price of home brand milk is being funded by higher prices on other grocery products or by lower levels of discounting on other products.

So while there have been public comments from Coles that it is “internally” funding the reduced price of home brand milk, it is clear that consumers will one way or another be funding the reduced price on home brand milk for simple reason that it is consumers who ultimately generate the “internal” funds for Coles.

Who will be funding the reduced price of home brand milk over time?

The question of who will be funding the reduced cost of home brand milk over time again impacts on consumers, but could also impact on dairy farmers. Thus, so while Coles can quite easily and at any time offset the lower prices on home brand milk through higher prices on other grocery products thereby adversely affecting consumers, it is also possible for Coles in future negotiations to demand that milk processor supply home brand milk to Coles at a lower price.

Of course, Coles could also demand that milk processors lower the price at which they supply branded milk to Coles. Seeking to lift profit margins on branded milk would be another obvious way that Coles could try to offset the reductions in the price of home brand milk.

If Coles were to force milk processors to reduce the price at which the processors sell home brand and/or branded milk to Coles, then the milk processor could simply then lower the farm gate price that they pay to dairy farmers.

Dangerously, a reduction in the farm gate price paid to dairy farmers would mean that the financial viability of dairy farming would be further reduced with the inevitable result that more dairy farmers will leave the land or stop producing milk. In turn, that would reduce the supply of fresh milk and would ordinarily lead to higher prices for fresh milk.

Of course, if over time Coles continued to maintain the reduced price of home brand milk in the face of higher fresh milk prices following falls in the supply of fresh milk, Coles would continue to be hit with increasingly lower profits or greater losses from sales of home brand milk. That, in turn, would lead to a vicious cycle where consumers would face the growing risk of higher prices on other grocery products and/or Coles trying to reduce the price it paid milk processors and/or the wholesale price it paid to suppliers of other grocery prices so as to increase profit margins on those other grocery products to offset it decision to maintain the reductions in the price of home brand milk.

In addition, as the supply of fresh milk fell Coles could also seek to encourage consumers to switch to long life (UHT) milk thereby giving Coles the opportunity to not only extract higher profit margins, but also to lower its costs given that long life (UHT) milk has lower handling costs and doesn't need to be refrigerated.

Clearly, Coles could over time offset the lower prices on home brand milk by:

(i) Raising the prices and/or profit margins on other grocery products which would be directly detrimental to consumers buying those other grocery products; and/or
(ii) Lowering the price that Coles pays milk processors for home brand and/or branded milk which would be directly detrimental to farmers and indirectly detrimental to consumers if a further loss of dairy farmers led to higher fresh milk prices over time or less access to fresh milk.

Is the lower price on home brand milk being offset by higher prices on other grocery products?

In the absence of full price transparency from the major supermarket chains, there is unfortunately no way for consumers to determine if the lower price on home brand milk is being offset by higher prices on other grocery products. Given that home brand milk is one of upwards of 20,000 or more products in a typical Coles supermarket there is ample opportunity for Coles to raise the price of other grocery products to offset or even exceed the price reductions on home brand milk.

Knowing what Coles is doing in relation to the price of other grocery products is essential to assessing if consumers are better or worse off as a result of the price reductions on home brand milk. Indeed, if the price reductions on home brand milk are being offset by higher prices on other grocery products, then clearly consumers would overall be worse off. Ultimately, there is no such thing as a "free lunch" as consumers will inevitably pay for the lower prices on home brand milk one way or another. This could include through higher prices on other grocery product; less discounts across the product range; and/or higher prices on fresh milk over time.

Under this scenario Coles may merely be using the gimmick of a price reduction on home brand milk to entice or induce consumers into thinking that they are “better off” in some way when unbeknown to consumers they are really worse off overall and over time when they shop at a Coles supermarket because of the way that Coles may have increased the prices of other grocery products.

What impact is the lower price on home brand milk having on the price and demand for branded milk?

While all eyes may be on the price and demand for home brand milk, it is important to consider how the recent price reductions on home brand milk will impact on the price and demand for branded milk. Given that home brand milk and branded milk are ordinarily substitutes for one another it would be expected that a reduction in the price of home brand milk would lead to an increase in the demand for home brand milk and a corresponding decrease in the demand for branded milk.

As the demand for branded milk decreases it would be expected that the price of branded milk would also fall over time in the hope of boosting demand for branded milk. A reduction in the price of branded milk would also eventually lead to lower prices being paid to the milk processors for branded milk and over time would lead to lower farm gate prices being paid to dairy farmers.

More dangerously, however, there is the further risk that given that the price of branded milk is generally significantly higher than home brand milk and that consumers can easily switch to home brand milk it would be expected that over time the market share of branded milk would be reduced as would the product choice available to consumers in relation to fresh milk.

In turn, the reduced market share of branded milk would lead to less shelf being devoted to branded milk and could ultimately even see the removal of branded milk altogether from supermarket shelves. That would undoubtedly be a further major, and potentially fatal, blow to dairy farmers.

What would happen if the demand for branded milk fell significantly?

Inevitably there is a real risk that if the demand of branded milk dropped dramatically then the shelf space currently taken by branded milk would diminish with branded milk either becoming a luxury item that is stocked only in small quantities at much higher prices; or disappearing altogether from supermarket shelves in the same way that other branded products have over time disappeared from the shelves of the major supermarket chains.

Such a reduction in branded milk, when coupled with a reduction of branded products generally, would significantly reduce the level of choice and competition that branded products currently provide for the benefit of consumers. Quite simply the presence of branded products provides suppliers with a degree of countervailing power against the considerable power of Coles and Woolworths and provides consumers with a degree of product choice. Any removal of branded products from supermarket shelves over time would steadily and inevitably remove the countervailing power of suppliers and increase the ability of Coles and Woolworths to both raise prices on home brand products and reduce the product choices that consumers currently enjoy.

List of Recommendations

(1) Establish an Office of the Australian Small Business and Farming Commissioner;

(2) For the relevant Federal Minister to give a direction that the ACCC formally monitor all aspects of the milk supply chain under the prices surveillance part of the *Competition and Consumer Act*;

(3) The relevant Federal Minister to ask the Productivity Commission to quantify the economic impact that the pricing of supermarket home-brand milk is having on (i) the milk supply chain; (ii) the pricing and demand for branded milk within the supermarket sector; (iii) the pricing and demand for long life (UHT) milk within the supermarket sector; and (iv) the pricing of other grocery products;

(4) Require all supermarkets that are greater in size than 2,000 square metres to publish online on a daily basis on their website the prices of all products sold in each supermarket;

(5) Develop a mandatory industry code of conduct under the *Competition and Consumer Act* dealing with relationships between dairy farmers and milk processors;

(6) Impose civil monetary penalties for breaches of mandatory industry codes of conduct under the *Competition and Consumer Act*.

(7) Extend the Australian Consumer Law framework dealing with unfair contract terms to business to business agreements involving small businesses and farmers; and

(8) Amend the *Competition and Consumer Act* to effectively prohibit anti-competitive price discrimination in line with overseas jurisdictions.

Establishing an Office of the Australian Small Business and Farming Commissioner

The establishment of a new Federal Government agency to be called the Australian Small Business and Farming Commissioner would ensure that there was a suitably qualified and independent person with specific responsibility for (i) researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes.

In effect the Australian Small Business and Farming Commissioner would be a “trouble shooter” who would systematically investigate new and emerging areas of disputation in such areas as the Australian dairy industry with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.

The Australian Small Business and Farming Commissioner would be available to assist industry participants to reach a business solution to disputes that arise within the dairy industry. The Australian Small Business and Farming Commissioner would play a distinct and valuable role which is unable to be performed by the Australian Competition and Consumer Commission. While the ACCC should be concerned with identifying and prosecuting breaches of the *Competition and Consumer Act*, there will clearly be instances where the viability of industry participants is the central issue and resolution of that issue needs a business assessment by an independent party such as the proposed Commissioner rather than a legal assessment by the ACCC.

RECOMMENDATION 1:

Establishing an Office of the Australian Small Business and Farming Commissioner

Placing the milk supply chain under the ACCC spotlight

In view of the highly concentrated nature of the milk processing and the supermarket sectors it is appropriate to place the milk supply chain under the spotlight from a competition and consumer perspective. This ongoing scrutiny can be performed by the ACCC and is expressly provided for under Part VIIA of the *Competition and Consumer Act*.

Indeed, under the prices surveillance part of the *Competition and Consumer Act* the relevant Federal Minister is able to the direct the ACCC to "formally monitor" the prices, costs and profits of an industry or specified companies. Such a direction can, for example, be made under section 95ZF of the *Competition and Consumer Act*:

COMPETITION AND CONSUMER ACT 2010- SECT 95ZF

Directions to monitor prices, costs and profits of a business

(1) The Minister may give the Commission a written direction:

(a) to monitor prices, costs and profits relating to the supply of goods or services by a specified person; and
(b) to give the Minister a report on the monitoring at a specified time or at specified intervals within a specified period.

Commercial confidentiality

(2) The Commission must, in preparing such a report, have regard to the need for commercial confidentiality.

Commission to send person a copy of the report

(3) The Commission must send the person a copy of the report on the day it gives the Minister the report.

Public inspection

(4) The Commission must also make copies of the report available for public inspection as soon as practicable after the person has received a copy of the report.

A direction under the prices surveillance part of the *Competition and Consumer Act* has previously been made in relation to unleaded petrol and can quite easily be given by Federal Minister in relation to the milk supply chain. This would represent an important competition and consumer safeguard.

RECOMMENDATION 2:

For the relevant Federal Minister to give a direction that the ACCC formally monitor all aspects of the milk supply chain under the prices surveillance part of the *Competition and Consumer Act*.

Placing the pricing of supermarket home-brand milk under the Productivity Commission spotlight

Whether or not consumers are better or worse off from the price reductions on home brand milk clearly depends on whether or not consumers are paying more for other grocery products. Clearly, if the price reductions on home brand milk are being more than offset by higher prices on other grocery products, then consumers will be worse. In the absence of full price transparency from Coles and Woolworths, consumers have no way of knowing if the price reductions on home brand milk are being offset by higher prices on other grocery products.

The inability of consumers to make informed decisions regarding the price of home brand milk and other grocery products represents a considerable "information asymmetry" and an obvious market failure. In dealing with this market failure it is important that consumers have the benefit of full price transparency regarding the pricing behaviour of the major supermarket chains.

An essential element of full price transparency involves having an independent study to quantify the economic impact that the pricing of supermarket home-brand milk is having on (i) the milk supply chain; (ii) the pricing of branded milk within the supermarket sector and (iii) the pricing of other grocery products. Such an independent study could easily be undertaken by the Productivity Commission and would provide a comprehensive assessment of whether or not the price reductions are being offset by higher prices on other grocery products.

Any commercial-in-confidence concerns that the major supermarket chains would have about providing all their pricing information would be completely addressed by providing the information to an independent body such as the Productivity Commission. The Productivity Commission would be an independent umpire which can objectively assess how the pricing behaviour of Coles and Woolworths is impacting on consumers and those involved in the milk supply chain.

One would even expect Coles and Woolworths to welcome such an independent assessment of their pricing behaviour by the Productivity Commission as both of them keep telling consumers how they are benefiting from "price cuts." The obvious benefit to Coles and Woolworths of a Productivity Commission study of their pricing behaviour is that there would be an independent body verifying their claims and how those claims are actually reflected in the prices of products across the full supermarket range. It is this independent verification of the pricing claims of Coles and Woolworths that would be of considerable benefit to consumers.

A Productivity Commission inquiry could also throw some light on how the current pricing of home brand milk also impacts on the pricing, and current and future demand for branded milk. As the pricing and demand for branded milk inevitably impacts on its future availability on the supermarket shelf, it is important that an independent assessment is undertaking of the whole issue of branded milk. Importantly, consumers need to be made aware of possibility of losing access to branded milk over time and how this may impact on their product choice in relation to fresh milk over time.

Similarly, it is important that any independent study into milk undertaken by the Productivity Commission include a review of the pricing behaviour along the milk supply chain. With a lot of public finger pointing between the major supermarket chains and the milk processors as to the pricing of fresh milk it is important that various claims and counter claims being made are independently assessed.

Finally, the Productivity Commission could also assess the impact that the supermarket pricing behaviour regarding fresh milk may also have on the price and demand for long life (UHT) milk. Given that a reduction in the availability of fresh milk may lead to price rises on fresh milk over time, it is important to assess how changes in the pricing of fresh milk could impact on the price and demand for long life (UHT) milk.

RECOMMENDATION 3:

The relevant Federal Minister to ask the Productivity Commission to quantify the economic impact that the pricing of supermarket home-brand milk is having on (i) the milk supply chain; (ii) the pricing and demand for branded milk within the supermarket sector; (iii) the pricing and demand for long life (UHT) milk within the supermarket sector; and (iv) the pricing of other grocery products.

The need for full price transparency from the major supermarket chains

Australian consumers remain the ongoing victims of “information asymmetries” in relation to supermarket pricing. In particular, Australian consumers are being denied full price transparency by the major supermarket chains.

While Woolworths has previously included a few thousand products online through its “price check” website, the pricing information on Woolworths website was only for a fraction of the upwards of 20,000 or more products typically sold at a Woolworths supermarket. Worse for consumers the pricing information on the Woolworths “price check” was updated only once a week. The Woolworths website even stated that if the standard shelf price changed during the week, the new shelf price on the website would only be updated the following Monday. The Woolworths price check website is currently “under review” and so consumers cannot presently access the website.

So while there is information online regarding weekly specials at a Coles and Woolworths, the real question is what about the prices of the many thousands of other products sold at a Coles and Woolworths supermarket that are not found online. Clearly, Coles and Woolworths continue in their failure to provide full price transparency to consumers.

There three basic reasons why is it important for consumers to get full pricing transparency from Woolworths and Coles:

(i) First, Woolworths and Coles may still charge different prices for the same product in each of their respective stores in the same geographic area. In the absence of full online price transparency, consumers lack access to comprehensive and up to date pricing data on which to make informed pricing decisions. Indeed, in the absence of full online price transparency, the only way that consumers can ever know where to find the cheapest price for a particular product is to conduct their own “searches” or rely on emerging price comparison websites. Both alternatives fall well short. Given the many hundreds of supermarkets operated by Coles and Woolworths it is clear that consumer searches would be futile as the cost to the consumers of conducting their own searches would be prohibitive. Similarly, in the absence of cooperation from Coles and Woolworths, the cost to price comparison websites of conducting their own searches would also be prohibitive;

(ii) Second, by having access to full pricing information consumer can shop more efficiently and cost effectively. Having access to timely online pricing information in advance of a shopping trip means that consumers could, if they so wished, shop strategically so as to buy different products at the lowest price from different supermarkets within the same shopping centre or precinct;

(iii) Third, having access to full pricing information allows consumers to track prices on an historical basis. In doing so, consumers would be able to identify trends in the pricing of particular products, as well as overall prices across the supermarket. In short, by having access to full pricing information consumers would be able to track the pricing of different products over time and across the supermarket so as to determine if they are better or worse off as a result of price changes on individual products or groups of products.

The lack of full price transparency is just another example of where Australian consumers are well and truly behind overseas consumers. Not only do Australian consumers consistently face some of the highest levels of food inflation in the developed world, but United Kingdom consumers have the benefit of the mysupermarket website (http://www.mysupermarket.co.uk/). Consumers in the United Kingdom can access online pricing information that is wide-ranging and regularly updated.

In contrast, Australian consumers are currently being denied access to full pricing transparency by Coles and Woolworths, as well as other major supermarket retailers. In such circumstances, is answer is simple. In the absence of the major supermarket chains and retailers voluntarily providing full pricing information online on a timely basis, that all supermarkets that are greater in size than 2,000 square metres be required to publish online on a daily basis on their website the prices of all products sold in each supermarket.

RECOMMENDATION 4:

Require all supermarkets that are greater in size than 2,000 square metres to publish online on a daily basis on their website the prices of all products sold in each supermarket.

Promoting transparent business relationships between dairy farmers and milk processors

Given the ongoing relationship between milk processors and dairy farmers it is important that there is full transparency between the two groups regarding the immediate and future challenges in their business relationship. It is also important that dairy farmers and milk processor have access to timely and cost effective dispute resolution processes.

A framework for full transparency and timely and cost effective dispute resolution could be usefully provided by a mandatory dairy industry code of conduct under the *Competition and Consumer Act*. Such a mandatory code could be drafted following industry consultation and overseen by the proposed Australian Small Business and Farming Commissioner.

RECOMMENDATION 5:

Develop a mandatory industry code of conduct under the *Competition and Consumer Act* dealing with relationships between dairy farmers and milk processors.

Promoting full compliance with industry standards of conduct

A failure to comply with a requirement of the mandatory industry code of conduct under the *Competition and Consumer Act* would clearly be a breach of the Code and, more dangerously for industry participants undermines the effectiveness of the particular industry code. Unless there is an appropriate deterrent to prevent breaches of an industry code, it is clear that aspects of a so-called mandatory Code could simply be ignored.

Given the importance of ensuring full compliance with a mandatory industry code of conduct under the *Competition and Consumer Act* it is appropriate to impose civil monetary penalties for breaches of such codes. Such penalties would be imposed by a Court following, for example, legal action by the ACCC, or alternatively by the proposed Australian Small Business and Farming Commissioner who could be given the power to enforce mandatory industry codes impacting on business relationships involving small businesses and farmers.

RECOMMENDATION 6:

Impose civil monetary penalties for breaches of mandatory industry codes of conduct under the *Competition and Consumer Act*.

Dealing with unfair contract terms in business agreements in the Australian dairy industry

Ensuring proper judicial scrutiny of unfair terms in business to business agreements involving small businesses and farmers would go a long way to promoting better business relationships within the Australian dairy industry. Such judicial scrutiny of unfair contract terms is currently lacking and unfortunately can act as a green light to, for example, milk processors that are intent on including contract terms that go beyond what is reasonably necessary to protecting their legitimate interests. In such circumstances, the new national legislative framework against unfair terms in consumer contracts could quite easily be extended to deal with unfair terms within business to business agreements.

Craig Emerson's reversal of Chris Bowen's and Federal Cabinet's endorsement of the need to include small businesses in new laws against unfair contract terms

A major omission from and, therefore, a major flaw in the Australian Consumer Law approach to unfair contract terms relates to Craig Emerson's decision, upon becoming Minister for Competition Policy and Consumer Affairs, to reverse the previous Minister's (Chris Bowen) position regarding the inclusion of small businesses under the new laws against unfair contract terms. In effect, Craig Emerson had decided to exclude small businesses altogether from the protection to be given to consumers under new laws against unfair contract terms contained in the new Australian Consumer Law.

The following is a summary of the issues arising under the Australian Consumer Law in relation to unfair contract terms in business to business contracts involving small businesses and farmers.

Under Minister Bowen's proposals, small businesses would have been included in the unfair contracts proposals if the standard form contract was for $2 million or less. Importantly, Minister Bowen's proposals were intended to provide both "consumers and small businesses" with protection from unfair contract terms.

In his media release of 5 June 2009 Minister Bowen stated:

> "Last year, COAG agreed that Australia should have a national unfair contract terms law and the Government is committed to ensuring that consumers and small businesses can access protection from unfair contract terms," Mr Bowen said."[1]

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[1] Minister Bowen's media release can be accessed at:
http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/060.htm&pageID=003&min=ceb&Year=&DocType=

Minister Bowen's proposals would have excluded standard form contracts above $2 million. This was noted by Minister Bowen in his media release where the Minister stated that his unfair contract proposals would include:

> "…an exclusion of a standard-form contract where the upfront price payable for the services (including financial services), good or land supplied under the contract exceeds $2 million;"[2]

However, on becoming Minister for Competition Policy and Consumers Affairs, Craig Emerson announced that small businesses would be excluded altogether from the new laws against unfair contract terms to be introduced into Federal Parliament. In his media release dated 24 June 2009 Craig Emerson stated:

> "The Bill will also introduce a national unfair contract terms law that will apply to standard form business-to-consumer contracts.
>
> In relation to business-to-business contracts, the Government is currently reviewing both the unconscionable conduct provisions of the Trade Practices Act and also the Franchising Code of Conduct.
>
> Since these reviews relate to business-to-business contracts, the Government will consider the issue of business-to-business standard form contracts when these reviews are complete."[3]

By applying the laws against unfair contract terms only to business to consumer contracts, Craig Emerson had changed the Federal Government's previous position and excluded small businesses altogether from the new laws against unfair contract terms.

Craig Emerson's decision to remove small businesses from the new laws against unfair contract terms was extremely disappointing given Federal Cabinet's previous endorsement of Chris Bowen's decision to apply the unfair contract proposals to both consumers and small businesses.

Craig Emerson's change of position is particularly troubling for a number of reasons. First, and most importantly, Craig Emerson's decision runs directly contrary to the position of the previous Minister (Chris Bowen), as well as the Federal Cabinet, who had all agreed that the new laws against unfair contract terms needed to apply to both consumers and small businesses.

The position of Chris Bowen and the Federal Cabinet to include small businesses in the new laws against unfair contracts proposals was reached after extensive consultation, but sadly was reversed by Craig Emerson within only 3 weeks in circumstances where the level of consultation by Craig Emerson, if any, could have only have been a very small fraction of the very extensive consultation undertaken to reach the previous Federal Cabinet-

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[2] Ibid
[3] Minister Emerson's media release can be accessed at:
http://www.craigemersonmp.com/files/Jun%2024%2009%20Consumer%20Law%20Billl.pdf

endorsed decision to include small businesses in the unfair contracts proposals.

Put simply, there was no justification for Minister Emerson's decision to exclude small businesses as there are more than enough safeguards in the new laws against unfair contract terms to maintain business certainty, while still giving small businesses a new and effective avenue to be able to challenge unfair contract terms.

There are ample safeguards in the new laws against unfair contract terms to strike an appropriate and objective balance between the ability of larger businesses to protect their legitimate business interests and the ability of small businesses to challenge unfair contract terms. These safeguards include:

(i) a term is 'unfair' only when it causes a significant imbalance in the parties' rights and obligations arising under the contract and it *is not reasonably necessary to protect the legitimate interests* of the larger business. The new laws against unfair contract terms do not prevent a larger business from protecting its legitimate business interests. This is the most important safeguard as the larger business is able to protect it legitimate interests. It is only when the larger business goes beyond what is reasonably necessary to protect its legitimate interests that the term becomes unfair. This safeguard alone is more than sufficient to allay the ill-conceived and irrational fears by larger businesses and their legal advisers regarding the new laws against unfair contract terms;

(ii) the new laws only relate to standard form contracts. These are offered on a take-it-or-leave-it basis. If the contract is not a standard form contract it will not be covered by the new laws against unfair contract terms.

(iii) some terms will not be able to be challenged under the new laws. These relate to:

- the main subject matter of the standard-form contract;
- the upfront price payable under the standard-form contract;

(iv) the new laws only operate in relation to contracts entered into or varied after the commencement of the new laws.

When these safeguards are all considered together they enable larger businesses to protect their legitimate business interests while allowing small businesses the ability to challenge only those terms that go beyond what is reasonably necessary to protect the legitimate business interests of the larger business.

In short, an effective legal framework for dealing with unfair contract terms in a business to business context involving small businesses or farmers would promote better business relationships within the dairy industry. Since there are currently no Federal laws dealing with unfair contract terms in business to business context involving small businesses or farmers, it is clear that there is a considerable gap in the law which has long disadvantaged small businesses and farmers by denying them an avenue for challenging unfair terms in their contracts with larger businesses.

RECOMMENDATION 7:

Extend the Australian Consumer Law framework dealing with unfair contract terms to business to business agreements involving small businesses and farmers.

Prohibiting anti-competitive price discrimination

While anti-competitive price discrimination is a form of anti-competitive conduct intended to be covered by section 46 of the *Competition and Consumer Act*, it remains a problem area given the current ineffectiveness of section 46. Indeed, the repeal of section 49 of the then *Trade Practices Act* in 1995 was premised on s 46 being adequate to deal with anti-competitive price discrimination. Unfortunately, section 46 has completely failed to live up to expectations in this regard, and consequently, Australia presently does not have an effective prohibition against anti-competitive price discrimination. This current lack of an effective prohibition against anti-competitive price discrimination is detrimental to competition and consumers and is out of step with international competition laws.

Price discrimination in the dairy industry can have an anti-competitive impact where lower wholesale prices that milk processors charge Coles and Woolworths for home brand milk lead to the milk processor charging higher wholesale prices for branded milk, especially to smaller retailers. Clearly, there is a level of return that a milk processor requires and, therefore, the lower the wholesale prices paid by Coles and Woolworths for home brand milk, the higher the wholesale prices that milk processor will charge smaller retailers for branded milk to make up for the lower returns or shortfall from Coles and Woolworths. Inevitably there is a cross-subsidy being paid by smaller retailers for branded milk to fund the lower wholesale prices at which milk processors sell home brand milk to Coles and Woolworths.

With smaller retailers at a substantial competitive disadvantage because of the higher wholesale prices they pay for branded milk, Coles and Woolworths need not compete as aggressively on the price of branded milk as they would have to if the smaller retailers were not faced with price discrimination at the wholesale level. Thus, in the absence of price discrimination at the wholesale level smaller retailers would provide a stronger competitive constraint on Coles and Woolworths at the retail level for the benefit of consumers.

Clearly, there is a very real danger that price discrimination in the wholesale market for milk is deterring or preventing competitive conduct in the retail market in a way that is substantially detrimental to consumers. In short, price discrimination at the wholesale level can be anti-competitive in that a smaller retailer is simply unable to compete as aggressively as possible in the retail market because of the price discrimination it faces at the wholesale level. Consequently, consumers are denied the benefits of vigorous competition between large and small retailers.

Needless to say, if smaller retailers are unable to be competitive because of price discrimination, or more precisely as a result of being forced to pay a higher wholesale price for branded milk in comparison to Coles and Woolworths, there is a further and very real danger that the smaller retailers will go out of business, thereby further reducing competition.

Where anti-competitive price discrimination is present, it should be dealt with under the *Competition and Consumer Act*. Given the continued ineffectiveness of section 46 it is appropriate to amend the *Competition and Consumer Act* to deal specifically with anti-competitive price discrimination. Such an amendment would be directly consistent with a number of international precedents including the United States *Robinson-Patman Act of 1936* and section 18 of the United Kingdom *Competition Act 1998*:

> **18.** - (1) Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in-
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;…
>
> …
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; …

RECOMMENDATION 8:

Amend the *Competition and Consumer Act* to effectively prohibit anti-competitive price discrimination in line with overseas jurisdictions