1	Written	Xenophon	Australian Dairy Farmers	You have stated in a media release that the market share of the supermarkets' private label milk has doubled since the 1999–00 financial year. What direct impact on the dairy industry has this had?

The share of domestic supermarket sales of drinking milk accounted for by private label products has risen from 22% of sales in 1999/2000 to around 50% in 2009/10.

More particularly in the case of plain fresh white milk, the share of supermarket sales accounted for by private label (home brand) lines has risen from 27% in 1999/2000 to around 70% at present. With modified milks the growth in private label sales has also been significant, but they currently hold a smaller share of supermarket sales in this category. Private label sales account for around 40% of modified milk sales in 2009/10.

Processors and dairy farmers who supply the drinking milk market rely on the margin from branded milk sales for their profitability as industry returns and margins on private label sales are significantly lower (or non-existent) than those achieved on branded product sales. Competition from unsustainably priced Coles home brand milk is taking market share away from branded products and has caused a net reduction in per unit industry returns and margins on domestic sales of drinking milk. The Coles action is an unwarranted escalation that reflects supermarket trends in discounting private label milk over the last ten years. The resultant reduction in revenue has placed downward pressure on both company and farm gate returns from drinking milk sales which has already seen the loss of value to the supply chain grow to more than $414 million per annum over the last decade.

This reduces the amount farmers receive from processors as an increased share of Coles private label milk is being sold at little or no margin and less of the more sustainably priced branded milk is being sold.

Many Queensland farmers whose milk payments are linked to branded milk sales have already seen their milk cheques drop this month (March) by thousands of dollars per farmer due to the recent unsustainable price discounting by Coles down to 1992 prices of $1 per litre.

Processors make little or no profit on private label milk sales. A long-term increase in the sales of private label milk will see further flow-on effects to farmers as Coles, due to its market power, dictates the price at which suppliers sell to them.

Coles' price strategy has been teamed with aggressive public and in-store marketing which sees them dominate shelf space leading to less choice for customers. This vicious cycle continues until in the long-term there is almost absolute domination by home brands with almost no customer choice or product innovation and worst of all for the customer – a likely increase in the price of their home brand milk once Coles' has achieved its goal of market dominance.

An inevitable consequence of Coles' action, if sustained, will be that the overall retail value of drinking milk sales will decline substantially (potentially by hundreds of million dollars per annum). This, in turn, must lead to reduced margins and income for a wide range of businesses (including milk vendors, corner stores, distributors, dairy manufacturers, other supermarkets and dairy farmers).

Stripping money out of a supply chain, over time, will build the pressure on the more vulnerable members of that chain to accept lower prices. Historically farm suppliers have borne a large part of such risk. As Coles' move will result in lower processor margins and take significant value from the dairy supply chain it must put pressure back on future farm gate prices, incomes and rural communities.

At a processor level one response to these developments has been that companies have increasingly focused their marketing and product development strategies around modified, flavoured and UHT milk lines. This reflects the fact that these product lines provide a higher margin on sales. While the trend therefore could be said to have encouraged increased innovation within the dairy industry in the area of modified and flavoured milks, a further shift in sales channels towards private label sales, based on discounted pricing, will put this innovation at risk and increase the downward pressure on industry returns and viability in major drinking milk production regions.

2	Written	Xenophon	Australian Dairy Farmers	a) Why has national milk production decreased from 11 billion litres in 2004 to 9 billion litres in 2011? b) Are similar trends being experienced in other countries? c) How have farmers increased efficiencies and production since deregulation? d) What scope is there for further efficiencies?	

*(a)*There have been a number of factors that have been drivers of the decline in national milk production from 11 billion litres in 2001/02 to 9 billion litres in 2011.These include:

- The negative impact of adverse climatic conditions across many production regions in a number of years (e.g.2002, 2003, 2005, 2006 and 2007) including droughts, floods and cyclones. These saw herd losses, and drastic shifts in the availability and pricing of key farm inputs and farm profitability to the detriment of dairy farming;
- The flow-on effects of the final deregulation of drinking milk pricing arrangements in 2000 on farm profitability in certain regions;

- The negative impacts of the Global Financial Crisis on farmgate returns in 2008/9 , and an associated rise in farm indebtedness;
- Increased competition for land use in different regions; and
- Rising uncertainty over future access to key resources (and the cost of such access) due to regulatory and policy changes in relation to water, climate change, etc.

Of these drivers adverse seasonal conditions (and their associated impact on farm debt, profitability and confidence) are likely to have accounted for a significant part of the decline in national production. For example; milk production in Victoria fell from a peak of production of 7.4 billion litres in 2001/02 to 5.8 billion litres in 2009/10. A significant part of this decline occurred in 2002 and 2003, where drought conditions saw production in irrigated dairy farms in that state fall by 900 million litres.

One ramification of these changes has been the increased importance of domestic market sales to overall dairy industry returns, particularly in the key drinking milk markets of Queensland, Northern NSW, Western Australia and to a lesser extent South Australia. Coles' actions directly affect these key drinking milk markets.

The Coles decision has been identified as a major factor affecting farmer confidence and their willingness to reinvest in their businesses (following the floods and cyclones). Evidence to the Committee has shown that it has damaged farmer morale far more than the drought, floods or Cyclone Yasi.

This unnecessary blow to farmer confidence comes at a critical time for the dairy industry. If unchecked, it could easily translate into a downward spiral in regional milk production. This will bring further, painful regional adjustment.

It is also likely to add unnecessary uncertainty and volatility to regional industry planning. A further decline in local milk supply in Northern and Western Australia is not consistent with the expected growth in medium term demand for drinking milk as the regional population expands. This suggests that the current Coles' strategy is both short sighted and likely to be self defeating.

Shortfalls in regional milk supply in coming years will have to be met either by offering much higher farm gate prices to local farmers to significantly expand or re-start businesses, or by increased long distance transporting of milk (at additional costs of up to 25 cents per litre) to meet demand. The resulting wholesale prices under either of these outcomes will certainly not fit within Coles' planned retail price structure.

Consumers, therefore, can expect to face renewed and greater price increases than would be the case if local producers and processors had been offered a more sustainable pathway forward.

(b) Total world milk production has grown on average by 2% over the past decade, although this rate of growth has slowed in more recent years. Global milk production growth in 2009 and 2010 has averaged 1% per annum.

There are no consistent trends in milk production across major producing countries.

Milk output in the European Union has been stable, but this reflects the ongoing application of production quotas in its member countries. Milk production has expanded, in the US and New Zealand, although there have been significant regional variations in production in these countries. Production has expanded in a number of emerging dairy nations such as China and Latin America. Production in major import markets such as Japan and Russia has declined in the last decade. Milk production in India has generally trended upwards although with some sizeable variations between years depending on seasonal conditions.

*c) A*ustralian farmers have adopted many farm practice changes to improve efficiency and maintain farm resilience in the face of more volatile and, at times, extremely adverse production conditions over the past decade. There have been major changes in farm production systems, to deal with increased volatility and complexity. This includes changing feed systems, water use practices and diversifying farm feed bases as well as further pursuit of scale economies in farm systems. The industry continues to promote genetic improvement of the herd in order to raise feed conversion efficiency, sustainability and profitability. It has also applied a range of new business management systems in order to maximise farm resilience.

Average milk production per cow has almost doubled over the last twenty years in Australia. Australian dairy farmers are among the most efficient in the world and operate without subsidies or tariffs unlike many other dairy producing nations in the world.

*(d) G*iven the pressures on farm profitability over the past decade and the expectation of ongoing volatility in both output and key input prices and margins, the dairy industry recognises the need to continue to focus on efficiency gains to both maintain farm viability and sustainability. The industry is currently investigating and adapting a range of new technologies as a way of insuring continued productivity gains in an uncertain operating environment. This includes automated milking systems, methane abatement and the use of gene marker technology to improve herd efficiency and milk conversion and to develop improved pasture and feed crops.

It should be noted that if prices supplied to dairy farmers are unsustainable, particularly in the key drinking milk markets of Queensland, Northern NSW and Western Australia, the first thing to suffer will be investment in innovation as farmers struggle to keep their farms operating. This consequence of Coles’ actions will soon be felt in these key markets and may cause long term damage to an industry already struggling from one of the worst droughts in Australia’s history, floods and Cyclone Yasi.

3	Written	Xenophon	Australian Dairy Farmers	Are you aware of any other times the major supermarkets significantly cut the prices of their dairy products or other fresh products for a sustained period? If so, what were the effects?	

Since dairy is a nutritious, healthy and established staple of the Australian diet, local supermarkets have periodically used dairy products, and specifically drinking milk, as a loss leader product to promote sales within their stores.

There are examples of previous price cutting by supermarkets (e.g. Woolworths and Coles price cuts of 2010 noted in the Coles Submission to the Milking it for All its Worth inquiry in 2010). However, Coles' current price cuts, if allowed, are set to be the most sustained move to permanently reduce the retail price of dairy products in Australian supermarkets. This makes it difficult to provide a historical comparison of the effects on dairy consumption of prolonged discounting by individual supermarkets.

However, two keys points to note in relation to this are:

(1) The measured ABS consumer price index for dairy products has been stable for the last two years. In this time dairy consumption has basically moved in line with domestic population growth (i.e. per capita consumption of dairy has remained stable; and
(2) Many economic studies of price elasticity show drinking milk demand to be extremely price inelastic. Recent World bank studies identified milk as having the lowest price elasticity of demand of all major agricultural products.

These findings are consistent with industry expectations that aggressive price discounting of drinking milk will have minimal impact on overall consumption within Australia, although the impacts on farm production and dairy farming families will be much greater.

Coles, and their parent company Wesfarmers, understands the above but continues to misrepresent the case regarding the elasticity of milk consumption in their strategy to use milk as a loss-leader and devalue it as a product.

Their unsustainable price cuts are fundamentally devaluing milk as a product, the last time milk was prices at $1 per litre was in 1992, and will, if allowed to continue, re-base the price of drinking milk in the long term at an unsustainable level and cause significant damage to the dairy industry, particularly in the key drinking milk markets of Queensland, Northern NSW and Western Australia.

4	Written	Xenophon	Australian Dairy Farmers	Do you think it is likely that processors will cut the price of their branded milk in an attempt to maintain market share? What influence do they have on its price on the supermarket shelf?	

The supermarket pricing policy has already resulted in declining sales of branded fresh milk products which is impacting some farmers now as their profits are linked to sales of branded products. For milk processors the ramifications of this drop are highly variable and lowering the price of branded milk is but one possible strategic response. A reduced margin means a reduced profit unless additional sales are achieved at the same time. This is particularly difficult given the lack of elasticity of demand and the perishable nature of milk.

However, there is already evidence that domestic processors are discounting the price of selected branded milk products in supermarkets in order to minimise the loss of sales revenue and market share in the face of substantial discounting of comparable private label lines.

It is difficult for ADF to assess the level of control that processors have on the pricing of branded product lines on supermarket shelves. These prices are subject to private commercial arrangements between processors and supermarkets, which also incorporate allowances relating to in store promotions, shelf location, freight and distribution. There is not the transparency at the retail level in the supply chain that there is at the farmgate level.

However, we would expect that the decision to discount current branded product lines in supermarkets would have been made by processors who would be absorbing the loss of branded sales income while the supermarkets maintain their margins. That is, it will be processors who are wearing the lower returns from discounting of branded product lines, and ultimately the dairy supply chain that will have to bear this reduction in overall revenue, meaning a further drop in farmer's incomes.

Further, milk processors do not have a range of literally thousands of products, as Coles does, which can be sold at prices to cover the losses associated with the sale of their discounted private label dairy products. The end result for the processors is less profitability and fewer funds to invest in developing new products.

In a normal market setting it could be said that the processors have a large role in setting milk prices on the supermarket shelf. However, the processors cannot compete with supermarkets in subsidising milk prices. They simply don't have the range or volume of product over which they can effectively defray the cost of low margins and given Coles' large retail market share and control of that market it is not possible to dictate supply of an inelastic, perishable product such as milk.

Processors also cannot compete with Coles marketing in an attempt to protect market share of their branded products. Coles not only has a much larger marketing budget than any processor but also controls the store and the shelf space on which the products sit – a huge marketing advantage that processors simply cannot overcome.

Given that processors make little or no margin on supermarket private label sales, and the impact of the Coles price cuts is a further shift in market share towards private labels, the increased downward pressure on industry returns will put at risk the viability of major drinking milk production regions as well as product and on-farm investment and innovation.

5	Written	Xenophon	Australian Dairy Farmers	Don't Coles and Woolworths need a guaranteed long-term milk supply? Wouldn't they need to pay a price to processors that is a high enough level to ensure that the price paid to farmers means they are profitable and encourages them to keep producing drinking milk?	

ADF strongly agrees that major supermarkets such as Coles and Woolworths, require a guaranteed long term milk supply in order to effectively meet the needs of Australian consumers of drinking milk unfortunately Coles' short-sighted marketing tactic to drop the price of milk to 1992 levels risks not only damaging the dairy industry in the long term but also the supply of drinking milk in key affected markets.

To secure this supply the supermarkets must pay a price to processors that is sufficient to ensure farmers receive a return that warrants their continued investment in dairy production in those regions of Australia that heavily depend on domestic drinking milk sales such as Queensland, Northern NSW and Western Australia.

Given the nature of drinking milk - a perishable, short shelf life product that has limited international trade opportunities - it is not feasible to assume that farmers and processors can automatically divert significant volumes of milk away from the domestic drinking milk market in the absence of a reasonable return for their milk supply.

It must be noted that the pricing for drinking milk processors and their farm suppliers must take into account the fact that drinking milk sales are generally constant over the year. To meet this demand farmers must produce drinking milk using production systems that deliver a flat stable supply of milk all year round. These systems embody production costs which are higher than those required to seasonally produce milk that is used to manufacture products that are traded against the international dairy market.

Coles and Woolworths need a guaranteed long-term milk supply. But ultimately, due to their market power, if they effectively control retail milk sales they will always dictate pricing and supply conditions. If the price of milk becomes higher through scarcity, the supermarkets will still have price control through volume and are powerful enough in the market place to underwrite necessary supply.

As mentioned above milk is also a perishable product that cannot be stored for any period of time and farmers cannot 'turn-off' production as some suppliers can. This means that it makes it even more difficult for farmers to exercise control in the short-term over the supply of drinking milk.

In the United Kingdom retailers have almost total control of the vertical supply chain from farm to store after having pushed out the vast majority of branded milk competition. This appears to be one of Wesfarmers and Coles' aims with its unsustainable price cuts and they clearly have little or no concern for the harm they cause to dairy farming families or drinking milk supplies through this strategy.

6	Written	Xenophon	Australian Dairy Farmers	a) Where is the milk that is sold in cities such as Darwin and Alice Springs produced and processed? b) Do you have any insights into the freight costs and any other costs associated with this? c) Who bears these costs?	

(a) Milk for remote locations such as Darwin and Alice Springs is produced and processed in Queensland and Northern NSW.

(b) Depending on the distance hauled, the additional freight charge for "long haul" milk varies between 18 cents and 23 cents per litre.

(c) The additional cost is typically shared between the manufacturers/processors and the retailers

7	Written	Xenophon	Australian Dairy Farmers	Coles have said that they are 'fully absorbing the price cut' and that there is 'no justification for a reduction in farmgate prices from processors now or in the medium term'. On the other hand, a number of submissions have claimed that when contracts are renegotiated Coles will decide not to absorb the price cut and will pressure processors to accept a lower price. If Coles are able to influence prices in this way and pay less to processors, why have they not always done so?	

ADF certainly does not believe that Coles is going to absorb the cost. ADF believes that Coles' customers and those at the start of the chain – dairy farmers are paying or will ultimately pay for these unsustainable price cuts.

It should also be noted that Coles has repeatedly refused to rule out dropping prices for processors and farmers in future contracts.

Associate Professor Frank Zumbo from the School of Business Law and Taxation at the University of New South Wales in an article in the Newcastle Herald on 9 March 2011 made a very pertinent statement regarding the potential impacts on Coles' customers.

'While Coles has said it has reduced the price of 5,000 products, it has been silent on what has happened to the price of the 15,000 other products sold in a supermarket. Again, consumers would lose out to the extent that the increases in the 15,000 non-milk products were greater than the reduction in the price of home brand milk.'

This aggressive discounting has happened before in the United Kingdom where the key executives Wesfarmers headhunted to implement Coles marketing strategy are from.

An article in the Business Spectator from 7 February 2008, sums up this team of British executives and Mr McLeod's primary goal perfectly, stating it is 'creating operating environments in which to relieve customers of their disposable income.'

ADF believes that the Coles' executives are here with the intent of replicating the UK model. It ultimately leads to less choice, higher prices for customers and unsustainable pressure on farmers.

According to the general manager of FUELtrac (a fuel monitoring agency), Geoff Trotter, petrol prices rose by up to 15 cents per litre on the weekend of January 29 and 30, just days after Coles announced its price cut on Australia Day. ''I think there is a connection between their grocery activities and their petrol activities,'' Mr Trotter told AAP. ''If there is an opportunity for them to cross-subsidise, if they are giving away margin on bread and milk, fuel is a wonderful way to recover that margin."

Associate Professor Frank Zumbo from the School of Business Law and Taxation at the University of New South Wales in an article dated 16 February titled ‘Don’t be fooled, the supermarkets are milking us’, stated that, “The sceptical customer will ask if the major supermarket chains are listening to consumers on the price of other products. We have seen petrol prices shoot up opportunistically despite the strong Aussie dollar and the Singapore benchmark price we use to calculate local prices having remained consistent in recent weeks. Yes, international crude oil prices have jumped but local prices are instead linked to the refined price of petrol out of Singapore. So petrol prices have jumped quickly and the major retailers have been able to increase their average retail petrol profits during the past year.” And, “This is the old “loss leader” trick. Get customers hooked by a super special and then fleece them on other products. It’s the oldest trick in the book and consumers shouldn’t be fooled.”

Dairy Australia estimates that private label (home brand) sales now match or slightly exceed those of processor branded lines. Private label products offer lower margins to milk processors compared to branded products.

Processors have been able to reduce the level of private label penetration in the modified and flavoured milk categories by product differentiation based on fat content and added nutrients etc. If sales of private label milk continue to climb due to Coles’ recent unsustainable price cuts, further eroding profitability for suppliers, then the ability of the industry to innovate through product development will be severely compromised for the drinking milk category.

Processors are in a difficult position in that the major supermarkets now control over 50% of all drinking milk sales nationally through supermarkets and the route trade and of all milk sales through supermarkets more than half of that is made up of supermarket store brand sales. As such the major super markets now control the main avenue for the sale of the processors proprietary brands to consumers as well as controlling a larger and larger volume of milk sales under their own supermarket brands which processors also need to bid for to sell milk.

Coles does have a material influence on milk prices, as other retailers dropped their prices to $1 per litre and less for their store brands after Coles dropped its price of Coles branded milk to $1. This devaluation or downward pressure triggered by Coles across the nation will see all retailing margins on milk placed under pressure if other retailers do not wish to lose market share and with this there is little other option to restore margins on discounted sales in the future other then seeking to reduce the price paid to the supplier. As such the processor will seek to reduce the cost of the raw resource thus placing further downward pressure on farmgate prices.

Coles and other major retailers, with their substantial market power, have in fact had a major influence over milk prices and lower returns to the fresh milk supply chain since the domestic fresh milk price was deregulated, whilst at the same time, through using milk as a marketing agent, have grown their own market share of grocery sales and of their own supermarket store brand milk.

As Coles increases its market share for Coles branded milk, through its cutthroat ‘Down Down’ discounting campaign, it will gain even more market power thereby enabling more pressure to be placed on processors when they put their Coles brand milk supply out for tender.

The key issue with the current price cut is that it is simply unsustainable. Coles, and its parent company Wesfarmers, are not acting as good corporate citizens and ensuring a fair return to all in the supply chain. The current unsustainable price cuts do not offer a fair return, or any return in some cases, to those in the supply chain. That is why the ADF has asked the ACCC to investigate Coles and also sought amendments to the Unconscionable Conduct (Section 51) provisions of the Competition and Consumer Act 2010. ADF also believes there is a necessity for a statutory duty of good faith to be enacted as part of the Act as soon as possible to provide an appropriate and accepted benchmark of standards of ethical conduct within the Australian dairy industry and businesses that deal with the industry.

8	Written	Xenophon	Australian Dairy Farmers	a) Are you aware of informal agreements between processors that they will not poach each other's suppliers? b) How complicated are the contracts between processors and producers? Could they be simplified?	

a) The ADF is not aware of informal agreements between processors not to poach each other suppliers. There are several large players in the drinking milk market and the processors routinely seek additional supply and, particularly in times of short supply, are looking to sign up new farmers.

(b) The contracts entered into between processor and producer are only as complicated as they need to be. Given all the different situations that need to be accommodated the basic contract template has to be flexible and adaptable, with the ability to provide clear signals of market demand especially on a seasonal basis.

There may be some small changes that could be made to simplify the contracts but the current issue is not in reality a contractual issue but one of sustainability, forced on the industry through Coles' unfair marketing tactics.

It should be noted that ADF supports all measures that increase transparency across the supply chain and would support any recommendations from the Committee (and the previous inquiry) that assist in this, particularly at a retailer and processor level.

9	Written	Xenophon	Australian Dairy Farmers	a) One submission suggested that producers should be able to have tradable and dual supply contracts and thereby trade their contracts between processors either in long or short-term tranches of milk volumes. What is your view of this proposal? b) What do you think of proposals that would require processors to gain ACCC approval for their contracts with dairy producers?	

(a) A major reason for holding a contract between dairy farmer and processor is to provide a reciprocal level of certainty of supply and payment. To maximize efficiency and to allow effective planning on the farm and in the factory, both parties to the contract must have a reasonable degree of predictability in their daily operations. Swapping supply in the short term would disrupt tanker rounds. A tradable contractual relationship between farmer and processor may undermine the matrix of services provided to the farmer by the company field staff. Buying bulk milk from farmers is not simply a matter of picking it up in a tanker. Tradable contracts may also cause difficulties in the operations of cooperatives which are farmer owned and directed.

ADF is willing to examine contractual issues between farmers and processors in more detail particularly with respect to strengthening provisions to assist farmers negotiating contracts, such as legal advice, but reiterates that the current issue is due to Coles pricing fresh drinking milk at a level that is unsustainable.

(b) ACCC oversight of contracts would introduce an unacceptable level of administrative red tape and would be an impediment to flexible and adaptable collective bargaining which is integral to Australia's dairy industry. The majority of Australia's dairy farms are small family dairy farms and any additional administrative burden would not be practical.

10	Written	Xenophon	Australian Dairy Farmers	In their submission, the Produce and Grocery Industry Code Administration Committee noted that in January 2009 Australian Dairy Farmers resigned from their committee. a) Was there a particular reason for this? b) How effective do you consider the Code is for dairy farmers? How could it be strengthened? c) Do you consider the effectiveness of the Code and the Produce and Grocery Industry Ombudsman is limited by the fact that the Code is voluntary?	

a) The ADF wrote to the Produce and Grocery Industry Code Administration Committee on 27 January 2009 to cease its membership as it considered 'the high value work of the PGICAC was delivered sometime ago with the bedding down of the Code. As such, we feel that we are now well able to progress any future considerations that emerge in this space through our membership of the National Farmers Federation.'

b) The Code has some strengths but a key weakness of it has been exposed through the current unsustainable price cuts by Coles. Farmers cannot take action under the Code, even though some farmers in Queensland are being directly affected already, as they contract with processors not with Coles. To increase its effectiveness the Code must cover the whole value chain, including dairy farmers, processors and retailers, and allow issues to be raised by any affected party across the value chain with any other party.

c) In light of the recent unsustainable price cuts by Coles, ADF believes that to be effective any Code must be mandatory and cover all stakeholders in the value chain.

11	Written	Xenophon	Australian Dairy Farmers	Are you familiar with the Horticulture Code of Conduct? Are there any aspects of this framework that could be helpful to the dairy industry, or used to strengthen the Produce and Grocery Industry Code?	

The ADF understands the Horticulture Code of Conduct was established in 2007 to improve the clarity of transparency of business transactions between horticulture growers, agents and wholesale traders of fresh products. It sets out dispute resolution procedures and guidelines for these transactions. It also provides for cooling off periods in relation to contracted horticulture produce agreements. However, the Code explicitly does not include retail operations within its ambit.

The applicability of the Horticulture Code to dairy is not immediately obvious. Very few dairy farmers would supply milk under agency arrangements as defined in the Code.

In many respects, the issues addressed by the Horticulture Code are already dealt with effectively within current commercial dairy marketing arrangements.

Dairy processors and manufacturers have in place, and make publicly available, the terms on which they will do business with individual farm suppliers. These include advance notice of expected payment provisions based on quality (cell count), milk characteristics (solids count), volume, timing of delivery etc. Quality testing systems are in place for all milk collections (with independent testing agents). These arrangements are often structured in formal supply agreements or contracts between farmers, their collective bargaining group and companies.

The Code would not seem to enhance (or affect) dairy farmers' ability to engage in collective bargaining over the sale of their milk.

The explicit requirement of the Code that producers who enter a produce agreement must indicate that they have either obtained independent legal advice before entering the agreement (or that they have deliberately decided not to seek such advice) may be difficult to implement in the dairy industry, for farmers supplying farmer-owned cooperatives.

Therefore, based on current dairy experience it is not apparent that extending the Horticulture Code to dairy would add any significant support or protection to dairy farm businesses, particularly as its provisions do not extend to issues relating to retail sales.

However, this does not preclude the dairy industry from exploring arrangements with the whole of the dairy supply chain. The ADF is happy to work with Government, retailers and other members of the supply chain to examine the issue of sustainability in the fresh milk market. We believe an ACCC authorisation would be required to convene such a forum.

It should be noted that ADF supports all measures that increase transparency across the supply chain and would support any recommendations from the Committee (and the previous inquiry) that assist in this, particularly at a retailer and processor level.

12	Written	Xenophon	Australian Dairy Farmers	In the UK some of their major supermarkets have introduced dedicated supplier arrangements, such as Tesco's Sustainable Dairy Group, and it is claimed that these farmers are paid a higher farmgate price which is reviewed by a consultancy to account for changes to costs of production, rather than relying on market forces. a) Are you familiar with these types of arrangements? b) Would they work in Australia? c) Are they beneficial to dairy farmers overall or do they just crowd out other cooperatives and processors, eventually leading to less competition?	

a) Yes, ADF is familiar with these types of arrangements and understands that they were implemented as Tesco's previous unsustainable discounting threatened the supply of milk for their contracts..

b) There are significant differences in the industry operating environment between Australia and the United Kingdom. The most notable is the fact that dairy farmers in the United Kingdom receive large farm subsidies. ADF understands that the average subsidy to dairy farmers in the United Kingdom is 30,000 pounds per annum, with farmers receiving a further bail out from the British Government during the Global Financial Crisis. Australian dairy farmers are among the most efficient in the world and operate without government support.

Because of the significant differences between the Australian and United Kingdom dairy markets it is difficult to make comparisons that are pertinent. In Australia there are many different dairy regions with different environmental conditions and market requirements. Australia has stringent environmental, animal and health and welfare and resource regulations that are generally legislated and managed on a national basis.

It is ADF's belief that Wesfarmers and Coles are intent on implementing a United Kingdom retailing model in Australia with the purpose of squeezing the value chain, which will impact most severely on those at the start of the chain, dairy farmers.

It is also worth noting that Tesco's Sustainable Dairy Group contracts are linked to production 'credentials' - requirements related to environmental management, animal health and welfare etc. This is of some concern to ADF as it is 'quasi-regulation' of individual farmers in an agricultural industry through a retailer and may result in different 'regulations' on a company by company basis making things extremely difficult for farmers to change whom they supply.

c) It is unfortunate that a model such as that used by Tesco's in the United Kingdom has become necessary and ADF hopes that it does not become necessary in Australia. ADF firmly believes that Tesco's Sustainable Dairy Group contracts model if implemented in Australia would lead to less competition among processors and ultimately 'crowd' some out of the market.

13	Written	Xenophon	Australian Dairy Farmers	The committee heard in 2010 that the national health standard for milk meant there were no significant differences between private label full cream milk and branded full cream milk, other than some minor specification differences. a) Is this correct? b) Do you think it is inevitable that, regardless of the current price discounts, consumers would realise this and switch to private label milk? c) Should it be regarded as price discrimination to sell the same product at a different price even if the product is sold in containers with different labels? (i.e. should branded and generic full cream milk be regarded as the same product?)	

a) In accordance with *FSANZ Standard 2.5.1 - Milk*, all packaged cows' milk for retail sale in Australia must meet minimum composition requirements for milk fat and protein. The standard also allows for milk composition to be adjusted to comply with the compositional requirements by the addition of and/or withdrawal of milk components, provided the adjustment does not alter the whey protein to casein ratio of the milk being adjusted.

b) As noted in our response to Question 1, private label milk sales already dominate retail supermarket sales of full cream milk in Australia. They currently account for around 70% of such sales. Industry does not expect this share to significantly reverse but recognises that this trend has put downward pressure on overall industry returns. If prices for domestic house brand drinking milk for remain heavily discounted, the natural expectation is these products will further increase their share of overall sales. As the ADIC submission shows, the lower margins applying on private label sales means that such a development must result in significantly lower aggregate revenue across the dairy supply chain and the extreme (and unacceptable) risk of lower returns to local farm suppliers.

c) The ADF believes there is a prima facie case of price discrimination from supermarket private label brands against processor proprietary brands, where the supermarket has sought to match their supermarket private label brand against processor proprietary brands.

Further to this we believe there is a strong prima facie case under section 46, including 46 (1AA) of the Competition and Consumer Act 2010 that Coles' actions constitute predatory pricing. And additionally in relation to deceptive and misleading statements made by Coles in their discount promotion the ADF believes there is a prima facie case of deceptive, misleading and or false advertising that should also be investigated by the ACCC.

14	Written	Xenophon	Australian Dairy Farmers	CHOICE have called for a comprehensive and coordinated National Food Policy to be developed and a supermarket Ombudsman to be established. The Government have also formed a National Food Policy Working Group to develop a National Food Plan. a) Do you consider the current arrangement of various government agencies and regulators is working effectively? b) What do you think should be included in a National Food Policy? c) What powers and functions do you consider a supermarket Ombudsman should have? d) CHOICE have also suggested that the Ombudsman be based within the ACCC—do you have a view on this?	

a) The ADF considers that the current arrangement of various government agencies and regulators is not working effectively. A player with substantial power in the market place is using that power to squeeze the value chain to the point where prices are unsustainable and, in ADF's view, predatory pricing, among other issues, is taking place.

Despite evidence of the negative impact on dairy farmers the Government, ACCC and other agencies have all stood by and taken no action, provided no direction, and provided no information to concerned dairy farmers or others.

ADF will supply a supplementary submission to the Committee with detailed recommendations on solutions to the issues raised by Coles' unsustainable pricing.

It should be noted that ADF is of the firm opinion that the ACCC must take a longer term view of market issues than it currently does. It must not only look at the impact of issues on the current market but examine potential future impacts – this is particularly the case for misuse of market power issues.

Coles, a wholly-owned subsidiary of Wesfarmers, has not only targeted dairy in its actions but other commodities as well and when its actions are viewed with an eye to what has recently taken place in the United Kingdom it does not bode well for farmers, processors, consumers or Australia's future food security.

b) The ADF is represented on the National Food Policy Working Group through the National Farmers' Federation. There are over 100,000 people employed in the dairy industry in Australia. The vast majority of these people are employed in regional and rural areas. Dairy is Australia's third largest rural industry with a value of over $3.4 billion at the farmgate. A National Food Policy must ensure that the importance of dairy and other agricultural industries to our nation are recognised at the highest levels of Government and by agencies, such as the ACCC, that report to Government.

A National Food Policy must ensure sustainable returns for our dairy farmers who compete against farmers in other countries who are often heavily subsidised through tariffs or other means. The ADF is not asking for protection through tariffs but merely for our regulators to ensure that unconscionable conduct is not allowed to undermine the value of our commodities. Businesses that deal with dairy farmers must act in good faith and work with them to ensure a fair price for their product.

Australia's food security is dependent on farmers and their produce. A National Food Policy must recognise the importance of food security and ensure that all stakeholders in the sector work with each other to maintain a viable agricultural sector.

A National Food Policy that provides clear and consistent direction on agricultural issues and which assists with domestic sustainability issues, international competitiveness and ensures access to natural resources is welcomed.

c) Any Ombudsman or Dairy Commissioner – be it a dairy specific Ombudsman/Commissioner or an expanded Produce and Grocery Ombudsman must be able to investigate complaints from a whole of value chain perspective. The current Coles' milk price cut is the perfect example of why this is absolutely necessary. The processors lack market power against an entity as big as Coles and as such any price impacts inevitably flow on to the dairy farmers at the start of the value chain. Farmers must have the power to complain about the behaviour of retailers (and processors). This is even more critical now given the lack of response by Government, the ACCC and other bodies to act in this matter.

Over the last decade major supermarket chains in Australian have significantly increased their market share and power. As this has occurred, the processing sector been left with less market power and heavily reduced options to sell fresh milk and other dairy products through.

A situation has been allowed to develop by Government and regulators in which major supermarkets chains have used their purchasing power to place considerable pressure on suppliers, especially for the supply of supermarket branded products. This increasing pressure on suppliers has over time led to downward price pressure on the supply chain, which inevitably flow on to the dairy farmers at the start of the supply chain.

Processors are understandably cautious about pushing back on large retailer pressure in relation to 'store brand' tenders as the major supermarket chains now provide the largest retail avenue to consumers in Australia for processor branded product sales, in addition to 'store brand' tenders now accounting for some 25% of all fresh milk sales nationally.

The discounting of milk by Coles, which was followed by other retailers will inevitably force down farm gate prices for milk. This fact has been acknowledged by public statements from Woolworths and other retailers stating that the reduction in price is unsustainable.

While for dairy farmers, collective bargaining provisions have been made available under the Act, dairy farmers do not currently have the ability to directly address the issues created by the major supermarket chains in sacrificing the value of fresh drinking milk to use it as an advertising and sales leverage agent for other grocery product sales.

To address this unsustainable situation, dairy farmers must have the ability enact a process to address the behaviour of retailers and equally processors.

The Ombudsman must also be empowered to direct parties in dispute to behave in a way that promotes ethical business conduct.

ADF notes that the consumer organisation Choice has recommended the establishment of an Australian Supermarket Ombudsman 'to tackle competition and fairness across the grocery sector.'

Choice explains that the Supermarket Ombudsman would be dedicated to the task of promoting and protecting competition in the supermarket industry through the better enforcement of existing legislation. They advise that the UK Government is currently implementing a 'Groceries

Code Adjudicator' under its Office of Fair Trading.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry recommends "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;

1. researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and
2. assisting industry participants to resolve disputes."

Associate Professor Frank Zumbo further stated that, "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."

ADF believes that the establishment of a dairy specific Ombudsman/ Commissioner and or a Supermarket Ombudsman must be implemented to ensure appropriate oversight of the industry.

d) ADF has been disappointed with the lack of any action from the ACCC in relation to Coles' actions but believes, to ensure appropriate price transparency and investigation, it is appropriate for the Ombudsman be based within the ACCC.