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Australian
**Small Business and
Family Enterprise**
Ombudsman

10 October 2016

Mr Mark Fitt
Committee Secretary
Senate Economics References Committee
PO Box 6100
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Fitt

INQUIRY INTO THE AUSTRALIAN DAIRY INDUSTRY

Our office has been involved in the various issues in the Australian dairy industry from a small business and family enterprise perspective. We have participated in:

- the Dairy Symposium chaired by the Deputy Prime Minister and Minister for Agriculture and Water Resources, the Hon. Barnaby Joyce MP (25 August 2016) that brought together industry participants and focused on the challenges facing the Australian dairy industry; and
- a follow up workshop with State Farmer Organisation Presidents and Processors chaired by Mr John McQueen, Interim CEO, Australian Dairy Farmers Limited (27 September 2016) to improve contractual practices and balance risk along the supply chain in the industry. The workshop commenced work on the development of a *Code of Best Practice on Contractual Relationships* and some of our observations are informed by the discussion and progress made at that workshop.

We also look forward to participating in the Australian Competition and Consumer Commission's inquiry into the dairy industry requested by the Treasurer, the Hon. Scott Morrison MP that will explore *inter alia* supply chain issues and contracting practices.

Approach

In this submission, we provide our views in relation to contracting practices in the Australian dairy industry that we believe are critical to ensure its long term health and growth.

We believe that the industry has already commenced initial steps to address the critical issues that it faces and, in response, begin the development of a *Code of Best Practice on Contractual Relationships*.

Our overall position is that industry issues are best addressed, wherever possible, by the participants in the industry. This approach should ensure a solution that is fit-for-purpose, is "owned" by the industry, and is focused on developing and growing the industry to remain competitive in international markets.

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Key issues

In considering the issues that the dairy industry faces, it is important to recognise that there is segmentation in dairy market/s that chiefly relates to fresh milk v. milk solids, and domestic markets (also taking into account regional differences) v. international markets.

We see three broad issues that impact across the market segments that are of critical importance to your inquiry, namely:

1. There is a lack of clarity and certainty around price within supplier agreements and contracts, and this results in risks being borne by those least able to manage the risks (particularly in relation to retrospective changes);
2. There is a lack of price signalling that is visible and communicated across the industry so that trends and opportunities are unclear and not understood (this has become a more important issue as pricing has become more volatile); and
3. Contracting practices are poor with contracts not being openly negotiated and lacking flexibility and transparency (such as, contracts that inappropriately lock in small businesses to particular processors).

We also recognise that these and other issues cause a significant impact on the mental and physical health of farmers, their families and others involved in the industry.

Pricing clarity and certainty

Participants in the dairy industry have recognised that there needs to be a focus on risk sharing along the supply chain, principally:

1. Contracts need to set out a clear price, pricing mechanism and/or price notification processes (this includes that there is appropriate notification and transparency in retrospective price step-downs, if such step-downs are necessary); and
2. There needs to be an appropriate sharing of risk by those most able to manage risk (the resetting of this risk can potentially be managed through a range of measures such as hedging and improved contracting practices – see below).

Price signals

The dairy industry has recognised that there is a need for better price signals and is working on an index to assist in communication of trends and facilitate business decision making. This should be accompanied by assisting farmers to understand and apply that price information.

Contracting practices

The industry has recognised that there is a need for greater fairness and transparency in contracting practices (and in negotiating contracts). This involves redrafting contracts to



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ensure that they are clear, realistic and easily understood, and address current contracting issues such as:

- The ability for processors to unilaterally terminate milk collections and processing;
- Loyalty payments operating in a way so as to unnecessarily lock-in farmers to a particular processor;
- Volume and exclusivity arrangements limiting farmer ability to sell excess milk to other processors;
- Unreasonable notice of termination periods; and
- Lack of notice, transparency and negotiation of contract variations.

It is also important for the industry that contracts have clear dispute resolution clauses that facilitate dealing with issues in an efficient, timely and low-cost manner. We recommend that alternative dispute resolution clauses be introduced into all agreements.

It is also important to monitor how the unfair contract terms legislation applies to industry contracts. Given that milk prices are generally set on a daily basis, there is an argument that the contracts are effectively separate daily (standard form) contracts that would each fall within the \$300,000 threshold. If this is the case, a number of existing contractual terms may be made void, such as clauses that provide for:

- limited (or no) notice of price and service changes;
- contract lock-in; and
- unilateral contract variation.

Way forward

At the meetings that 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 recognised that this means improving the way that it operates within the current structures and moving to improve the way that 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.

Please let me know if you would like us to clarify or expand on anything issues.

Yours sincerely

Kate Carnell AO

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