



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

ECONOMICS REFERENCES COMMITTEE

**Reference: Impacts of supermarket price decisions on the dairy industry**

WEDNESDAY, 9 MARCH 2011

SYDNEY

BY AUTHORITY OF THE SENATE



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**SENATE ECONOMICS**  
**REFERENCES COMMITTEE**  
**Wednesday, 9 March 2011**

**Members:** Senator Eggleston (Chair), Senator Hurley (Deputy Chair) and Senators Bushby, McGauran, Pratt and Xenophon

**Substitute members:** Senator O'Brien to replace Senator Pratt for the committee's inquiry into the impacts of supermarket price decisions on the dairy industry

**Participating members:** Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Coonan, Cormann, Crossin, Eggleston, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Ian Macdonald, McEwen, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

**Senators in attendance:** Senator Eggleston (Chair), Senator Hurley (Deputy Chair) and Senators Colbeck, Heffernan, O'Brien, Ryan, Williams and Xenophon

**Terms of reference for the inquiry:**

To inquire into and report on:

The impact on the Australian dairy industry supply chain of the recent decision by Coles supermarket (followed by Woolworths, Aldi and Franklins) to heavily discount the price of milk (to \$1 per litre) and other dairy products, with particular reference to:

- (a) farm gate, wholesale and retail milk prices;
- (b) the decrease in Australian production of milk from 11 billion litres in 2004 to 9 billion litres in 2011, of which only 25 per cent is drinking milk;
- (c) whether such a price reduction is anti-competitive;
- (d) the suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry;
- (e) the recommendations of the 2010 Economics References Committee report, *Milking it for all it's worth—competition and pricing in the Australian dairy industry* and how these have progressed;
- (f) the need for any legislative amendments; and
- (g) any other related matters.

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**Committee met at 11.52 am**

**CHAIR (Senator Eggleston)**—I hereby declare open this second hearing of the Senate Economics References Committee inquiry into the impact of supermarket price decisions on the dairy industry. On 10 February 2011, the Senate referred this inquiry to the committee for report by 15 April 2011. To date, the committee has received over 90 submissions, which are available on its website. A further public hearing will be heard tomorrow in Canberra, with an additional hearing in Canberra to be held at a later date.

These are public proceedings although the committee may determine or agree to a request to have evidence heard in camera. I ask photographers and cameramen to follow the instructions of the committee secretariat and ensure that senators' and witnesses' laptops and personal papers are not filmed. I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and each action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a Senate committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may also be made at any other time.

I remind members of the committee that the Senate has resolved that all departmental officers shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions to superior officers or to a minister. This resolution prohibits only asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[11.54 am]

**CUMMINGS, Mr John, Chairman, National Association of Retail Grocers of Australia**

**HENRICK, Mr Kenneth Michael, Chief Executive Officer, National Association of Retail Grocers of Australia**

**CHAIR**—I welcome representatives of the National Association of Retail Grocers of Australia, otherwise known as NARGA, and I invite you to make an opening statement.

**Mr Cummings**—Thank you for the opportunity to present to the inquiry on milk pricing. I come to you as the Chairman of the National Association of Retail Grocers of Australia, which looks after the interests of all the independent supermarkets throughout Western Australia, and as a retailer myself with knowledge of milk pricing in Western Australia and the effect it has had on the milk and dairy sectors in WA.

Since we have put in our written submission, I have been able to do some research and find out some estimates of pricing from an ex-executive of Peters and Brownes in Western Australia, and I think we have put those in front of you. At the moment, I would like to address those and use them as the point for where we are coming from.

There are a couple of points we would like to make. Firstly, we have no objection to any retailer selling products at whatever price they wish to. We are not suggesting that at any stage Coles should be forced to lift their price or be forced to work at a specific margin or anything like that. We do, however, recognise that current pricing is causing difficulties for farmers, processors and small independent retailers. To that end, we have put in front of you the approximate costs in the milk supply chain in Western Australia. What we have tried to do is to get an estimate of how much two litres of milk would be.

I am told that the cost of production of two litres of milk in Western Australia is around \$1.40. In addition to that \$1.40, which is the processors' cost of production, there is a 4c a unit distribution cost to get that milk to Coles, which is their generic or house brand, and there is a 10c a unit cost to get milk to the smaller, independent stores. Marketing cost on branded milk is 7c, which equates to about two to three per cent of the wholesale value; that is what processors put into the marketing of branded milk.

So we can see that there is a differentiation of some 13c from the processor to deliver milk to an independent store versus house-brand milk to a Coles supermarket. We estimate that the Coles price for two litres of private-label milk, after all of their terms and after the stripped down net, net costs, to be at about \$1.50. It could be \$1.60, but we are not sure. The wholesale price of the same supplier who has that contract to supply house-brand milk to Coles will sell to a small retailer at \$3.50. It is the same product but there is a \$2 difference in cost to the small retailer versus to Coles, and the only extra cost of that processor selling to the smaller store is the 17c for distribution and marketing costs.

We have been saying for some time that the only way that the processors can continue to supply cheaper house-brand or generic milk to both Coles and Woolworths is to recoup that margin that they lose on the supply of the product by the sale to other customers. It is clearly happening in this case.

**Senator COLBECK**—Let us go back to the \$1.40. That includes the payments to dairy farmers?

**Mr Cummings**—That includes the processors.

**Senator COLBECK**—So what is the farm gate component of that as far as you are aware?

**Mr Cummings**—As I understand it, the farm gate price in Western Australia is currently 38c per litre.

**Senator XENOPHON**—The cost?

**Mr Cummings**—That is the farm gate price.

**Senator HEFFERNAN**—Is that tier 1 or tier 2?

**Senator COLBECK**—I do not think that applies in WA; it is a different market.

**Senator HEFFERNAN**—By the way, it was near enough to 40c in Wagga Wagga this morning.

**Senator COLBECK**—So the farm gate price is about 38c?

**Mr Cummings**—Yes.

**Senator COLBECK**—The purpose of the question is to try and get a sense of the processing cost. The basic information I have at this point in time is that processors are providing this milk to the supermarkets at what they call a marginal cost, versus their whole-of-business cost, which is generally the price inputs into their marginal brands which contribute to the whole mix of this equation. So what we are saying is that about 76c of that \$1.40 is going to the farmer and the rest is going to the processor for the processing cost on a per litre basis.

**Mr Cummings**—It is two litres.

**Senator COLBECK**—I am working on the \$1.40.

**Mr Henrick**—The \$1.40 is for two litres.

**Senator COLBECK**—I understand that. I am just trying to work back to what a per-litre processing, pick-up and delivery cost might be. That looks pretty cheap. That price is 64c a litre, so that is 32c a litre for all of those elements—that is the contribution in that to the processing

price. Let's go to the \$1.50 price. What is the justification for such a significant difference in the price between \$1.50 versus \$3.50?

**Mr Cummings**—The \$3.50, we would say, is the only way that the processor can actually average his margin out. Everybody has agreed that it is marginal for Fonterra or National Foods to supply house-brand milk. They are not making money out of it. Obviously, they must be recouping margin from somewhere else. We have also been saying for some time that we believe we have been seeing the waterbedding effect in the dairy sector in Australia where you have got high prices for ice-cream and yoghurt. Again, I would assume that the processor is recouping margin out of that.

**Senator COLBECK**—In their submission to us, National Foods indicated that their EBIT was planned at two per cent. That was eroded already, prior to the process that Coles are going through at the moment with this particular campaign and we will ask them this afternoon what their projected EBIT might be. But what you are saying is that the impact of the price pressure on the processors to provide this milk at such a low price to the supermarkets is causing what you call a waterbedding effect, where all of their other products are having to be priced at a much higher margin so that they actually balance out their overall cost of business?

**Mr Cummings**—Absolutely. In simple terms, I would think that if I was the man who was running National Foods and reporting to my boss in Kirin Brewery, I would simply say, 'I'll run this business on a 45 per cent GP,' or whatever that was, and I would not have thought my boss would care if I gave away milk providing I returned 45 per cent GP on the turnover.

**Senator COLBECK**—When Coles say they are effectively going to try and strip margin out of the processors, it does not appear as though there is a lot of margin in the processors left to strip out.

**Mr Cummings**—Fonterra have been trying to sell Peters and Brownes dairy in Western Australia from some years. The sale was about to go through, on my understanding, at \$210 million two weeks ago. The sale has now been put on hold because of this price war—the sale has fallen over. The prospective buyer must be looking at it now and saying, 'There's no money in this business anymore.'

**Senator COLBECK**—So when Coles say they are bearing the cost of this—although we did hear significant evidence yesterday that there are other impacts from this price war, other than them just selling milk at a cheap price—there are a range of other implications that are right now working their way through the market.

**Mr Cummings**—If it made economic sense to sell milk at \$1.50 or \$1.60, whatever the contract price is, why would the processor not sell all of their branded milk at the same price? Here, the only added costs are a marketing cost of three per cent of your wholesale and 10c a unit to get the vendor to deliver it to the door—and that would be the door of the coffee shop out here.

**Senator HEFFERNAN**—Are you including in the figures the reconstituted milk? That is to the lower standard—three per cent protein, three per cent fat—which is a practice you would recognise, that they water the job down.

**Mr Cummings**—Yes.

**Senator HEFFERNAN**—It definitely is a different milk to the fully labelled milk. I noticed the milk out here in the garbage can is eight per cent protein, but the standard is three.

**Mr Cummings**—These figures were supplied to me by somebody who did due diligence on buying Peters and Brownes from Fonterra and he put the cost of production of two litres of milk at \$1.40.

**Senator HEFFERNAN**—He is doing all right. I have a list here of 300 vendors—

**CHAIR**—Senator Heffernan, that is fine, but Senator Colbeck still has the call.

**Senator HEFFERNAN**—which gives the percentage of all the discounts that the milk vendor has to give to compete. It is up to a 40 per cent discount on what it costs him as a milk vendor to purchase it from the processor.

**CHAIR**—Senator Heffernan, we are a bit off subject. Your turn will come. Senator Colbeck has a line of inquiry, so we will let him follow it.

**Senator COLBECK**—I want to get a sense of your access to a similarly priced product for your market.

**Mr Cummings**—We have that price of \$3.50, being the published wholesale price. Prior to Coles dropping the price we were paying around \$2.20 to \$2.30 for two litres of milk. In Western Australia you have National Foods supplying Pura, Fonterra supplying Brownes, and Harvey Fresh supplying their own brand. They obviously could not sit by and see their market diminish. They can't not sell branded milk. Harvey Fresh do not have a contract with Coles or Woolworths, so if they sat around they would sit and watch their business go broke. We are currently selling Harvey Fresh milk for \$1.99—

**Senator COLBECK**—That is for two litres?

**Mr Cummings**—Two litres.

**Senator WILLIAMS**—What are you paying for it?

**Mr Cummings**—I am happy to provide that confidentially to the committee but I would rather not give that price out publicly for the simple reason that if I were to tell Coles or Woolworths how much I was paying for a competitor's product, what do you reckon they would do?

**CHAIR**—If you wish to, we can go in camera.

**Senator COLBECK**—Chair, I would appreciate some advice.

**Mr Cummings**—We are paying less than \$2.

**Senator COLBECK**—I am expecting that to be the answer but if the witness is prepared to provide us with some information I would appreciate it if it can be received in camera, from my perspective, and obviously the rest of the committee can deal with that. Part of this process is to try to get a decent understanding of the costs through the supply chain. Coles has told us that the place where the murky stuff is located is between the processor and the dairy farmer but I have had no trouble finding out what the price of milk being paid at the farm gate is. The thing that I am really having trouble finding out, and I think we are all in the same boat, is what the price is between the processors and Coles and the other supermarkets. I am concerned that what they are telling the public about where the murkiness lies, as far as openness and clarity are concerned, is not in fact where it really is. As I said, I had no trouble finding out what the price of milk is at the farm gate—I just have to ask a dairy farmer anywhere or look at some of the dairy industry websites—but finding out what the real prices are between the supermarkets and the processors is where the secrecy is. I understand the reasons and the background for that but for Coles to try to tell me in a letter that the secrecy is somewhere else I think is a bit rough and certainly misleading to me.

**Mr Cummings**—I can say to you that right now we are selling Brownes milk at a retail price of \$2.49, Harvey Fresh for \$1.99 and Pura for \$2.49.

**Senator COLBECK**—And those prices would all have had reductions post this campaign?

**Mr Cummings**—Prior. In January they would all have been around the \$2.89 to \$3 mark. We have taken a reduced margin on some of those lines but we are not selling them below cost.

**Senator COLBECK**—What about the relationship with the processors? They have had to take a reduction in price as well as part of that process to retain market.

**Mr Cummings**—That have had to do it, absolutely. As I said, Harvey Fresh cannot stand by and not sell milk, and we are told that that pressure will go down to the farm gate when they renew their contract.

**Senator COLBECK**—That is one of the concerns that we have had as part of this process. Coles have said, because they deal directly with the processors, they do not impact on the farm price, but my experience, and I think that of most others, is that the retail price does have an impact on what happens at the farm gate.

**Mr Cummings**—If what we say is the case, that the processors have been recouping the lost margin by selling to other customers at a higher price, then if they have not got those customers to sell to or they have not got the higher price to sell it at, they will no longer recoup the margin and therefore they will push their loss down the line.

**Senator COLBECK**—The other pertinent point you have made is that the potential sale of one of the processing companies has effectively if not fallen over then been put on hold as a direct result of what is going on at the moment, as I am aware some other contracts along the supply chain might have been as well. For Coles to suggest that this is all insulated and they are bearing the cost I think does not really bear fruit at the end of the day.

**Mr Cummings**—It is a ridiculous proposition.

**CHAIR**—You have provided some additional documents. Would you like to formally request that they be tabled?

**Mr Henrick**—Yes, Chair.

**Senator O'BRIEN**—You refer in your written submission to a Federal Court case in 1981, *J Cool and Sons v O'Brien Glass Industries*. We have not had an opportunity to obtain a copy of the decision—I can, but if you have a copy—

**Mr Henrick**—No, we do not have a copy of the full decision.

**Senator O'BRIEN**—That is fine; I thought I would short circuit my library work. Others may have it already. I think you imply in your original submission that there was something improper about Professor Hilmer's potential conflict of interest, his having been a director of Westfield Group at the time he recommended the removal of section 49 of the Trade Practices Act. Do you want to enlarge on that or clarify your submission?

**Mr Henrick**—The point I was making was that there did appear to be, on the surface, a conflict of interest. Whether there was in practice, I do not know. The recommendation to repeal section 49 at that time would have, on the surface of it, been in conflict with his position as a director of Westfield.

**Senator O'BRIEN**—Is there any aspect of the Westfield operation that you can call to mind which might have impacted via section 49, as it was then?

**Mr Henrick**—Differential prices for retail leases.

**Senator O'BRIEN**—Are you saying to me you think there was a likely conflict of interest in that instance?

**Mr Henrick**—I do not know whether there was—

**Senator O'BRIEN**—He was a director of the company; the company was engaged in commercial practices involving leases at shopping centres, and differential pricing of leases in shopping centres in your mind may have been potentially in conflict with section 49 of the Trade Practices Act as it was then.

**Mr Henrick**—That is right.

**Senator O'BRIEN**—That is a reasonable prima facie case to ask for some sort of explanation, I would think. The other aspect of your submission is the impact of the cutting of the supermarket price for milk. You talked about waterbedding at the previous inquiry and you have raised the issue again. Can you give us some examples of a waterbedding effect having taken place since the Australia Day announcement of the \$1 a litre milk sale by Coles, which was followed by a number of other major retailers.

**Mr Cummings**—I think the first example is that the processors still do not sell milk at the same price to other customers as they do to Coles and Woolworths. That is a practice that is still

going on today. Again, that is a waterbedding effect. They are recouping margins from other customers so they can continue to supply cheap milk to Coles and Woolworths.

**Senator O'BRIEN**—You did make that submission at the previous inquiry, too. As I said, I thought you also said ice cream and yoghurt and potentially other dairy products were effectively, if I understand waterbedding, rising in price to subsidise the lower returns from selling more of the lower priced product to the major supermarkets by the processors.

**Mr Cummings**—I do not have the figures in front of me, but we gave the examples before of lack of promotional activity on yoghurts and ice cream. My recollection was that yoghurts had gone up by some 15 or 20 per cent over the last three years, and ice cream by about the same amount. We are still seeing that. National Foods and Fonterra are not public utilities; they are not there to just provide cheap milk. They have to make money along the way somewhere, and they have to make money from some people. If their branded milk drops they must push up the prices of these other products as well. I do not see how they could do it any other way. Quite simply, being a supermarket retailer myself, if customers only came into Coles, Woolworths or our store and bought the 10 lines we were advertising at cost each week, we would not be here in a month's time, would we?

**Senator HEFFERNAN**—What percentage of the milk in Western Australia—

**Senator O'BRIEN**—Hang on. That is a matter for you to raise, Senator, when you have the call but at the moment I am trying to ask some questions. In relation to the, you say, non-promotion of these other dairy items by the processors, are you able to supply the committee with some information on notice—that is, written information—which would assist us to substantiate the claim that you make and, in the context of that, can you give us any idea of the breakdown in value, in the retail sector, of those different commodities?

**Mr Cummings**—Yes, I certainly can.

**Senator O'BRIEN**—For example, if on the one hand a consumer is saving 70 cents on two litres of milk but paying an extra dollar on the other items, do you have an idea in your mind as to whether that is how it works out?

**Mr Cummings**—Certainly. I can go into our store and pull out the actual percentages of each of those product lines as a percentage of turnover. Interestingly enough, when I did that on whole milk our store percentage of turnover was basically the same as for Coles and Woolworths. I must say, in Western Australia, I have not seen any evidence of market shift from whole milk to Coles and Woolworths. Definitely, the processors are saying to us, 'We can't sell branded milk to Coles anymore.' Harvey Fresh said to me, 'It's not worth my while even turning up there.' Coles have the Harvey Fresh two-litre light milk sitting out by itself at \$3.17. Well, \$3.17 or two bucks—you wouldn't have to be Einstein to figure out which one you should buy, would you?

**Senator O'BRIEN**—Not if they are the same and that is the question.

**Mr Cummings**—Milk is milk. I think consumers in the main—

**Senator O'BRIEN**—In your dealings with the processors, have you satisfied yourself that the milk in the reduced price container is identical to the milk in the proprietary brand container?

**Mr Cummings**—Having actually milked a cow myself, it all comes out the same way. It would be exactly the same.

**Senator O'BRIEN**—I do not know that it would satisfy you, given it has gone through processing. That is the question.

**Mr Cummings**—It must be exactly the same.

**Senator O'BRIEN**—Are they claiming it is the same? You are dealing with Harvey Fresh.

**Mr Cummings**—They have not claimed that there is any difference in it. Nobody has ever said to me, 'It is cheaper to produce that milk for this reason.'

**Senator O'BRIEN**—Your proposition remains that the provisions which previously existed in section 49 of the Trade Practices Act be reinstated. You quote, I think, Mr Samuel, as saying that section has never been enforced by the regulator, but you draw our attention to where it was enforced by a private company.

**Mr Cummings**—Yes.

**Senator O'BRIEN**—Have you any knowledge as to why the regulator has never acted on the then existing section 49?

**Mr Henrick**—Since we put that submission in, I have discovered that the previous version of the Trade Practices Act, Trade Practices Act 1965, also contained a similar provision and the then regulator did not apply that either. It seems—and this is in the submission we gave you today—that the various regulators took the view that they, for whatever reason, would not bother applying that part of the legislation and that they would leave that to private action.

**Senator O'BRIEN**—With the Cool and Sons and O'Brien case, was there a penalty or damages imposed?

**Mr Henrick**—Yes, I believe so. The judge observed early in the case that it was possible for that conduct to be in breach of both section 49 and other sections of the act. Indeed, he found that the conduct had breached both 47 and 49. The only time section 49 was tested it was successful.

**Senator O'BRIEN**—In your original submission you say that the reason that no cases were taken by the regulator might be that section 49 included an effects test rather than the purpose test. Can you explain further why that is significant?

**Mr Henrick**—A purpose test is very difficult to prove because you have effectively to know what was in somebody's mind when they did something, and the only way that you can do that is if you have a whistleblower or a smoking gun document that proves what they were intending to do. The effects tests, which apply in some other jurisdictions, are proven on the basis of the

result of the conduct, and if that conduct has results that are anti-competitive, then that is the case proven.

**Senator O'BRIEN**—On notice, can you tell us the other jurisdictions where that test is used?

**Mr Cummings**—Throughout Europe, in America, in Canada—

**Mr Henrick**—Throughout Europe, yes.

**Senator O'BRIEN**—You may be able to give us some more specific information—

**Mr Cummings**—New Zealand is quite interesting in this—

**CHAIR**—We are quite interested in international comparisons in this. If you can provide a document of that kind, we would be very grateful.

**Senator O'BRIEN**—I am sorry—I cut you off.

**Mr Henrick**—I think I was just finished, Senator. The effects test is a much easier test to prove, and removing that made it more difficult to prove anti-competitive price discrimination.

**Senator O'BRIEN**—So, in essence, what you are asking the committee to do is to recommend a change in the law so that independent retailers would need to be offered milk at the same price as the major supermarkets would be offered it and they could trade the same milk in the same competitive market as the major retailers—if I can put it that way.

**Mr Henrick**—Yes.

**Mr Cummings**—Yes indeed. We also recognise that there may be a reason for a generic milk to be cheaper than a branded milk. We understand that, and effective legislation would not stop that from occurring.

**Senator O'BRIEN**—Sure.

**Mr Cummings**—But the difference of \$2 at the moment is something that you just cannot get to. You cannot get to it, and I have to admit that it does get up my nose that every day I figure out that I am actually subsidising Fonterra to sell house brand milk to Coles by the price they charge me for their branded milk and other products.

**Mr Henrick**—That legislation, by the way, would not prohibit economies of scale. But they would have to be genuine economies of scale.

**Senator O'BRIEN**—So it would not prevent, for example, the major retailer saying, 'I want a discount because I am buying bigger bulk.'

**Mr Henrick**—Yes, totally.

**Senator O'BRIEN**—So that would be permissible.

**Mr Cummings**—Yes.

**Mr Henrick**—Absolutely.

**Senator O'BRIEN**—But a fixed price, irrespective of quantity, should fall foul of the revision to the previous law, in your submission.

**Mr Cummings**—If the price discrimination brings about anti-competitive activity. The anti-competitive activity in this is that, if you are in a town that does not have a Coles supermarket in it—for example, Wongan Hills—you might be paying \$3.67 for two litres of Brownes milk because the processor can get away with selling it to the customer at that price. He has to recoup his margin to sell cheaper milk to Coles, to Woolworths and, in some instances, to me.

**Senator O'BRIEN**—The last area I wanted to explore is that obviously this would not just apply to milk, and there are a number of other products that are being sold as the home brand in a variety of circumstances. Are you suggesting that exactly the same thing is happening with manufacturers? That is, where they engage in this home brand packaging arrangement, are they are inflating the price of their other commodity to subsidise their market.

**Mr Cummings**—It could be occurring, but when you go into production of grocery products that have a number of components to them, you can cut down the specs on the products. People assume that Heinz baked beans have more baked beans in them than house brand baked beans have, but I have never counted them, so I cannot judge on that one. You can drop specifications, and in a lot of instances you see those house brands with a differentiation; but I am not aware of one where there is such a differentiation as there is in milk.

**Senator O'BRIEN**—I can think of a couple, but it does not matter. I am interested in the consequence of changing the law in other areas, and it is probably something we need to expand—

**Mr Cummings**—I understand that, and we are not suggesting that that would be the case. When section 49 was in the Trade Practices Act before, house brands were around. There is a similar prohibition in UK law, and Tesco—the most successful house brand in the world—have recognised it. If they can do it, there is no reason that Coles or Woolworths or IGA or FoodWorks or Aldi could not do it in Australia. Aldi operate in the UK; Aldi operate through all Europe.

**Mr Henrick**—Senator, it is not just house brands of course. People have told me of other examples—for example, slabs of VB being available to the major chains at prices that are about six dollars cheaper than what is available to independent liquor wholesalers.

**Senator O'BRIEN**—Coca-Cola is another example which has been mentioned.

**Mr Henrick**—I do not know about Coke, but—

**Senator RYAN**—We had this conversation outside, Mr Henrick, and I am assuming it was not private—

**Mr Henrick**—Sure.

**Senator RYAN**—Your proposal would not prohibit discounts based on volume—

**Mr Henrick**—Absolutely.

**Senator RYAN**—can explain part of these two.

**Mr Cummings**—Or promotional activity. They would still occur, because they are not anticompetitive in their nature.

**Mr Henrick**—Just by way of clarification, Senator, the UK law simply says it is prohibited ‘to apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive advantage’. In other words, if you give somebody a higher price for no reason—if there is no rational basis for the higher price—you put that person at a competitive disadvantage and therefore you distort competition, and that is what is prohibited. Section 49 used to do that. But the expression in the UK law is much clearer than what section 49 was.

**Senator XENOPHON**—Gentlemen, I have less than five minutes to ask you a lot of questions so if you could keep those—

**CHAIR**—Sorry, Senator Xenophon. We started a bit late, so we are going to extend the time.

**Senator XENOPHON**—I am conscious of my colleagues—including Senator Heffernan, who is in the back of the room. I just want to go to the impact on the dairy industry, the long-term sustainability, because that has been one of the key factors here. In their submission, Woolworths said that, basically, this is not sustainable for the dairy industry. You would agree with that?

**Mr Cummings**—Totally.

**Senator XENOPHON**—So you acknowledge, that if you could get milk at the same price, that would knock out the dairy industry?

**Mr Cummings**—If we were effective and if we did have that prohibition on antidiscriminatory price discrimination, the process would have to put the price of contract milk up and bring the branded price down and there would be a differentiation that we would see of between 20c to 30c between the supply of house-brand milk to brand milk.

**Senator XENOPHON**—Are we in this position now because you have two supermarket chains that have such a dominant control over the market?

**Mr Cummings**—Two supermarket chains; two processes. It is interesting that one of the reasons National Foods gave to the ACCC as to why they had to buy every second dairy in

Australia was that they needed to get the scale of their business up to a level where they could take on their major customers.

**Senator XENOPHON**—Okay. Let's keep moving. Associate Professor Zumbo, in his submission, talked about the whole issue of the discounts given and the price differential for other goods sold. Coles previously had deep discounts on a rotating group of products. Professor Zumbo asked whether 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 engaging on other products. As retailers you monitor what your competitors do. What is your understanding of whether Coles is actually reducing its discounts and deep discounts on other products as a result of this milk price war?

**Mr Cummings**—I think from an industry perspective we have to recognise that Coles are in a marketing scenario at the moment. Research goes back to when Stuckey used to run the company. Research in a number of years has shown that Australian consumers have always perceived Coles as being expensive. So they are using legitimate marketing terms to change that perception. And that is fine. There are no problems there. At the end of the day, Coles will be like any other business; Wesfarmers have a return that they have to give and they will have to get that profit—

**Senator XENOPHON**—And their forecasts to the market have been that they will keep their margins up on groceries.

**Mr Cummings**—Absolutely. They are using whatever pressure they can to put that onto suppliers. It is interesting to note—not just in Coles supermarket business, but also their other business—that Michael Luscombe had a complaint, reported in the *Financial Review*, of Bunnings using anticompetitive activity to put pressure on their suppliers not to supply Woolworths to their hardware business, or not to supply them at the same price, and was also basically land banking.

**Senator XENOPHON**—But, in answer to my specific question, has there been any monitoring done to indicate whether Coles is discounting less on other products?

**Mr Cummings**—No.

**Mr Henrick**—There is too vast a range of products to know, although I seem to remember reading reports that the day that this discounting of milk was announced there were price increases on petrol.

**Mr Cummings**—Also, with the way the grocery sector promotes, you have to remember that the deep cut specials are actually supplied by the supplier. We sell Cadbury block chocolate at \$2.99 because Cadbury want to sell them at \$2.99. So do Coles and so do Woolworths. Coles does not make that call and we do not make that call. The price that Coca-Cola is sold for is actually set by the price Coca-Cola is selling it to you.

**Senator XENOPHON**—How many of your drinking milk products are UHT milk at the moment?

**Mr Cummings**—Very little.

**Senator XENOPHON**—Less than 10 per cent?

**Mr Cummings**—Way less. We only sell UHT milk when it is on special.

**Senator XENOPHON**—You are familiar with the fact that there are some European markets where it is the other way around?

**Mr Cummings**—Yes, and the guy who gave me these figures said the only long-term way out of this is going to be that sectors of Australia will not have fresh milk, and Western Australia will be one of them. If that occurs, there is only one wish I have: that the UHT milk still comes from Australia. Let's hope it is not powder bought from Brazil, taken up to China, rehydrated and brought down to me in Perth to put on my cornflakes for breakfast.

**Senator WILLIAMS**—A scary scenario.

**Senator XENOPHON**—I am getting travel sick just thinking of that circuit. Is there a lack of transparency in the pricing mechanism at the moment?

**Mr Cummings**—There is a total lack of transparency. Again, we go back to the grocery inquiry. We asked for transparency, and I think farmers have every right to expect to see transparency. If I am going to go broke, at least tell me why I am going broke.

**Senator XENOPHON**—Finally, the management team at Coles has been imported from the UK. There is nothing wrong with coming from the UK, but the management team has come from the UK.

**CHAIR**—The advisory team or the management?

**Senator XENOPHON**—The management team, Ian McLeod—and advisers.

**CHAIR**—From Tesco.

**Senator XENOPHON**—From Tesco and the like. If we go down that path, how different will the shopping experience be and how different will our marketplace be compared to what we have now?

**Mr Cummings**—I think it will be completely different. I do not know what the outcome of this scenario will be, but this will mean that my grandchildren in Western Australia will never drink fresh milk. I do not know what nutritional difference that will make. If they decide not to drink milk because it is not fresh, what is that going to mean? There are a whole pile of different things. It is scary.

**Senator WILLIAMS**—We heard a lot about the Western Australian dairy industry and the concerns there yesterday. We also heard that the further you transport milk in a tanker the more it deteriorates. How confident are you that, if this price war continues, the farm gate price in Western Australia will go down and down for the dairy farmers? Do you see it as inevitable?

**Mr Cummings**—It has to happen. The Sorgiovanni family have millions of dollars invested in Harvey Fresh. Call me old-fashioned, but I have not seen anybody give up millions of dollars without a fight, and the fight they will have to take up with be with the farmer, No. 1, to reduce the price. It does not matter in Australia whether you are canning fruit or producing milk; if your biggest customer comes to you and says, 'I'm only paying this,' then when you take the price of the can away you have to go to the bloke who is growing the peaches and say, 'This is bad news, but all I can afford to pay you for your peaches is 50c a kilo,' because if I do not do it we will not sell the can.

**Senator WILLIAMS**—Would you have a problem if this committee recommends the Productivity Commission has a good solid look at the whole milk industry, from the farm gate to the household fridge?

**Mr Cummings**—I think that those farmers actually deserve it. In Western Australia, we are talking about the third generation of dairy farmers—people who get up every morning at three o'clock to milk cows so that we can put milk on our cornflakes.

**Senator WILLIAMS**—Seven days a week.

**Mr Cummings**—And we have just turned our back on them.

**Senator WILLIAMS**—Just for the record, do you sell two-litre bottles of milk in your supermarket?

**Mr Cummings**—Yes.

**Senator WILLIAMS**—What do you sell them for?

**Mr Cummings**—As I said before, we sell Brownes full cream at \$2.49, Harvey Fresh—

**Senator WILLIAMS**—No, water—sorry. Do you sell two-litre bottles of water in your supermarket?

**Mr Cummings**—Yes. Mount Franklin is \$2.79, I think.

**Senator WILLIAMS**—So people pay 79c more for two litres of water than they do for milk?

**Mr Cummings**—Yes, indeed.

**Senator WILLIAMS**—That is amazing, isn't it?

**Mr Cummings**—It is amazing.

**CHAIR**—Coming back to the question of trade practices, how effective do you feel the ACCC and the Trade Practices Act, now the Competition and Consumer Act, have been in ensuring competition in the dairy industry?

**Mr Cummings**—I do not think they have been effective at all. The problems were raised in our submission to the grocery inquiry—I think we included a couple of quotes from National Foods in our submission to the grocery inquiry in 2008. The ACCC are the people who can obtain that transparency. They are the people who can find out what the actual cost of milk is, what the contract prices to Coles and Woolworths are, what the trading terms are and all those sorts of things. If I were a young trade practices lawyer working for the ACCC and the dairy sector file landed on my desk, I would say: ‘You beauty, something I can find out, here,’ and I would attack it with a bit of vigour. They do not seem to have any vigour.

**CHAIR**—Yesterday, one of the witnesses suggested to us that Coles might in fact have had a conversation with the ACCC before this pricing regime was introduced. Do you have any information that might confirm that or could you see any point in Coles discussing this with the ACCC prior to implementing it?

**Mr Cummings**—I have no information on that, but I would make the comment that it would seem to me, with all of the things that we have been doing and from my involvement with NARGA, that Coles and Woolworths have basically been able to do what they wanted to, whenever they wanted to, with the ACCC sitting on the sidelines cheering them on.

**Senator HEFFERNAN**—Surely that is because of the combination of the consolidations in the processing industry—it is a combination of the two. I mean, 82 per cent of the pre-packaged market is with the retailers and there are three consolidated international processors. This is exactly the same as what happened after the consolidation of the wine industry. It is no good asking the ACCC. The ACCC—I chaired the inquiry—thought that 73 per cent of the wholesale market and 100 per cent of the manufacture in a combined Incitec Pivot was not a monopoly. Give me a break!

**CHAIR**—I am concerned about the issue of predatory pricing, which is not legal in Australia. Could Coles in some way have discussed that issue with this price in mind with the ACCC? Do you think that they feel that they are within the bounds of legality in proceeding with this?

**Mr Henrick**—The predatory pricing provision, as it currently stands, does not actually work if you have no prohibition on anticompetitive price discrimination, because the pricing advantage that they get early in the chain allows them to undercut anybody else’s price without selling below cost.

**Mr Cummings**—Other jurisdictions have recognised that, and that is why they have both.

**CHAIR**—That issue was raised, in passing, yesterday. Thank you for clarifying that.

**Senator HEFFERNAN**—People wonder where the subsidisation is coming. I have a list of outlets of a milk vendor who goes through all his outlets. He is buying it generally branded at \$2.70 and he is giving up to 40 per cent discounts to resellers. He tells me that, as part of the reselling operation, the resellers think it is cheaper to go to Coles and buy direct at Coles, who are now offering to deliver the milk to some of these resellers in a refrigerated truck and bypass the vendor. Have you struck that over there?

**Mr Cummings**—I was told last week that one of the bigger distributors, who has a contract with Fonterra and who has been running five trucks for the last five years, is just about to sell one and is thinking of going down to three.

**Senator HEFFERNAN**—I will table these tomorrow, because the witness has got the guts to turn up and give evidence.

**Mr Cummings**—I think the point being made is that it is not just the retailer who is subsidising the supply of milk, it is everybody involved in the supply chain.

**Senator HEFFERNAN**—I might also say that having chaired an earlier milk inquiry when we struck good old Tasmanians who were expecting their farmers to present the milk to the processors for 16c a litre that the subsidies have come off. The cover for this discounting war, with 82 per cent of the prepackaged market as I said and three major processors, is the international market which of course is a garbage argument because the international market has improved more than the reluctant improvement that has been allowed to the farmers at the farm gate in the meantime. The other trick of the trade, and I do not want to dob the processor in, but one of the processors, as of this morning, is lowering the standard to the base standard. Do you understand what the base standard in protein and fat content is?

**Mr Cummings**—I do not know the technicalities.

**Senator HEFFERNAN**—If you look at the milk carton in the garbage can out there you will see on the side that it lists milk protein at eight per cent, but you can go down to three and that is what is happening. The taste of that milk, generic milk, is completely different to whole milk. We have heard the arguments and we took evidence in Tasmania on reconstituted milk. There are a whole range of tricks of the trade but the fundamental issue is the ACCC has allowed the consolidation of the industry. The ACCC do not have the powers unless they can demonstrate predatory behaviour. We have to change the rules. Obviously, this is going to lead to a bigger global problem in the food task. In 2050 the global food task will double.

**CHAIR**—Do you have a question, Senator?

**Senator HEFFERNAN**—Can you recommend to this committee what you think are reasonable changes to the powers of the ACCC? Coles do not have an exit strategy, the only exit strategy will be the dairy industry.

**Mr Cummings**—Without a doubt. We think that the prohibition of price discrimination will go a long way to equalising that. There should be greater scrutiny by the ACCC on the sector. The sector is broken. It needs help. We cannot expect farmers to continue to milk the cows for no profit. We did some research with Accenture on a paddock to plate food chain in Australia and we would contend that this is happening in other food sectors as well, it is just that the dairy sector is an easy one to look at. Our concern is that, if the ACCC or somebody do not investigate the dairy sector and understand it, they will not understand the other sectors.

**Senator HEFFERNAN**—Being able to lower the milk to the lowest standard—isn't that a con job on consumers?

**Mr Cummings**—Of course it is.

**Senator HEFFERNAN**—Thank you.

**Mr Henrick**—In talking about the ACCC's activities it gives lie to the Hilmer inquiry recommendation regarding section 49 when Hilmer said that 45 and 46 could take care of these issues. Clearly, they have not been able to either because the two sections do not work or because the ACCC is reluctant to take cases or both.

**Senator HEFFERNAN**—So it will not surprise you to know that the bread manufacturers have also been approached some months ago, but they have not been quite game to put that on the table yet. They have been ready, obviously they are going to talk that market down too.

**CHAIR**—You would support the reintroduction of section 49 I gather?

**Mr Cummings**—Totally.

**Mr Henrick**—Certainly.

**Proceedings suspended from 12.43 pm to 1.29 pm**

**BEZZI, Mr Marcus, Executive General Manager, Enforcement and Compliance, Australian Competition and Consumer Commission**

**CASSIDY, Mr Brian, Chief Executive Officer, Australian Competition and Consumer Commission**

**GRIMWADE, Mr Tim, Executive General Manager, Mergers and Acquisitions, Australian Competition and Consumer Commission**

**PEARSON, Mr Mark, Deputy Chief Executive Officer, Australian Competition and Consumer Commission**

**CHAIR**—I welcome the ACCC to these hearings. I invite the ACCC to make an opening statement, if they so desire.

**Mr Cassidy**—We do not have an opening statement. We are here to answer any questions the committee may have and assist as best we can.

**Senator COLBECK**—A lot of the discussion around this whole milk pricing debate has pointed towards predatory pricing behaviour. There is a form of words in the act that outlines what it means. Can you give me a sense of how you make those determinations and what sort of parameters come into that process?

**Mr Cassidy**—Predatory pricing has two key elements to it. Firstly, there has to be a target. There must be an intention to predate someone. That is different to someone suffering loss or harm as a result of the competitive process. What the company with market power does must be targeted at a competitor. It could be a particular competitor, it could be more than one competitor but it must be targeted at someone. Secondly, it must have the purpose of damaging whoever it is targeted at. It could be an existing competitor, or it could be a potential new competitor. They are the two key ingredients that we look for and what is in the legislation is really an embellishment of those key ingredients.

**Senator COLBECK**—So the elements are intention to predate and a purpose of damaging the target.

**Mr Cassidy**—Purpose of damaging the target but also having a target or someone that the conduct is aimed at, not perhaps someone who has suffered in the competitive process. The conduct must be targeted at at least one competitor.

**Senator COLBECK**—Does targeting it broadly at the market in that context not necessarily constitute that sort of action?

**Mr Cassidy**—No, it would be unlikely to in the sense that it is a competitive process in which someone is trying to gain market share, and that is not predatory behaviour.

**Senator COLBECK**—In this overall context how do you go about the process of determining it? Let me use an example: our motive in all of this is to provide cheaper milk to our customers. That is the stated motive that is put on the public record. How do you go about determining what is effectively the action versus what is the stated action?

**Mr Cassidy**—We would look at it in general terms. We would look at the action taken and whether in all likelihood it is about delivering cheaper prices for consumers or whether the action that was taken and the way it was taken was really more likely to be about damaging a particular competitor where whatever benefits were offered to the consumer were probably a by-product rather than being the prime objective. Let me give you a hypothetical example. If a firm with market power, with the ability to do it, was selling products at below cost and choosing the particular outlets in which to sell the products and the outlets just happened to be sitting alongside a particular competitor, you might say that is getting lower prices to consumers but if that is the objective why are they just doing it in these particular outlets? You would start to form a suspicion that what the conduct is really about is damaging the competitor rather than providing lower prices to consumers.

**Senator COLBECK**—I understand what you are saying and I could probably go down a particular track on that if I wanted to because I have to say I have some perspectives about that sort of activity. You have probably investigated several of those cases in the past but I am trying to get a broader sense of where—

**Mr Bezzi**—And some of those cases that you are referring to may not have involved a sustained period, which is the other element of inquiry.

**Senator COLBECK**—That was the next point I was going to come to. Are there any timeframes that you look at around this particular process? It has been put to me quietly and privately that this activity could go on for a period of, say, about six months and it does not offend any of the triggers that you might look at in trying to determine whether or not this sort of behaviour might offend the act. Can you give us a sense of how you determine those sorts of timeframes?

**Mr Cassidy**—Again I am talking in general terms, but the sort of timeframe involved would really depend on the nature of the industry. Let us use the petroleum industry, for argument's sake. In most capital cities you have a weekly price cycle. At least at some points during the cycle there is probably below-cost selling occurring, so if you are looking at behaviour in the petroleum market where the behaviour only lasts a matter of days, you may well say that that is within the normal sort of parameters of the price variations in this industry. On the other hand, it may well be an industry or a market where for someone to sell below cost, even for a relatively short period, could be significantly damaging and unusual in the context of that particular market. You might think of markets or industries where things are done on a one-off basis, for argument's sake, so in those sorts of markets or industries selling below cost, on the face of it undertaking predatory behaviour, for even a relatively short period may meet the requirement in terms of selling for a reasonable period. It really depends on the nature of the industry.

**Senator HEFFERNAN**—How do you determine what is cost?

**Mr Cassidy**—The relevant cost is the cost of whoever it is who is alleged to be undertaking the predatory behaviour. If the allegation is—and this is a common mistake that people make—that, say, Senator Colbeck is undertaking predatory pricing then the cost that is relevant is his cost. If he is selling below what happens to be your cost of supply, that is not relevant because the relevant cost is whether he is selling below his cost of supply.

**Senator HEFFERNAN**—So by consolidated retailing and consolidated processing, if 300 or 400 milk vendors that are out there are all put out of business because they cannot negotiate with a consolidated processor the price that a consolidated retailer can, then that is tough tits.

**Mr Cassidy**—Well, that is an example—

**Senator HEFFERNAN**—That is what is happening all over.

**Mr Cassidy**—which you get quite often in the area of volume discounts, where someone buying in volume will probably get a better deal and a lower cost than someone who is buying in much lesser amounts. But it is the cost of the person who is undertaking the behaviour that is relevant.

**Senator HEFFERNAN**—If the consolidated retailer who has got the better price from the consolidated processor is able to offset that by lowering the standard of the product and then using the excess fat and protein to put into a yoghurt or a soft cheese back to Japan, that is okay?

**Mr Cassidy**—This is what I thought you might have been going to initially. You can, where you have an integrated operation, get some difficult economic issues about just what is the cost of supply for a particular product where multiple products are being provided. But that is an empirical issue for us that we have to assess and deal with, and there are ways of dealing with so-called joint costs and overheads and so forth to decide what the cost of supply of a particular product is.

**Senator COLBECK**—Can we go back to the time thing. How do you determine it? You said that you look at it on an industry basis. What would you pick up that might allow you to determine this? I will put something specific on the record. I have already said that the background that I am getting is that this will go for about six months and then prices will return to normal, and that will be within a time frame that will not offend what is understood in the act. But we have evidence from one of the processors that this sort of activity considerably changed the market in the UK within three months. Would that be something that would direct your attention to what sort of time frame might impact on this sort of circumstance?

**Mr Cassidy**—We would look at the normal pricing behaviour within the relevant market. I would not accept the proposition that has been put to you that six months is necessarily not long enough, which is what I think you are saying. I do not know how someone would make that judgment. Certainly, we have not arrived at that sort of position. But as I say, it is something that you look at in the context of the particular market and the pricing practices in that market.

**Senator COLBECK**—And potentially look at other markets where there have been significant shifts in the practices or activities in that market that have made significant changes in the behaviour of the market? The example has been put to us of one of the major supermarkets

effectively changed the direction, activities and behaviour of the market within a period of three months. That would be something that you would consider as part of your determination on what a time frame might be?

**Mr Cassidy**—Sure, we do not just look at current pricing behaviour; we would also look at the history within the industry or particular sector about what has happened in the past and what sort of time periods seem to be crucial. Yes, you would take all that into account.

**Senator COLBECK**—Getting back to Senator Heffernan's issue with price and you talking about selling below cost, how do you determine what cost is, and what powers do you have to seek out information to determine what cost is?

**Mr Cassidy**—The wording of the act is 'reason to believe' that there may have been a breach of the act. That is a fairly low threshold if you think about it. So if we have such a reason we have our formal information gathering powers. We can get information from a company—essentially we can get all their books. We can see what their supply costs are and what they are paying their suppliers. We can get the company's full accounts, including the sort of internal information that would not normally be made public, in order to get to the issue of what their cost of supply is.

**Senator COLBECK**—But to go down that path you first have to satisfy yourselves of intention to predate and a purpose of damaging a particular target within the market?

**Mr Cassidy**—According to the wording in the act, we have to have a reason to believe not necessarily that there has been a breach but a reason to believe that there may have been a breach of the law or predation. We cannot just do it off the top of our hats; we do need to have some basis to form our suspicion. We have been challenged on this in court on occasions over a period of time. It is a fairly large threshold but we do need to have something.

**Senator COLBECK**—So purely selling something at or below cost is not a test on its own?

**Mr Cassidy**—No, that it just one leg. You can have selling below cost as part of end of season sales, clearance sales and closing down sales. There are all sorts of reasons that you might have selling below cost, at least for a period. That is only one leg.

**Senator WILLIAMS**—I have a supplementary on that question about selling below cost: if Coles buy two litres of milk and land it in their store for \$1.50, does that cost also include the margin for running their people at the check-outs, their electricity and their rent? In other words, \$1.70 could be their cost. Is \$1.50 the price at which the product landed in their shop or does it include the margin to run their store? That is what I am asking.

**Mr Bezzi**—It is the cost of supply, so it would include the additional amount. It includes the 20c.

**Senator WILLIAMS**—It includes the labour factor and the electricity factor et cetera?

**Mr Bezzi**—The cost of supply, yes

**Senator HEFFERNAN**—So we have got to sit back and watch the milk vendor industry be put out of business, which is happening, because they are buying it at \$2.70 and being expected to sell it at a price to compete in the newsagents, the corner stores and everywhere else where it is delivered for \$2.20. This is not damaging a huge part of the industry, you say, because it is not specifically targeted—but that is going to be the impact. Coles—it could be Woolies or Billy the blow-in—are now using trucks to intercept people who are going to Coles to buy milk for \$2 and then resell it in the newsagents or wherever. Coles are saying to them: ‘We’ll save you the trouble. We’ll deliver it.’ Eventually they will get control of more of the milk market than they have now. If they have got control they can do what they like with the consolidation processes, and eventually that all gets passed back to the dairy farmers. Don’t try and kid me that this isn’t going backwards to the dairy farmer. Don’t you have a problem with that? That is what is happening. We are going to get the evidence tomorrow.

**Mr Cassidy**—You guys say that you will get the evidence tomorrow. I have to say to you in the context of this discussion that we are not sitting on our hands. We are engaged with the parties involved in this. I do not want to go into the details of exactly what we are doing or what we have done, but I have to say to you at this point that we have no evidence that Coles is selling below cost. If someone has got that evidence—

**Senator HEFFERNAN**—I do not know—

**Mr Cassidy**—I am sorry. Just let me finish. If someone has got that evidence—because there are some fairly wild claims being made—then we would certainly like to have it. But on the basis of what we have got, we have no evidence.

**Senator HEFFERNAN**—I hear what you are saying. But to save time the question is: what is cost? If the genuine cost to the milk vendors out there is 80c a litre more than Coles, Aldi or anyone else, then they can screw the consolidated processor down because of market power, which eventually puts the vendors out of business. You say that is not damaging—

**Mr Bezzi**—It is different. What you have talked about is not relevant to our assessment.

**Senator HEFFERNAN**—It bloody well ought to be.

**Mr Bezzi**—We are bound by the provision in the Competition and Consumer Act and our focus—

**Senator HEFFERNAN**—Try explaining that to a milk vendor.

**Mr Bezzi**—is on the cost to the corporation that is making the supply.

**Senator HEFFERNAN**—Do you agree that in Australia there is a monopoly situation in milk processing?

**Mr Cassidy**—No.

**Senator HEFFERNAN**—You think three is enough?

**Mr Cassidy**—A monopoly is one.

**Senator HEFFERNAN**—Yes, but a monopoly power; this is about market power. You were the blokes who said 73 per cent of the wholesale market and 100 per cent of the manufacturers was not a monopoly in fertiliser.

**Mr Cassidy**—I am not going to be open to the fertiliser discussions that we had over a long period. There is not a monopoly in milk processing. There are some very big, well-heeled players—

**Senator HEFFERNAN**—So put that test—

**CHAIR**—Senator Heffernan, we have got to move on around the table.

**Mr Cassidy**—I have to insist on being able to finish my answers.

**Senator HEFFERNAN**—I will come back.

**Mr Cassidy**—Okay.

**Senator O'BRIEN**—I want to ask some questions which arise from evidence we received yesterday. Does the ACCC engage in consultation with business about what is permitted under trade practices law in terms of their operation in markets? For example, could a company come to the ACCC and say: 'We're not sure if this particular practice falls within the law. What is your view?'

**Mr Cassidy**—We do not normally provide legal advice, if I can put it that way, in the sense of the law enforcer because that is not our role and it can place us in an awkward position. We do—

**Senator O'BRIEN**—You do not normally provide legal advice.

**Mr Cassidy**—We do spend a reasonable amount of our time and effort in trying to explain it all to parties generally, be they big businesses, small businesses or consumers. If someone has specific conduct that they want to undertake, unless they want to approach us, say for arguments sake, authorisation for that conduct, then they need to seek their own advice on whether that specific conduct is likely to breach the law or not.

**Senator O'BRIEN**—It was suggested to us that Coles would have gone to the ACCC to seek their view as to the legitimacy of their arrangements with processors in reducing milk prices and engaging in what some would say is a very extreme form of competition. Did they do that?

**Mr Cassidy**—No, that is flatly wrong—they did not approach us.

**Senator O'BRIEN**—So they have not come to the ACCC about this before?

**Mr Cassidy**—They did not approach us before; they have not approached us since. That is just flatly wrong.

**Senator O'BRIEN**—Did Coles or Woolworths consult with the ACCC about their generic brand pricing practices at all?

**Mr Cassidy**—Over what period?

**Senator O'BRIEN**—Let's say over the last three or four years.

**Mr Bezzi**—We have lots of interactions with Coles and Woolworths on a whole range of investigations that we conduct from time to time. If you are asking whether they came to us and ask for clearance, the answer is no.

**Senator O'BRIEN**—How they conduct themselves to engage with you to ascertain a view might be described in a variety of ways. I am trying to ascertain whether they have come to the ACCC in any way which could be described as seeking the ACCC's view of certain business practices relevant to their operations.

**Mr Grimwade**—There is one area where they may have, and that is in the merger space. There is a process the ACCC conducts where parties intending to merge or acquire can come in and seek the commission's view in relation to a proposed acquisition.

**Senator O'BRIEN**—But what about other than that?

**Mr Cassidy**—Other than that I would say it would be so unusual that the answer would be no. We are talking about some very well-heeled, well-resourced players here—

**Senator O'BRIEN**—We will agree with you on that comment!

**Mr Cassidy**—Yes, and I do not just mean the retailers, in terms of the milk supply chain. They have their own sources of legal advice. It is simply not the case that, other than as Mr Grimwade said, in the merger space, they come to us asking, 'Is this all right' or 'Is that all right'.

**Senator O'BRIEN**—For completeness, can you check and confirm that?

**Mr Cassidy**—We will take that on notice and check. As Mr Bezzi said, we will be a bit careful, because obviously we may well have had discussions with one or more of the retailers on one or more issues over periods of time. But we will check on that specific issue.

**Senator O'BRIEN**—I would appreciate it if you could do that. I am sure the committee would appreciate that. The other issue I wanted to raise arises from a submission we have about previous section 49 and the different test applied to that section. It is suggested that the test for section 49 was an effects test rather than a purpose test. I wonder whether you could confirm, if you know, that that is the case, that there was a differentiation between that and other existing provisions in the act which you have spoken about in your evidence today—that is, the purpose of certain conduct. And can you tell us of any other provisions in the Trade Practices Act that are tested against the effect of conduct rather than the purpose of conduct?

**Mr Cassidy**—The usual formulation that you find in the competition provisions of the act normally refer to purpose and/or effect, so it covers both. Section 46, which deals with abuse of market power—predatory behaviour—is couched purely in terms of purpose. Some of the secondary boycott provisions are couched in terms of purpose and effect. It is true that the old section 49 on price discrimination was couched purely in terms of effect.

**Senator O'BRIEN**—There is no standard formula.

**Mr Cassidy**—Yes. There is no single answer; that is the story.

**Mr Bezzi**—Probably their usual position is purpose and/or effect.

**Mr Cassidy**—And/or effect—it does not mean the most common.

**Senator O'BRIEN**—Is it the experience of the ACCC that proving effect is easier than purpose?

**Mr Cassidy**—It can be. In subsection 46(7) there is a provision where you can deduce what the purpose was from the conduct. So if you look at the conduct and you say to yourself the only purpose they could have had in doing what they did was in order to damage a competitor, you can get it by that sort of deduction rather than unnecessarily having direct evidence of what the purpose was. That makes it a bit easier. Having said that, I would agree with the general proposition, and I suspect my colleagues would as well, that it is probably easier to establish effect than it is to establish purpose.

**Mr Bezzi**—I slightly qualify that by saying that if you are dealing with an organisation that is in the habit of having lots of exchanges by email and you get your hands on emails which really indicate what their true purpose was, it can sometimes be an easier case than for purpose, in practical terms.

**Senator O'BRIEN**—And can you count those outcomes on both hands, in terms of your experience in prosecution? How many times do you actually get the red hot trail leading back to absolute proof of purpose?

**Mr Bezzi**—I would not want to put a figure on it, but it is not that unusual.

**Mr Cassidy**—You would be surprised at what we do find when we use our information gathering powers. I can remember one particular investigation where we found basically a manual, if you like, on how to avoid investigations by us. It was curiously called an information handling manual, but it had a lot of detail in it about shredding documents and so on.

**Senator HURLEY**—They did not shred quite enough, obviously.

**Mr Cassidy**—That is right—they did not shred the manual, which was probably an error. We do, as I say, get some interesting documents when we use our investigation powers.

**Mr Bezzi**—We have another case we are running at the moment where we have uncovered an email that, if you were trying to tick off all the elements that you needed to for the offence and

put it in one document, contains everything. It is a beautiful piece of work and it was a joy to uncover.

**Senator O'BRIEN**—The parliament repealed section 49 on the basis of the advice of Professor Hilmer's committee that sections 45 or 46 would do the same job, and that therefore section 49 was unnecessary. Have those sections dealt with the issue of price discrimination on the same product between businesses?

**Mr Cassidy**—As you would know, we have had a number of problems with section 46 arising out of a number of High Court cases where the law was not clarified until 2007. I would probably take it on notice, if I could, just to check. I will say that to the best of my knowledge and recollection, there was never a successful case under section 49.

**Senator O'BRIEN**—We are told there was. We are told there were private proceedings; it is *J Cool and Sons v O'Brien Glass Industries* in 1981.

**Mr Cassidy**—Let us take that on notice as well and we will have a look at it.

**Senator O'BRIEN**—We are going to do the same, but that is the submission we have, and that it was a successful case, and that damages were awarded. That is what we have been told in evidence so far.

**Mr Cassidy**—We will check on that for you as well, if that helps.

**Senator O'BRIEN**—Yes, it would. I have no evidence that any regulator has used that section, for reasons which are unclear. Perhaps the behaviour was not followed while the section in place.

**Mr Cassidy**—If you look at section 49, basically it said price discrimination is unlawful if it has the effect of 'substantially lessening competition'. Then there were a couple of exclusions, which included price discrimination because of differing costs and price discrimination in order to match a competitor. When you took all of that into account you had to be able to establish that there was the effect of substantial lessening of competition. Various types of pricing were excluded. So you ended up with a fairly small set of pricing behaviours which potentially would have fallen under that section for consideration.

**Senator O'BRIEN**—Do you know of any such behaviour that takes place now? Perhaps that is an unfair question because it is not in the act that you are charged with administering. It might be a hypothetical question. But it is suggested to us that, were that provision in place, the current behaviour of Coles, for example, might offend that section.

**Mr Cassidy**—Could I perhaps just address that, because I have seen that proposition put.

**CHAIR**—If you would, because it has been raised.

**Mr Cassidy**—The first thing I would say is that if you look at the wording of that section it said:

A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality ...

That raises an interesting issue as to whether branded milk and home-brand milk are of like grade and quality. You might immediately say it is; indeed, perhaps it comes from the same cow.

**Senator O'BRIEN**—Through the same processor, through the same machines, handled by the same people.

**Mr Cassidy**—But, on the other hand, processors spend a lot of time and a lot of money trying to convince consumers that there is a difference. I suspect that, in a hypothetical world, if we had section 49 in place and we were to seek to apply it in the current situation, you would probably find that the processors would be mounting a very strong case that in fact what you are talking about here are two different products, of not the same grade or quality. You may not necessarily agree with that.

**Senator O'BRIEN**—I am not certain that they would do that.

**Senator COLBECK**—We actually have the evidence on the record at a previous inquiry, and I think Fonterra was the company that gave it to us, that said they are effectively the same thing.

**Mr Cassidy**—I know. But, as I say—and you have seen the ads over a period of time, the same as we have—the processors have spent a lot of time and a lot of money trying to convince consumers that they are different.

The second point I would raise—which is interesting to think about when you think about how 49 would apply in the current situation—is that before the Coles action we already had quite a discrepancy in the price of branded versus home-brand milk. Indeed, that was shown in the report of this committee in, I think, table 3.4. The gap was about 60c or 70c a litre. What Coles has done, followed by others, might have widened that gap by 10c or 12c a litre. You then get the question: if it would have applied to the Coles behaviour, what would then be the case in relation to home-brand milk and branded milk more generally? Would that section result in the cost of home-brand milk increasing by 60c or 70c a litre, back to being equal to branded milk?

**Senator O'BRIEN**—Let me put another theoretical proposition to you, and that is: if the provision was in place, the processor would have been much more cautious about offering such a great differential in price for very similar if not the same product, between what is in one carton and what is in another, lest they offended the provision.

**Mr Cassidy**—Yes, if you go back in history, that could be right. But I am just asking you to think a bit about what would be the outcome of that—would it be that home-brand milk would be 60c or 70c a litre dearer than it currently is?

**Senator O'BRIEN**—Yes, you could hypothesise that way.

**Mr Cassidy**—In which case, what does that mean for a lot of consumers?

**Senator O'BRIEN**—That is right. You could hypothesise that way. You could hypothesise that the price pressure would have brought the price down to all retailers.

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**Mr Cassidy**—Maybe it would have gone like that, in which case home-brand milk would have only been 30c or 40c dearer than it is now.

**Senator COLBECK**—Perhaps the water-bedding effect, which we have discussed, and I know you have looked at, might not be so significant. There is an argument that the branded product is at a far higher price so that the processing companies can get an across-the-board return on their overall investment. So because of the downward price pressure from the supermarkets on the supermarket branded product there is a water-bedding effect that keeps the price of the branded product higher.

**Mr Cassidy**—That is one possible explanation.

**Senator COLBECK**—It is an argument that has been discussed.

**Senator O'BRIEN**—These are all hypotheses.

**Mr Cassidy**—What I am saying to you is that you can probably speculate on what the situation would be if we had had section 49 in existence all along, but it perhaps becomes a rather more difficult exercise if you talk about somehow reinstating section 49 now as it would apply to the milk market.

**Senator O'BRIEN**—Do you mean difficult politically or legally?

**Mr Cassidy**—I am just speculating with you as to what the impact would be on milk prices and, ultimately, on consumers.

**Senator O'BRIEN**—I think I understand.

**Senator XENOPHON**—Where is your chairman, Mr Samuel, today?

**Mr Cassidy**—He has commitments in Melbourne.

**Senator XENOPHON**—Can you tell us what those commitments are?

**Mr Cassidy**—Various meetings. There was never any suggestion that the chairman was coming today.

**Senator XENOPHON**—I never made the suggestion. I am just asking where is.

**Mr Cassidy**—He has commitments in Melbourne. We were asked to come tomorrow, but I have commitments in Melbourne tomorrow so that is why I am here today.

**Senator XENOPHON**—Then perhaps I will ask you about what Mr Samuel, who isn't here today but who did speak to the Sky News business program last night, said in relation to this:

But I do think we've actually got to start looking at others in the supply chain, and treat with a healthy scepticism some of these protestations about concerns of the farmer, when it may well be that the primary concern is for these major corporation's bottom line, their profits ...

Do you agree with that comment?

**Mr Cassidy**—I do. I think a certain amount of the argument and what has been put around is basically coming from what are some very well-heeled vested interests, if I can put it that way—in particular, the processors and, I have to say, Woolworths. They are not small entities.

**Senator XENOPHON**—So yesterday, when this committee heard evidence in Melbourne from Australian Dairy Farmers; from Dairy Australia; from Norco, a relatively small processor; from the South Australian Dairyfarmers Association; from Dairy Farmers Milk Co-operative; from the Queensland Dairyfarmers Organisation and from Warrnambool Cheese and Butter about their concerns as to the impact this would have on them, and in particular on dairy farmers, were they protestations?

**Mr Cassidy**—No, I think they are genuine concerns, and they are based partly on the history in this industry, which has seen dairy farmers at the wrong end, if you like, of some of the pricing practices. But, equally, arguments that are being put about how this threatens the existence of branded milk and so forth, are not arguments coming from the farmers; they are arguments coming from other, well-heeled parties.

**Senator XENOPHON**—All right. You may want to read the evidence tomorrow because what you have just said is contradicted.

**Mr Cassidy**—I know what you are saying, but I think they are two different propositions. Certainly we understand the concern of the farmers. Indeed, our main concern is with the farmers on the one hand and with consumers on the other, because they are the smaller parties in all this. But some of the arguments that are being mounted have little to do with the farmers or consumers; they have a lot more to do with the position of the processors.

**Senator XENOPHON**—What arguments are these?

**CHAIR**—Do you want to specify those arguments?

**Mr Cassidy**—For argument's sake, the argument or the concern about what is currently happening may result in branded milk ending up with a significantly lower share of the market.

**Senator WILLIAMS**—What was happening there?

**Mr Cassidy**—That is basically a processor argument.

**Senator WILLIAMS**—There is a raft of it already.

**CHAIR**—Are there any other arguments, Mr Cassidy, that you can call to our attention? Because yesterday we did hear a lot about the plight of the dairy farmers.

**Mr Cassidy**—Sorry, do not get me wrong—I am not saying that the farmers do not have a concern, and I am not saying that, at least based on what has happened in the industry in the past, it is not a legitimate concern; what I am saying is that some of the other arguments that are around are not coming from dairy farmers but from other players in the industry.

**CHAIR**—You have mentioned one argument so far. What are some others?

**Mr Cassidy**—The argument that what is happening at the moment may well see the demise of convenience stores and corner stores and so forth.

**CHAIR**—Selling milk, yes.

**Mr Cassidy**—I would suggest to you that that is an argument which is perhaps coming from some of the larger competitors—Coles and so on—rather than necessarily from those entities themselves.

**CHAIR**—That is possible, but they do not have an organisation to present themselves to us.

**Mr Cassidy**—That is true. I am not disagreeing that farmers have a legitimate concern; all I am saying is that there are a number of arguments around in this which I do not think are emanating from the farmers.

**Senator XENOPHON**—You referred to the history—that is, that the dairy farmers have been at the wrong end of history on this in terms of the impact they have had in the past. Is that correct?

**Mr Cassidy**—Yes.

**Senator XENOPHON**—So what is it about selling milk at \$1 a litre that will not impact on dairy farmers when dairy farmers in Queensland, for instance, indicate that their margins in Far North Queensland are 2c a litre?

**Mr Cassidy**—At the present time, I think all the major retailers have indicated that they are absorbing the cost of the discounting, and—

**Senator XENOPHON**—No, that is wrong, Mr Cassidy.

**Mr Cassidy**—I would like to finish my answers and to insist on that.

**CHAIR**—That is fair, Senator Xenophon.

**Mr Cassidy**—Again, we have no evidence to the contrary on that. I go back to 2000, when Woolworths changed the arrangements for purchasing home brand milk. They moved to a national tender, which drove down the price that they were paying for their home brand milk, and that flowed straight through the chain and ended up with the farmer. That is the sort of history I refer to, but that is not happening at the present time.

**Senator XENOPHON**—Did the ACCC have any representative at the Senate hearing yesterday in Melbourne?

**Mr Cassidy**—Not to the best of my knowledge, no.

**Senator XENOPHON**—Perhaps, if someone was there, they would have heard evidence from the Queensland dairy farmers and, I believe, from the Dairy Farmers Milk Co-operative that under the current contractual arrangements in terms of tier 1 and tier 2, if the sale of branded milk falls—as it has in the evidence given—it would mean that dairy farmers, as Senator Williams has pointed out, would get paid at a tier 2 level rather than at a tier 1 level so that their overall return would drop. It already has dropped, so perhaps if the ACCC was at the hearing yesterday they would have heard evidence from a number of dairy farmers and representative organisations. Would that change your position at all?

**Mr Cassidy**—That does not, I think, conflict with what I have just said—

**Senator XENOPHON**—How so?

**Mr Cassidy**—about the discounting being passed on. You are talking about the consequence of a shift in demand between home brand milk and branded milk.

**Senator XENOPHON**—You said there was no evidence of that a few minutes ago.

**Mr Cassidy**—No, let us be clear: I said there was no evidence that the cost of the discounting—in other words, the money that Coles, Woolworths and whoever else is currently not getting on their home brand milk—is being passed down the chain. There is simply no evidence of that, and they have each said they are not going to do it.

**Senator XENOPHON**—Maybe, if you had been at the Senate hearing yesterday, you would have heard that.

**Mr Cassidy**—I would not have heard it, because that is not what you described; what you described was a shift in demand from home brand milk to branded milk—

**Senator XENOPHON**—I am describing both.

**Mr Cassidy**—and that that is causing problems.

**Senator XENOPHON**—Yes, it is.

**Mr Cassidy**—That is a different issue.

**Senator XENOPHON**—No, it is not a different issue; it is under the current contractual arrangements.

**Mr Cassidy**—This is a different issue—it is not the passing back of the cost of the discounting.

**Senator COLBECK**—It is indirectly, because the farmers get paid a lower price for the supply of generic milk.

**Mr Cassidy**—Yes, but a shift in demand is occurring from the discounting rather than the passing back of the cost of the discounting itself.

**Senator COLBECK**—It is an indirect passing back of costs, so it is a consequence down the supply chain. There is absolutely no question about the fact that it is a consequence down the supply chain. The dairy farmers are getting paid less because they are putting more of their milk into a lower-priced market.

**Mr Cassidy**—Yes, I understand that. I am just saying that that is different to the proposition I was just putting to you.

**Senator COLBECK**—I understand the difference in what you are saying, but the argument that there is no consequence of this to dairy farmers quite frankly does not stack up.

**Mr Cassidy**—No, I did not say that. I said that the direct cost of the discounting is not being passed back.

**CHAIR**—All right, so that is your point.

**Senator XENOPHON**—Maybe we could clarify that once and for all. Under the terms of the current contracts between dairy farmers and processors, if there is evidence that their sales of branded milk drop, whilst the processors will still take the same volume of milk from those dairy farmers, the rate at which the remuneration or the contracted price actually drops—because it shifts from tier 1 to tier 2 at a lower rate—is impacted on as a result of this price war. Is that something that the ACCC will look at?

**Mr Cassidy**—That is something we are aware of and we do have that as part of the current activities we are undertaking. To the best of our knowledge and evidence, so far, the shift between branded to home brand milk following the discounting has been relatively modest.

**Senator XENOPHON**—On what basis do you make that conclusion?

**Mr Cassidy**—I make it on the basis of the material we have before us.

**Senator WILLIAMS**—Which came from where?

**Mr Cassidy**—The issue is, if I might say, that it has a differential impact geographically. It depends on where the dairy farmers are. Some supply almost exclusively for the branded milk, so they will be impacted on more severely by that modest shift than, say, other dairy farmers who are perhaps supplying for the export market or a range of milk products.

**Senator XENOPHON**—Let us talk about drinking milk—fresh milk. You say ‘modest shift’. What is your definition of modest?

**Mr Cassidy**—Sorry, I am just not prepared to start giving numbers.

**Senator XENOPHON**—Do you have those numbers, Mr Cassidy?

**Mr Cassidy**—We have quantitative data, yes.

**Senator XENOPHON**—And you are not prepared to share with the committee what the shift has been.

**Mr Cassidy**—Let me perhaps take it on notice.

**Senator XENOPHON**—Do you have that information?

**Mr Cassidy**—I am not going to be drawn into putting on the table, if I can put it this way, evidence and material that we are in the process of currently gathering.

**Senator XENOPHON**—If it is just the aggregate material on the difference between branded milk and home brand milk as a result of this price war, surely it could not be commercial-in-confidence, could it?

**Mr Cassidy**—Let us take it on notice and I will see what we can do.

**Senator XENOPHON**—Do you have that information?

**Mr Cassidy**—I have just answered that question. We have quantitative information.

**Senator XENOPHON**—But you are not prepared to tell the committee what it is.

**Mr Cassidy**—I will take it on notice.

**Senator WILLIAMS**—Why won't you tell us?

**Mr Cassidy**—Because I want to take it on notice.

**Senator WILLIAMS**—Is there a reason for that? Why won't you tell us now? Do you not want the public to find out? We are seeking information. Why won't tell us?

**Mr Cassidy**—But if I take it on notice and then provide you with an answer it becomes public, so it is not that. I will need—and, indeed, Mr Bezzi and his people will need—to have a close look at the information we have, to make sure that in providing an answer we are not impinging on our current activities.

**Senator XENOPHON**—Mr Cassidy, you knew why you were coming here today. It is a milk inquiry.

**Mr Cassidy**—That is right.

**Senator XENOPHON**—You know what the terms of reference are—

**Mr Cassidy**—That is right.

**Senator XENOPHON**—and you will not share this information with us about the shift.

**Mr Cassidy**—No, I am not saying I will not share it. I am saying I will take the question on notice.

**Senator XENOPHON**—Why weren't you prepared for it today?

**Mr Cassidy**—Senator, there are multiple questions that could be asked. We have prepared as best we can, but we need to take a question like that on notice.

**Senator XENOPHON**—It is a pretty basic question, is it not? It is a pretty fundamental question.

**CHAIR**—It is a very relevant question, but never mind. It is not very productive to pursue it any more.

**Senator XENOPHON**—Senator O'Brien asked a series of very pertinent questions on the issue of communications between the major supermarket chains, including Coles, I think, and the ACCC. I have a supplementary question on that issue. You may be prepared to answer it now but you might want to take it as another question on notice. Has the ACCC had any communications with Coles in the last 12 months about its pricing strategy with respect to milk?

**Mr Cassidy**—Yes.

**Senator XENOPHON**—You have?

**Mr Cassidy**—Yes.

**Senator XENOPHON**—Did that include a pricing strategy in relation to home brand milk?

**Mr Cassidy**—That is the point at which I will take that question on notice. I repeat: I am simply not going to sit here and start going into the details of our current activities on this. Apart from anything else, that could have an adverse bearing on our ability to take action if we need to somewhere down the track. That is a fairly basic investigative issue.

**Mr Bezzi**—We have to protect our enforcement processes. I have to protect my staff.

**Senator XENOPHON**—I know you want to protect your staff and your enforcement processes. There are dairy farmers that are on the edge—

**Senator WILLIAMS**—They want to protect their livelihood as well.

**Senator XENOPHON**—and they want to protect their livelihood.

**Mr Bezzi**—We have a job to do, which is to enforce the act. We have to be careful that we are in a position to do that.

**Senator XENOPHON**—Hang on a second: you reckon you have to enforce the act. You have a situation where the Chairman of the ACCC goes on about protestations. You have Mr Cassidy, the chief executive, saying that wild claims are being made. Haven't you already prejudged this issue?

**Mr Cassidy**—Not at all.

**Senator XENOPHON**—Are you sure?

**Mr Cassidy**—Yes, I am positive. If we have prejudged it then the resources that we have on this would be somewhere else.

**Senator XENOPHON**—Why do you talk about wild claims? Isn't that prejudging an issue? Isn't that unwise?

**Mr Cassidy**—You do not need to look at some of the claims for very long, as I said earlier, to realise that they are not coming from the farmers; they are coming from other players in the industry. That is the point I was making.

**CHAIR**—That is interesting. We might go to Senator Ryan.

**Senator RYAN**—My question follows from Senator Xenophon's question. I appreciate the need to maintain some confidentiality around your enforcement procedures. But if not to a committee to which you have been given notice and which has been the subject of substantial public debate, with whom will you discuss in more detail in a forum that can be iterative—that is, you provide information and we ask further questions—what contacts you have had with a player over such a contentious issue? Is this the sort of thing that should be pursued at Senate estimates committees if not now?

**Mr Cassidy**—When we respond to whatever questions we end up taking on notice, we will quite happily come back to this committee for this inquiry if you want to ask us further questions. But we simply cannot answer a couple of those questions on the spot.

**Senator RYAN**—That is important, I think. Any iterative process to this is very important.

**Mr Cassidy**—We have done that before with Senator Heffernan. I almost do not want to raise fertilisers, but we appeared before Senator Heffernan's committee on fertilisers three or four times.

**Senator XENOPHON**—Mr Cassidy, why won't you tell this committee whether you have actually had discussions with Coles about their milk price discounting? Why won't you tell us?

**Mr Bezzi**—He said we have.

**Mr Cassidy**—I gave you the answer yes.

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**Senator XENOPHON**—How long ago?

**Mr Cassidy**—No—

**Senator XENOPHON**—You are not going to tell us how long ago it was. It was before 26 January, wasn't it?

**Mr Cassidy**—No. So there is a yes and there is a no.

**Senator WILLIAMS**—Mr Cassidy, in your inquiry you are obviously looking at the whole milk discounting situation. In your investigations, will you be looking at the movements in prices at the farm gate for the dairy farmers?

**Mr Cassidy**—Again, I do not want to seem unhelpful, but I do not want to get into particulars of what information we will be seeking and what information we will not. But let me say we are looking at the whole supply chain in relation to milk.

**Senator WILLIAMS**—Of course the whole supply chain includes dairy farmers, where it actually starts.

**Mr Cassidy**—That is right.

**Senator WILLIAMS**—Coles have said there is no justification for lowering the farm gate price of milk. Have you seen their comments about that?

**Mr Cassidy**—I have seen their public comments.

**Senator WILLIAMS**—They are saying there is no justification for lowering the price per litre paid to the dairy farmers. Let me explain what Senator Xenophon was on about in shearers' language. Parmalat are paying the dairy farmers 58c a litre for branded milk. They are paying the dairy farmers 44c for generic brand milk. Nola Marino MP tabled a graph yesterday showing that since 26 January there has been a huge increase in the sales of the generic-type branded milk.

So the more those dairy farmers have to go down to 44c a litre, the less they have going in at 58c a litre and it has already affected their farm-gate price. Yet Coles says there is no justification to reduce the farm-gate price. Surely Coles has got it wrong. There is evidence we had yesterday and I am assuming it is not misleading. There is the first example of reduction of the farm-gate price for the dairy farmer.

**Mr Cassidy**—I understand the point that you are making. But I am not here to answer for Coles. I think that is a question you need to put to Coles.

**Senator WILLIAMS**—Is it not affecting competition and livelihood et cetera? Surely that would come under your umbrella.

**Mr Cassidy**—You would be asking me to comment on a statement that Coles has made. I think that is something for Coles. In terms of the underlying situation that you are describing, which I understand, as I said, that is part of our current looking at this issue.

**Senator WILLIAMS**—When will we have a decision from you from looking at this issue?

**Mr Cassidy**—I cannot answer that by saying it is going to be next week or the following week. It really depends on what we find in our interactions with the parties.

**Senator WILLIAMS**—Would you expect it to be this year?

**Mr Cassidy**—Again, I do not want to be drawn on putting a time frame on this. I do not think that is helpful.

**Senator WILLIAMS**—Okay. Mr Bezzi, you said you have a lot of interaction with Coles and Woolworths—correct?

**Mr Bezzi**—Certainly, yes. They are major retailers, there are a range of compliance and enforcement issues to deal with.

**Senator WILLIAMS**—Within the hierarchy of Coles and Woolworths, you would know individuals personally. Are there people in those big organisations who you deal with on a regular basis, to talk to and discuss things?

**Mr Bezzi**—Yes.

**Senator WILLIAMS**—So you know them personally?

**Mr Bezzi**—In a professional sense, yes.

**Senator WILLIAMS**—You have never been out to dinner with them at night or anything like that?

**Mr Bezzi**—No, not that I can recall.

**Senator WILLIAMS**—I just wanted to clarify that. That is pleasing to hear. I will hand on to someone else.

**Senator HURLEY**—We certainly did hear some quite strong concerns from processors about the whole process and about the action by the big retailers, Coles and Woolworths in particular. Have you received any complaints from those milk processors?

**Mr Bezzi**—We might need to take that on notice to be sure that this is the correct answer, but I think the answer is no. We have had complaints from some industry associations and from one retailer that I can think of and a whole lot of form complaints from dairy farmers.

**Senator HURLEY**—Right.

**Mr Bezzi**—Perhaps we could check that and take it on notice.

**Senator HURLEY**—I think it is well acknowledged in what we have heard so far that it is the farmers who are at the bottom of the chain that do seem, depending on where they are, to be very much affected by not only this but what has happened previously in driving down the price of milk. One of the solutions to this that has been discussed is collective bargaining. It was mentioned that in some instances the ACCC has rejected applications for collective bargaining. Can you tell us a little bit about your process for that and whether that is true.

**Mr Cassidy**—The mention was in relation to dairy, was it?

**Senator HURLEY**—Yes. Dairy farmers collectively bargaining with milk processors, not the retailers.

**Mr Cassidy**—There is an authorisation in place with the Australian dairy farmers that has been in place since 2002, which is Australia wide, which allows any dairy farmers to collectively negotiate with their local processor or processors. That covers the whole of Australia. In fact, I think it is the only whole of Australia collective bargaining arrangement that we have authorised. Separately to that there was a collective bargaining arrangement authorised, I think in southern Queensland. They wanted to extend that into northern New South Wales. We had a problem initially with the way that they were proposing to do that, with the wording of the authorisation application if I can put it that way. We did not agree to that. They went away, reworked that, came back and then we did agree to it.

That is the only rejection of collective bargaining in the dairy sector that I am aware of, but that was more a technical hitch rather than something that still stands today. To come back to where I started, this was an authorisation in the case of collective bargaining by any dairy farmers anywhere in Australia with their relevant processors.

**Senator HEFFERNAN**—The difficulty with that of course is that you have got, you say not monopolistic processors but, if I could just take you, with permission of the Chair, to the north Queensland situation—

**Senator HURLEY**—I think, Senator Heffernan, that you are able to follow on from my questions, if I could just continue. That Australia-wide approval for collective bargaining is with the dairy farmers.

**Mr Cassidy**—That is right.

**Senator HURLEY**—The dairy farmers milk processing—

**Mr Cassidy**—Any group of dairy farmers can get together and collectively bargain with their processor or with any processor within their relevant geographic area. It has been used. We know of some dairy farmers who, as part of that collective bargaining, have shifted from one processor to another where they had a choice of processors. That collective bargaining arrangement has been used. I think it could be used more, to be quite honest. The dairy industry is just one of a number of industries where, in our view, there is not as much use being made of collective bargaining as there could be, even though there has been more made in dairy than perhaps in

some other industries. Given processors have an interest in reaching agreement with farmers for the supply of milk, if they have certain overhead costs then the nature of processing is that they require throughput so it is a situation where dairy farmers would be well placed in getting together and collectively bargaining with processors.

**Senator HURLEY**—If this situation with their home-brand or generic milk gets to be a longterm situation, or even worse, then there is no problem with the dairy farmers getting together and saying, ‘We want more for home-brand milk.’

**Mr Cassidy**—There is no impediment to dairy farmers getting together and collectively bargaining, that is right.

**Senator HURLEY**—Where, of course, there is a choice of milk processors—which may be a great difficulty in some areas—and there is not only one processor to take it.

**Mr Cassidy**—That is right. As I was saying earlier, the situation with dairy farmers does vary between geographic areas, although in most—I would not say all—areas there is more than one processor operating, so the majority of dairy farmers would have a choice.

**Senator HURLEY**—It would not be legal for the processors to get together to decide that they were not to offer very much.

**Mr Cassidy**—No, the processors have no authorisation from us in relation to them getting together.

**Mr Bezzi**—And they would be on the receiving end of an investigation from us. If we got wind that that was going on it would be a very serious cartel matter.

**Senator HURLEY**—The processors are saying that they do not have the power to deal with the big retailers because the big retailers are the big retailers of their milk. Is there any remedy there or is the competition between milk processors in Australia enough to say they are big enough and competitive enough on their own to deal with these big retailers?

**Mr Cassidy**—The processors we have in Australia—leaving aside some small or localised ones—are basically multinational companies. They are not little guys who are in a sense incapable of looking after themselves; they are quite substantial entities in their own right.

**Senator HURLEY**—They are in a bargaining situation with fresh milk. Some people in the industry are saying that it will not be a problem if retailers cannot acquire fresh milk from the processors because they all want to go to UHT and powdered milk, in any case, and that this is a situation that has arisen in Europe. I think Senator Xenophon might have said the same thing, earlier today. Are there countries in Europe where UHT or powdered milk is the predominant form of milk supply, rather than fresh milk?

**Mr Cassidy**—We understand that is the case. I suspect you are starting to get into an area which is more for DAFF, who I think you are seeing tomorrow and who, in a sense, know a lot more about the dairy industry, both locally and internationally, than we do—but, yes, I have

certainly seen that. There are some areas in Europe where long-life milk is a fairly significant component of the milk-drinking market.

**Senator HURLEY**—Is that what retailers or any other part of the industry wanted?

**Mr Cassidy**—I do not know the answer to that. As I said, it is perhaps something that DAFF would be better placed to answer.

**Senator HURLEY**—If this is a demonstrated phenomenon in another country, where some arrangement which has been profitable for one group has caused a loss of fresh milk in a country and which might be a longterm strategy, would it be something that you could or should take into account in your inquiries?

**Mr Cassidy**—It would certainly be relevant. It goes back to the questions we were asked earlier by Senator Colbeck on predatory behaviour, motivation and so forth. Equally, I would say that branded milk is about six per cent of the total output of the Australian dairy industry. You would have a long way to go before you got to a position in Australia where you did not have fresh milk.

**Senator HURLEY**—We have a long way to go, but that does not mean we want to allow conditions where—

**Mr Cassidy**—No, I am just putting it into perspective. Branded milk, which some people allege is being targeted, is actually about six per cent of the output of the Australian dairy industry.

**CHAIR**—Mr Cassidy, you mentioned predatory pricing. Is there a time factor in predatory pricing—consideration of the length of time that prices are kept low?

**Mr Cassidy**— Senator Colbeck asked earlier the question of how we judge that. I said it really depends on the nature of the industry, the degree to which prices in the industry move and, if you like, the history of the industry. If someone is selling below cost and it goes on for longer than X months then that must be one of the criteria met for predatory pricing, because the relevant period depends on the nature of the industry.

**CHAIR**—Yes, exactly. Coles have said they are going to keep prices ‘down, down, down’ forever.

**Senator XENOPHON**—‘Down, down and staying down.’

**CHAIR**—Is that the kind of remark that might lead you to be more vigilant in assessing this issue of predatory pricing?

**Mr Cassidy**—I will answer your question by putting it slightly differently. When looking at an issue of possible predatory pricing, if the alleged perpetrator of predatory pricing says, ‘I am going to keep pricing the way I am forever more’—or at least for a lengthy period of time—then clearly the timing issue is something we would take into consideration.

**CHAIR**—Very good. We will expect you to keep a close eye on Coles, for that reason.

**Senator HEFFERNAN**—Staying on predatory pricing, I would have thought that 80-odd per cent of the pre-package market with two in Australia against 40 per cent for five in the United States and 60 per cent for five in Canada is a fair bit of market power as a retailer. You say that the spectre of three of the processors is not a monopoly, but geographically they can be very much of a monopoly. I take the instance of Parmalat in northern Queensland: one of the two retailers, without being too specific, renegotiates and decides to go with National Foods. As a consequence the dairy farmers on the Atherton Tablelands are up the ditch—as it were, without the ‘s’ word. Parmalat says to National Foods, ‘We will package your milk for you and you can sell it up here’ and they say, ‘No, we’re going to get it from southern Queensland; we know what the cost of freight is.’ As a consequence the Cairns milk goes to Darwin almost at a loss. Do you think that is appropriate behaviour? Don’t you think that is monopolistic?

**Mr Cassidy**—The question you pose for us is whether the behaviour breaches or potentially breaches the law. I suppose—

**Senator HEFFERNAN**—I understand that, as you know. But the difficulty is: is not the law, like the gene patent law, out of date on this interpretation? That is clearly stupid for the Atherton Tablelands dairy farmers to have to send their bloody milk to Darwin to sell it and the southern Queensland bloke sends his milk to Cairns to sell it as a consequence of a set of rules for which you are the bunny. The law, as I see it, is inadequate. Is there not something we should be doing about this? This seems crazy because the option then is for the dairy farmers on the Atherton Tablelands to say, ‘Well, we’ll give it away.’

**Mr Cassidy**—Your question is a bit difficult to respond to without having a lot more detail on exactly what is going on and why. I just cannot respond to that off the top of my head.

**Senator HEFFERNAN**—You say that three international processors are not a monopoly, but they can behave very much in a monopolistic way geographically. It does not matter. The good idea of collective bargaining does not work, because the combination of the three international processors with a couple of local retailers does away with the capacity to bargain. They just say, ‘We don’t want your milk; send it to Darwin mate.’ Is that not a loophole?

**Mr Cassidy**—I know what you are saying, and I said earlier that while in most areas there are a number of processors who are operating, so dairy farmers do have a choice as to who they supply, there are some geographic areas where that is not the case, where they may have only two or perhaps even one processor. I do not know that I would necessarily agree that that means collective bargaining cannot of any use at all.

**Senator HEFFERNAN**—But it does mean that there is a monopoly.

**Mr Cassidy**—If you only have one, that is a monopoly.

**Senator HEFFERNAN**—Yes, well we have a monopoly situation in a good bit of the dairy market in Australia.

**Mr Cassidy**—I do not know that we would agree with that.

**Senator HEFFERNAN**—No, I am sure you would not.

**Mr Cassidy**—Sorry, I am not sort of saying it off the top of my head. In our 2008 grocery report we had dairy as one of our case studies. If you look at that report it documents where the various processors operate and how many of them are operating in the various geographic areas. No, we certainly would not agree that in most of Australia you have a monopolistic-processor situation.

**Senator HEFFERNAN**—But where you do, it has a flow-on effect. The cost of getting milk from South-East Queensland to Cairns is ridiculous compared to getting it from the Atherton Tablelands.

**Mr Bezzi**—That may also make it more competitive, more possible for the dairy farmers in North Queensland to do what we have seen reported in the *Sydney Morning Herald* this morning. Some of the farmers on the South Coast of New South Wales have got together, established their own processing capacity and have taken advantage of the fact that they do not have to pay the extra transport costs.

**Senator HEFFERNAN**—I agree with that. It means there is something wrong with the system now and, like the fertiliser thing, we need competition. The cover in this argument by Coles and others has been the international market. Sure, the subsidies come off in Europe, and the global food fight is on, but the equivalence of difference in the export—the non-market, manufactured milk—is not reflected in the return at the farm gate. It has been a very reluctant exercise to put the price up at the farm gate despite the spike in the international market. Are you aware of that? It is a con job.

**Mr Cassidy**—You may be talking about particular geographic situations but, as a general proposition, the farm gate price of milk has been increasing in recent times, reflecting what has been happening in the international milk market.

**Senator HEFFERNAN**—It has gone from 34c to about 40c around Wagga, where I live.

**Senator RYAN**—Mr Cassidy, I would like to give you the chance to put on record a response to my summation of a couple of issues that have been raised by the submitters. There is a regulatory reluctance by the ACCC and its predecessor agencies to pursue abuse of market power issues through the courts. A substantial number of instances of alleged predatory pricing or abuse of market power are brought to the ACCC but there is a reluctance to pursue these, in a legal way, in this retail grocery and other sectors. I would like your response to that.

**Mr Cassidy**—It would probably not surprise you if I said I do not agree with that. We did have a problem with the law for a period of time after the Boral case in 2003, the Metway case, the Rural Press case and the Northern Territory power case. They all went to the High Court which, basically, said that the law was different to what we thought it was. That was not remedied until 2007. But there has been no reluctance on our part and I have answered this question previously. We currently have 12 detailed investigations underway in relation to section 46 conduct. The problem we had up until 2007 was that, even though we might have had six, seven or eight investigations underway at any one time, when we got to external legal advisers,

which we were required to do, the advice was that the case we had would not meet the sorts of thresholds the High Court had set, and that has been our problem.

**Mr Bezzi**—Having said that, we have had one successful predatory pricing case that we concluded in recent months, which we are very pleased about—I have to put this on the record. We feel that the result we got in that was a very good result and it sent a strong signal to industry that we are serious about pursuing predatory pricing cases. There was a very substantial penalty imposed. It was a difficult case. It was an industry where there were substantial resources arrayed against us, but we pursued it and we got, I think, a very good result.

**Mr Cassidy**—That was Cabcharge, and we are awaiting judgment on another case in the courts at the moment.

**Senator RYAN**—One of the other things that has been put, in private conversation, to a number of us on this side of the table is that there is a reluctance—I am not trying to substantiate the claim; it was observation rather than judgment—by some suppliers in the retail grocery sector to come forward and speak publicly to us, even if it were in camera, because of the market power and the fact that their businesses are often dependent upon one retailer or the other, sometimes both. It has also been put to me that that actually is a challenge for the ACCC. What is your response to those claims?

**Mr Cassidy**—Again, talking in general terms, we do encounter this. There can be a reluctance on the part of parties to come forward, particularly when they are dealing with some powerful interests. That is one of the reasons why we are very protective of our investigations and about whether or not we are carrying out investigations. Part of encouraging people to come forward is that we do what we can to protect our sources. There are provisions in the act that provide that harassing someone or taking action against someone because they have assisted us with an investigation constitutes an offence.

**Senator RYAN**—Have you had grounds to utilise that provision?

**Mr Cassidy**—We have.

**Senator RYAN**—Is it an oft-used provision or is it rarely used? I am not familiar with it.

**Mr Cassidy**—It is not oft-used, but it is there. We have used it.

**Senator RYAN**—Do you find it is an effective deterrent to misbehaviour and that it sends a signal to those who would like to come forward that it is an effective incentive for them for protection to speak to you, or do you think there needs to be something else operating?

**Mr Cassidy**—I would not say we need anything else operating, but we are terribly conscious of the issue you raise. We do do all we can. Again, this is one of the reasons we do not like talking about our investigations and our processes. We go to quite considerable lengths to protect those who do come forward.

**Senator RYAN**—Is it possible for you to take on notice how many times that process has been used in recent years with a short description of the case or the circumstances?

**Mr Cassidy**—Sure. We can do that.

**Mr Bezzi**—The other thing that is very important for witnesses is that we be able to protect the confidential information that they give to us through the process right up to the court process. We find in some cases that it is becoming difficult for us to do that in the court process.

**Senator RYAN**—Because of the court process and the discovery process?

**Mr Bezzi**—It is because of some aspects of the court process that have become slightly more difficult in the last while.

**Senator RYAN**—Turning to an issue that was discussed briefly before on the potential for parts of Australia—this is observation rather than my own judgment—to lose access to regular fresh milk supplies and have them replaced with UHT. Is it fair to characterise your role as one where unless there was an abuse of market power provision that—if parts of Australia did not have access to fresh milk but had access only to UHT, as I imagine some parts of Australia do at the moment—it is not a policy issue for the ACCC, it is actually a policy issue for this side of the table?

**Mr Cassidy**—That is correct. Our frame of reference, if you like, is to enforce the law. We need to have conduct which, at least on the face of it, may constitute a breach of the act. We cannot look at a situation, and this goes a bit perhaps to some of Senator Heffernan's questions earlier, and say, 'We do not like that, so we're going to do something about it.' It has to be in the context of a potential breach of the law.

**Senator WILLIAMS**—Mr Cassidy, we heard earlier today that most countries, perhaps all countries excluding New Zealand and Australia, have a section 49 or equivalent. Are you aware of that? Which jurisdictions have a trade practices provision similar to section 49? We are told that it exists in Europe, Canada and the USA.

**Mr Cassidy**—Canada does not. The USA has the Robinson-Patman act, although there have been a number of recommendations that it be repealed. I think there is still on the books a provision in European law, article 85 (1)d, which prohibits agreements that apply dissimilar conditions to equivalent transactions with other trading parties—there is a competition test—thereby placing them at a competitive disadvantage. That sort of law does exist in some countries, although I would not agree with your proposition that most countries have it, because those sorts of laws have been repealed in a number of countries in recent years.

**Senator WILLIAMS**—Why was it removed in Australia? Was it simply because sections 45 and 46 could have done the job, or was there a particular reason?

**Mr Cassidy**—The logic of it goes back to the Hilmer inquiry—the National Competition Policy Review Committee. They observed that anticompetitive price discrimination almost invariably involves a firm with market power. You have to have market power to make it stick. Alternatively, a group of suppliers has to get together and agree on the price discrimination; otherwise, it just does not work. The point the committee made was that if it is a use of market power then that is what section 46 is about. If it is a group of suppliers getting together and deciding on the anticompetitive price discrimination, then that is what section 45 is about.

Basically, the Hilmer committee said that they did not see a role for section 49, because the conduct in question was already covered by sections 45 and 46.

**Senator COLBECK**—I just want to go back to some evidence Mr Bezzi gave us earlier about not having any evidence of milk being sold below cost at this point in time. I am not verballing you by saying that, I hope.

**Mr Bezzi**—No. That is a fair statement.

**Senator COLBECK**—I want to go back to evidence that Coles gave us in a previous inquiry. They said that their gross margin on their milk was about 22 per cent. Their advertisements say that their price is going from \$2.47 to \$2. That is a 23½ per cent reduction in their price, which exceeds their gross margin. I need to get a definition of what you determine to be ‘below cost’, taking into consideration that Coles have publicly said—and I am happy to accept what they have publicly said so far—that they have in fact paid their supplier an increase in their price. If I add all those things up, that says to me that they are selling below cost. Their advice initially was that their gross margin, which includes all their in-store costs, is about 22 per cent. They have reduced their price by 23 per cent and they have increased their costs from the supplier. That is the evidence that is on the public record. You are telling us that there is no evidence that they are selling below cost. That brings me to question the evidence they have given us as a Senate inquiry and whether they have actually misled us.

**Mr Bezzi**—It is hard for me to give you an answer on the run. I would need to understand exactly what products you mean. Are you talking about the line that has been withdrawn or the home brand line that continues to be sold?

**Senator COLBECK**—I think that is where it comes back to detail in evidence, but their evidence to us was that generally their gross margin on their milk in their store was 22 per cent. That is all I have on the public record, so that is all I have to go on. They have given their processor an increase in price but they have reduced their price by 23½ per cent, which is greater than what they have said their gross margin is. To me, that is evidence that they are selling below cost. You have access to stuff that I do not, and obviously we will get the opportunity to question Coles further on that, but in the context of a lot of the other things they have been saying publicly, I do not think their public statements are adding up. Here is another circumstance of their public statements not adding up.

**Mr Bezzi**—We are looking very carefully at all their public statements. We are also looking very carefully at other information and evidence that we have gathered. I probably cannot go into the detail of that at the moment.

**Senator COLBECK**—No. I do not want you to jeopardise anything, but perhaps I can get you to clarify something. You indicated to Senator Williams, I think, that cost includes—

**Mr Bezzi**—It is the cost of supply. It is the cost of making the supply from the store.

**Senator COLBECK**—So it is not just the price they pay their supplier for it.

**Mr Bezzi**—No.

**Senator COLBECK**—It includes some of their in-store costs.

**Mr Bezzi**—Yes, in-store costs, staff costs and all the costs of supply.

**Senator XENOPHON**—On notice, in relation to any communications between the ACCC and Coles on milk pricing in the past 12 months, can you advise on what date or dates such communications took place? Secondly, were the communications in person, by phone, in writing or by other means? Thirdly, who were the parties to such communications?

My next question on notice: in terms of the advertising slogans ‘Down, down’ and ‘Staying down’, surely there must be parameters as to what time frame that will be in? And is there a potential conflict between being misleading if you do not keep prices down low enough and, if you keep them down too long, a potential impact on the issue of predatory pricing?

**Mr Bezzi**—We can handle those questions on notice.

**CHAIR**—With that we conclude this session. I thank the ACCC for being here and for being so willing to answer questions, some of which were difficult. You provided good answers, and we look forward to seeing you again on another occasion. Thank you very much.

**Proceedings suspended from 3.00 pm to 3.20 pm**

**ZUMBO, Associate Professor Frank, Private capacity**

**CHAIR**—We welcome Professor Zumbo, who is a frequent witness at our various inquiries. Professor Zumbo, would you like to make an opening statement?

**Prof. Zumbo**—Thank you. As always, I welcome and appreciate the opportunity to appear before this committee. Yes, I am a frequent flyer in terms of this committee; I certainly enjoy appearing before it. The issue we have today is ultimately a microcosm of a range of problems we face in the economy. Having listened to the ACCC evidence, I have to say from the outset that there is a common thread in the problems we face in milk, groceries and banks, and it is the inaction of the ACCC over an extended period—the failure of the ACCC to stop the increasing consolidation of these markets, which means they are becoming more concentrated. As they do, we have markets characterised by oligopolies. These oligopolies operate as a cosy club, and the milk processing sector is an example of that; it is highly concentrated. Our grocery sector, our supermarket sector, is one of the most concentrated sectors in the world. When you look at the fact that we have some of the most highly concentrated sectors in the world, it is hardly surprising that we have these regular inquiries. I suspect we will have inquiries into other sectors, particularly as Coles and others choose to strategically lower prices on particular items.

In relation to milk, home brand milk in particular, there are two threshold questions that need to be addressed. The first is: is home brand milk being sold below cost? We can have a discussion about what the relative cost is, but we can ultimately get a number as to what represents the cost to Coles and the others. In relation to Coles, the question is: is Coles selling home brand milk below cost? That is a threshold question because there is a law, commonly known as the Birdsville amendment, that prohibits predatory pricing. That law states that, if you price below cost, if you lower your costs for a sustained period of time for an anticompetitive purpose, that may amount to a breach of the Competition and Consumer Act, previously the Trade Practices Act.

I have to say, for the sake of completeness, that I was fortunate enough to draft the Birdsville amendment. Having drafted that section and having been aware of the problem with section 46 for an extended period of time I can tell you that there is a major problem with section 46 generally. The Birdsville amendment tried to fix one of the problems in relation to predatory pricing. But section 46 does not deal effectively with all the areas that it was expected to deal with.

We have heard evidence that section 49 of the old Trade Practices Act was repealed. That was a provision against anticompetitive price discrimination, made on the basis that section 46 would do the same work. But section 46 has not done the same work. Section 46 has failed in its objective of dealing with abuses of market power. There were High Court decisions that basically undermined the effectiveness of section 46. In one of the areas, predatory pricing, we were fortunate enough to remedy the problems that the High Court gave rise to in their, I believe, mistaken decisions—with all due respect. The Birdsville amendment dealt with only predatory pricing; therefore, section 46 needs to be remedied in relation to other areas, including anticompetitive price discrimination.

We need to know whether home brand milk is sold below cost. At the end of the day, it is a simple yes-or-no answer. Coles will come up with a number and then we will work out whether it is below cost. If it is not below cost then it is the end of the matter in terms of the Birdsville amendment and predatory pricing. If it is below cost then further questions need to be asked—that is, whether it is for a sustained period and Coles has provided us with evidence that those prices will be staying down so you can suggest that it is a sustained period. Then the question is whether it is for an anti-competitive purpose. In that regard, the ACCC would be able to review all those emails. We heard from the ACCC that they look forward to finding those emails that give away what Coles is trying to do.

It is a question that the ACCC can answer. The ACCC do have the powers, the ACCC can investigate, they can call Coles in and ask what Coles believe their cost is. The ACCC can consider that carefully and make an assessment as to whether there is a breach of the Birdsville amendment. It is a very simple exercise that the ACCC can undertake. It may involve complex information, I accept that, but it is an exercise that can and should be done and should be done urgently.

The other threshold question is the question I believe all consumers would like answered. If Coles are reducing the price of home brand milk, what are Coles doing to the prices of other products in the supermarket? We have been told publicly by Coles that they have lowered or are expecting to lower upwards of 5,000 items. However, there are upwards of 20,000 products or more at a Coles supermarket. The real question is: what is happening to the other 15,000 products? Are the prices of those other 15,000 products going up? In other words, if the price cuts to home brand milk are being offset by higher grocery prices elsewhere in the supermarket then consumers will be worse off. We cannot look at the reduction in the home brand milk price in isolation from what Coles may be doing in relation to other products.

Ultimately what Coles are doing is one of the oldest tricks in the retailing book—that is, you lower the price of a handful of items, you get a bit of publicity, you hook consumers in and then you fleece them on other products in the supermarket—a very simple strategy. When the corner store did that and lowered a handful of products, people did not worry so much about that. But when you have one supermarket chain and then a second supermarket chain and together they operate 87 per cent of supermarkets over 2,000 square metres you have an economy-wide problem. That problem has a knock-on effect for milk processors.

There is no doubt, given past practice of Coles and Woolworths, that they will seek to push down the price they pay to milk processors because Coles and Woolworths are in the business of increasing the profit margins on their products. Over time the milk processors will do the same. They get squeezed, they want to protect their margins so they squeeze the dairy farmer. The problem for dairy farmers is they reach a point where they can be squeezed no more and they go off the land or they get into some other type of farming. The real danger is, when you have this behaviour of Coles and Woolworths at a retail level, that has a knock-on effect down the chain to a point where it may jeopardise access to fresh milk in Australia.

**Senator HEFFERNAN**—The dairy farmer squeezes the cow.

**Prof. Zumbo**—Yes, more squeezing goes on! There is a point beyond which you cannot squeeze the cow obviously. The point then becomes, if we lose access to that fresh milk or there

is a reduction in supply of fresh milk, over time the price of fresh milk will inevitably go up. Fresh milk may become a luxury item, but the one thing we need to be very mindful of is that I do not believe that Coles and Woolworths would lose any sleep if they substituted long-life UHT milk for fresh milk. Fresh milk is a nuisance to handle with its costs and refrigeration. If they did not sell fresh milk or they sold a whole lot less of it and moved consumers on to long-life UHT milk, I do not believe Coles and Woolworths would lose any sleep. In some countries in Europe that is what has happened—basically you only get long-life UHT milk.

Those are the two fundamental questions. Ultimately, I have made eight recommendations and I have targeted those recommendations. There were other recommendations I could have made. We have some of the weakest competition laws in the world. We need to strengthen those laws. But in dealing with this particular inquiry, I focused on the recommendations that I believe would bring immediate benefit, immediate relief on some of these issues that we are facing today.

From what we have seen, the ACCC likes to watch. They take a long time to investigate. They could not even answer the question on whether they could give an answer about their investigation before the end of the year. If we have to wait beyond the year then there is something seriously wrong with someone's investigative processes. But this is not an inquiry into the ACCC. We probably do need an inquiry into the ACCC, but that is for another day.

What we need is an office of the Australian small business and farming commissioner. I will be fair to the ACCC, to this extent: some of the issues that are raised are business related issues. They are about dairy farmers dealing with milk processors and milk processors dealing with Coles and Woolworths and other supermarket chains. Some of those issues do not directly raise issues under the Competition and Consumer Act. They are business issues. There may be business disputes. So you really need a mechanism, a small business and farming commissioner, that can help the dairy farmers in a very practical way in their dealings with the milk processors. A commissioner would provide a valuable role in dealing with those areas that fall through the cracks at the moment, areas that the ACCC takes too long to investigate and where there may be a lack of dispute resolution processes and, ultimately, a small business and farming commissioner could provide dispute resolution processes.

The other thing we need to do is provide full price transparency to consumers. There was the failed GROCERYchoice website. Following that we were told there would be an industry website. Then Woolworths came out and said they would have a prices check website with a number of their products, several thousand, but not the full range of products on the website. Coles have said in the past that they would not match or follow Woolworths in terms of providing a prices website. Coles did not want to be in that space of providing online full pricing transparency. They all provide weekly specials online—they would do that—but what I am talking about is consumers being able to go online and review the prices of grocery items across the supermarket chains. That empowers consumers.

Woolworths had made that start but, having gone onto the website the other night, I got the one line that said the prices check website from Woolworths had been pulled and was currently under review; therefore, that small step—perhaps a token step, but a step nonetheless—by Woolworths to provide some pricing transparency is no longer available to consumers. Having dug around a little bit more, I found that there was one reference to the Woolworths price check

website being under review, in an article about a month ago. So it appears that it has been offline for at least a month. It would be very interesting to know how long it has been offline and how long it will continue to be offline because, at the time, Woolworths made a big deal about the price check website and the benefit it would provide to consumers. But that benefit is non-existent until the site is restored or until Woolworths makes a decision as to whether it will restore it. So there are some broad issues. I will not go through all the other recommendations—I will touch on those in answers to senators' questions—but I was hoping to provide a glimpse of the future and a glimpse of some of the real problems we face today.

**CHAIR**—Thank you very much, Professor. One of the things you have talked about a lot is competition law. Do you think there are any specific gaps in competition law which have a particular relevance to the dairy industry and which we might consider some way of remedying?

**Prof. Zumbo**—There are two areas that need to be remedied in our competition laws. The first is we need an effective prohibition against any competitive price discrimination. Australia is out of line, out of step, with international practice in this area. Other jurisdictions have express prohibitions against anti-competitive price discrimination. We do not. Any hope that section 46 would deal with that issue, I have to say, with all due respect, is somewhat misplaced if not delusional. We therefore do need an express prohibition against anti-competitive price discrimination.

The other one that I do not mention here but is one of my old favourites is that we need a general divestiture power, as per the United Kingdom and the United States. Once again, Australia is out of step with international best practice in not having a general divestiture power. To the extent that those two provisions are not in our competition laws we are out of step with international best practice and those two areas need to be remedied.

**CHAIR**—Can you give us some more detail about a divestiture power?

**Prof. Zumbo**—The way that a divestiture power would work is simply that a court would have that as a possible order in relation to, for example, abuses of market power. There is no reason why it could not be expanded to other potential breaches of the competition laws but typically it is linked in with a monopolisation or an abuse of market power provision.

**CHAIR**—Is that a percentage of the company, if you like, that has to be sold off or the whole lot? How does it work in practice?

**Prof. Zumbo**—In practice it could be sold off as particular units, and it could be broken up on a geographical basis. It would be up to the discretion of the court in appropriate circumstances. In the case of vertically integrated companies it could be a vertical separation. It would need to depend very much on the particular factual context.

**Senator RYAN**—Just on that, Professor Zumbo, is it only in response to effectively a conviction upon a breach that those powers are utilised?

**Prof. Zumbo**—Yes, that is the US model. The UK model is slightly different in that under their competition laws there is an ability to bring about a restructure of an industry in certain circumstances.

**Senator O'BRIEN**—Can you supply the committee with the details of other jurisdictions where there are price discrimination laws, and copies of the provisions if that is possible, and the same in relation to the divestiture power that you mentioned?

**Prof. Zumbo**—Sure.

**Senator O'BRIEN**—In relation to your ombudsman proposal, are you saying that the organisations which represent farmers and other small business people are ineffective and therefore there needs to be some sort of public mechanism to carry their case to government? Is that what you are suggesting?

**Prof. Zumbo**—I am not sure I understand your question. The role of a commissioner is to assist, in this particular situation, dairy farmers in their dealings with milk processors. In this context the dairy farmers themselves could approach the commissioner and an industry association on behalf of the dairy farmers could approach the commissioner, so the commissioner is a vehicle. There is one currently operating in Victoria—the Victorian Small Business Commissioner. I am currently working with the South Australian Labor government in relation to a small business commissioner in South Australia where the proposal is that a farmer or small business can take a grievance directly to the commissioner, or someone else on behalf of the small business or farmer can do so. It is not about excluding industry associations; it is more of a reflection that the ACCC is ill equipped to deal with certain issues. The ACCC is not into dispute resolution processes such as mediation, but a small business and farming commissioner could adopt those processes in helping to deal with dispute resolution in that sector, as well as other sectors.

**Senator O'BRIEN**—So it is a dispute resolution body?

**Prof. Zumbo**—Largely so, but not solely.

**Senator O'BRIEN**—What are the other functions?

**Prof. Zumbo**—The others could be to identify emerging trends where there are issues, such as a lack of transparency in negotiations, and to provide more timely information. The commissioner could assist in facilitating that. The commissioner could be available to facilitate development of industry codes, to help streamline processes and to help negotiation processes. There are mandatory codes already and they work effectively in other sectors. The commissioner would essentially be a troubleshooter who is available to dairy farmers in this case but, as I said, other sectors and small businesses generally would be able to approach the commission. The commissioner can then deal with those issues in an appropriate manner.

**Senator O'BRIEN**—Would this be a Commonwealth agency?

**Prof. Zumbo**—Federally, yes, but there is no reason why each of the states could not have one. As I said, Victoria has had one since 2003. The South Australian government is in the process of establishing one. The Western Australian government has announced one. But it would make sense for there to be a federal commissioner.

**Senator O'BRIEN**—Do you know how many people work in the Victorian agency that has been established?

**Prof. Zumbo**—It is a very small agency. I cannot give you the precise numbers, but it is very small—we are talking of, I think, 15 to 20 people—they have mediators on a professional panel and they operate very effectively on a very small budget of less than a few million dollars.

**Senator O'BRIEN**—Do they have multiple offices around Victoria or just one?

**Prof. Zumbo**—They have a central office in Melbourne and they have a telephone help desk. They run it on \$2 million or \$3 million. It is a very effective investment to provide an avenue for dairy farmers, in this case, and a whole range of other areas to come to a commissioner.

**Senator O'BRIEN**—Do you envisage that that could work across Australia with eight capital city offices and similar staffing, perhaps smaller in the smaller states and the territories?

**Prof. Zumbo**—Yes, in the same way as the ACCC operates as a national body. I would not expect the commissioner to have the number of staff that the ACCC has—it has hundreds of staff—but this body could be a very effective body with a presence in each capital city and a central help desk.

**Senator O'BRIEN**—A hundred and something staff nationally?

**Prof. Zumbo**—It may even be able to be done on less, depending on the scope.

**Senator O'BRIEN**—Expanding on the Victorian numbers you gave us, it would have something like a hundred-plus staff?

**Prof. Zumbo**—Yes. A hundred people, more or less, and a budget upwards of \$10 million would get you a long way.

**Senator O'BRIEN**—In Victoria it is \$2 million to \$3 million, you were saying.

**Prof. Zumbo**—Yes. But, obviously, there are proportionally fewer disputes in other states. It is a proposal that provides an avenue that is not there at the moment unless you are in Victoria or, soon, in South Australia.

**Senator O'BRIEN**—Do you have any idea what the budget in South Australia will be?

**Prof. Zumbo**—No, that is in the early stages. They have only gone through a consultation period.

**Senator O'BRIEN**—There would not be a lot of point in the Commonwealth establishing one in competition with those states that already have them, would there?

**Prof. Zumbo**—No, but there might be issues that a state based commissioner did not have the ability to deal with. For example, in the South Australian example the commissioner could look at disputes between a small business or a farmer and a state or local agency, but for

constitutional and other reasons it would not look at federal issues involving a small business and a federal government agency. So a commissioner could operate in terms of dealing with issues between small businesses and a Commonwealth agency.

**Senator O'BRIEN**—Potentially duplicating it in Victoria for that reason?

**Prof. Zumbo**—No. There would not be duplication to the extent that there would be a memorandum of understanding between the bodies. If it were a federal issue it would be referred to the federal body; if it were a South Australian specific issue it would be referred to the South Australian body. In the same way there are state fair trading agencies that deal with the ACCC and that talk amongst themselves on those issues.

**Senator O'BRIEN**—Do the state fair trading agencies work in this field at all—the small business and farming sector?

**Prof. Zumbo**—Generally not. In terms of the enforcement of competition and consumer laws and fair trading laws, it is basically the ACCC. If they do not look at the matter, and they generally do not get involved in individual disputes, unless there is some other code of conduct that applies, that case falls between the cracks.

**Senator XENOPHON**—Professor Zumbo, you look like a Status Quo fan.

**Senator O'BRIEN**—Is that the band or the state of affairs?

**Senator XENOPHON**—The band from the seventies.

**Prof. Zumbo**—Because the status quo in what is happening in the supermarket industry probably needs to change.

**Senator XENOPHON**—No, I want you to go musical for a minute in relation to the Coles marketing slogan 'Down, down and staying down,' which uses the Status Quo jingle. What is your understanding of what 'down, down and staying down' means? Is it a week, is it a month, is it a year?

**Prof. Zumbo**—It seems to be indefinite—staying down—unless it could be suggested to be puffery and therefore an obviously ridiculous statement, but I do not think that is an obviously ridiculous statement. I think that is a statement that consumers may and will take comfort from believing that this price will stay down for a long time.

**Senator XENOPHON**—Can you just explain this to the committee: is there a twin-edged sword that if Coles advertise, 'Prices are down, down and staying down'—you see it on their billboards or at bus stop shelters and in their media advertising—and if they are only doing it for a relatively short period then there is an argument that they have failed to keep their promise. Are there any potential breaches? But if they do it for a prolonged period—you may want to elaborate on this—is there the potential that that could be predatory pricing under the Birdsville amendment or under other parts of the competition and consumer laws?

**Prof. Zumbo**—I have to say that some of the advertising that has been undertaken by Coles and also Woolworths raises some very serious issues under our laws against misleading conduct. If you say ‘staying down’ you give the impression to the average consumer that prices are staying down for a very long time.

**Senator XENOPHON**—Which is?

**Prof. Zumbo**—To me, it is indefinite—at the very least, staying down for the foreseeable future. It depends on the impression that is being created or that is likely to be created in consumers’ minds. But, to my mind, the impression that is being created is for a very long time, which is certainly way beyond this year and possibly next year. You are talking about years here; you are not talking about months. In that sense, they have backed themselves into a corner in that whenever the price goes below cost price there may be issues under the Birdsville amendment. But there is also the broader problem that Coles and Woolworths individually are giving the impression that they are cutting prices throughout the supermarket—‘Prices coming down everywhere.’ That is the sort of impression you get. But when you look at what is actually being said—Coles have said that they have lowered the prices of upwards of 5,000 items. If the impression that consumers are getting is that prices across the supermarket are being lowered then perhaps the impression in consumers’ minds is that means more than 5,000 items, out of the potentially 20,000 items or more, so there may potentially be misleading conduct, giving the impression that a whole lot of prices are being reduced when only a fraction of the total offer has been reduced.

**Senator XENOPHON**—Because Coles have said that their forecast of the market is that they will increase or maintain their supermarket margins? Is that your understanding?

**Prof. Zumbo**—Yes, and that is just rational behaviour. Coles are in the business of increasing their profit margins across the supermarket chain, but that raises an interesting question. Hence my question about whether the price cuts on home-brand milk are being offset by higher prices elsewhere. Because if they cut their profit margins on home-brand milk, which is a major seller, they are going to have to lift their profit margins significantly on other products to make up for that and to increase their profit margins across the supermarket chain.

**Senator XENOPHON**—But if you are living on a diet of milk, olive oil, bread and eggs, you are okay?

**Prof. Zumbo**—You may not be in terms of cholesterol but, from a pricing point of view, you may be better off. But the danger is that we cannot say that consumers are better off because of these milk price cuts, for the simple reason we do not know what is happening to the price of other products in the supermarket.

**Senator XENOPHON**—I have one final question about the issue of below cost. How will it be defined in this context: yesterday I think we heard evidence that transporting milk from Victoria to northern New South Wales cost 23c a litre. Is below cost looked at nationally—I do not know how the hell they do it in terms of it costing \$1 a litre in Darwin or Kununurra where there are no milk-processing plants anywhere near the place—or do you look at those regional markets or at the overall market in terms of any ACCC issues or any breaches of the law?

**Prof. Zumbo**—To answer that question, you look at all relevant markets. You look at all those markets and you look at the cost of getting the home-brand milk onto the shelf—the acquisition price and the advertising that goes with it. The legislation talks about the relevant costs and the legislation looks at ‘a market’ and that is defined by relevance—

**Senator XENOPHON**—Is the market a supermarket?

**Prof. Zumbo**—It could be an individual supermarket in certain instances in terms of local markets, but generally it is looked at a state level, a regional level and a national level. It just becomes an analysis of the markets.

**Senator XENOPHON**—At a previous inquiry on this matter, Senator Colbeck in a previous line of questioning, forensically went through Coles’ previous claims in terms of what their margins were, what they are now charging, which seems on the face of it to be below cost. Is that the sort of thing that should be setting off alarm bells for the ACCC to investigate?

**Prof. Zumbo**—Clearly. That sort of evidence that Senator Colbeck has pointed to is, I believe, sufficient reason to suspect a possible breach to trigger the operation of section 155 of the Competition and Consumer Act, which allows the ACCC to demand information—from Coles in this case.

**Senator WILLIAMS**—You said in your opening statement that section 46 does not deal with all the issues that should have, section 46 has failed the market power test and section 46 needs to be remedied. What in detail has to be done to section 46, in your opinion?

**Prof. Zumbo**—I have to say that, in relation to the Birdsville amendment and predatory pricing. I believe that that aspect of section 46 is effective. I would advise that the template used in relation to the Birdsville amendment—that is, the threshold trigger’s being a corporation having a substantial market share—be the trigger for the rest of section 46, because the current trigger for the rest of section 46 is that the corporation has to have a substantial degree of market power.

The problem with having substantial market power is that that has been very narrowly defined by the High Court—so much so that very few people or organisations would have substantial market power as defined by the High Court. They have defined it narrowly to mean the ability to raise prices without losing business, so the only people who have substantial market power according to the High Court under the rest of section 46 are those corporations who can raise prices without losing business. You basically have to be a monopoly to be in that situation. If there were two or three players in the market, you could not raise prices without losing business because, as we have seen with home brand milk, if you lower your price others will match you. So under the other parts of section 46 Coles may not have a substantial degree of market power, but it does have a substantial degree of market share for the purposes of the Birdsville amendment.

**Senator WILLIAMS**—You said in your opening statement, ‘Coles and Woolworths would not lose any sleep at all if UHT milk became the norm in Australia.’ Do you stand by that?

**Prof. Zumbo**—Absolutely.

**Senator WILLIAMS**—I find that an alarming statement when I look back at the history of Wesfarmers, who commenced in 1914 as a farmer's co-op working in conjunction with the farmers, because now we are getting the evidence that what they are doing in leading this milk price war is actually going to damage the very people that Wesfarmers kicked off with.

**Prof. Zumbo**—They may rationalise it that consumers will change their buying habits. We heard from the ACCC that this is simply consumers changing their buying habits, but buying habits can be dictated by pricing strategies. So not only is there the threat of losing fresh milk but, alternatively, fresh milk prices could go up. So, if you wanted fresh milk in the future, Coles and Woolworths would be likely to stock it, but it would be a lot more than \$1 a litre. To say that it would be totally removed from the shelves would not be correct because there would be an avenue for Coles and Woolworths to stock it for a period of time simply because they could gouge people on fresh milk in the future.

The real immediate danger is branded milk. I see that branded milk will be diminished over time and ultimately fall off the shelf or, once again, if it does not fall off the shelf completely it will be at much higher prices, as a luxury item. You see that across the supermarket floor, where Coles and Woolworths are pushing their home brand products because those are their products—they get more of a margin on their products, they are pushing those branded products off the shelves across the supermarket and consumers are missing out on product choice. So ultimately the power of Coles and Woolworths is that they dictate to consumers what they buy by reference to the products that Coles and Woolworths make available on their shelves.

**Senator WILLIAMS**—I will just take you to a couple of your recommendations now. You recommend the establishment of an office of Australian small business and farming commissioner. What powers would that office have? I hear what you are saying about mediation. For example, in this case they would bring in the dairy farmers, the processors, the wholesalers and Coles. They would talk through the issues and they would highlight the problems that this discounting war may have in relation to the processor and the dairy farmer. Are you saying that that might be a situation which could bring this to a stop and perhaps lean to the survival of the dairy farmers, which is my concern, or would that body require greater powers so that if they could not come to an agreement in this time of mediation they could then go to the minister or somewhere else to seek a bigger stick?

**Prof. Zumbo**—In relation to the prospect of binding determinations, the commissioner could be given the power to make them, but traditionally that power is not given to commissioners.

**Senator WILLIAMS**—A commissioner would be in a very powerful position if they were able to say to Coles, 'You will not sell your milk at \$2 because that'll send our dairy farmers broke; you'll sell it at a minimum of \$2.40.'

**Prof. Zumbo**—They would be, and therefore that power has not been given to commissioners. In the Victorian model the small business commission do not have coercive powers. The proposal in South Australia is for the small business commission to be given the power to require the production of information relevant to the performance of the functions of the commissioner. That would be a coercive power to get information to get to the bottom of a particular issue. Ordinarily, the role of a commissioner is to help parties come together. It is a persuasive, embracing type of role. But a commissioner's role is also to identify ways to deal

with ongoing industry issues through mandatory industry codes of conduct. So they are on the ground, they can consult with the industry, bring the industry together and make recommendations to government about the opportunity for a mandatory code, for example.

**Senator WILLIAMS**—My final question is in relation to Senator Colbeck's point about Coles saying in the previous inquiry that the gross profit on their milk was 22 per cent. The price of milk has now been reduced by, I think, 23½ per cent. If that is the case—and we assume they did not give false or misleading evidence to the inquiry—the only way they could be making a profit would be if the cost to them has been reduced by the wholesale supplier. Would that be true?

**Prof. Zumbo**—They are questions that have to be asked and answered by Coles. The reality is that there are too many unanswered questions at the moment, and the onus is on Coles to come clean on this information or, in the absence of that, on the ACCC to investigate. As I have indicated, I believe the ACCC has the power to investigate.

**Senator HEFFERNAN**—I want to go to your understanding of monopolies. In Northern Queensland, you have one processor and a couple of major supermarkets, which has caused the distortion of the market so the northern milk has to go to Darwin to get sold, obviously, at a cost. Southern Queensland milk has to go to Cairns to get sold because of the market power of a retailer. How would you describe that if it is not a monopoly?

**Prof. Zumbo**—It is probably a question of semantics. 'Monopoly' is used to describe a situation where you have one player. Where you have a small number of players, it is usually referred to as an 'oligopoly'. Ultimately the end result could be the same, but for different reasons. A monopolist can do whatever they want because they are the only one in the market. But oligopolies tend to act as a cosy club. In the absence of collusion, and there is always a possibility there is collusion, the players just copy one another. The ACCC letting the situation get to three major processors means that you have greater opportunities for those players to just copy one another, shadow one another and act as a cosy club.

**Senator HEFFERNAN**—If the outcome of that is that the Atherton Tablelands blokes have to continue to send off their milk because of the consolidation of the retail industry, they will eventually not have a reason to milk the cows. Isn't that predatory?

**Prof. Zumbo**—The point you make is valid—they will stop milking the cows. That will be a threat to fresh milk and the industry and community as a whole. Whether or not that is predatory depends on the particular situation. We have heard from the ACCC that they see no evidence to indicate it is predatory. But it is up to the ACCC to go get the evidence in those particular cases.

**Senator HEFFERNAN**—The ACCC talk a whole lot of mumbo jumbo. Can I go to another issue, the real cost. I do not know how you determine the real cost for the processor, who obviously can only pass it back to the farm gate. There has been an increase in farm gate prices, as Senator Colbeck has pointed out, which means, if it is true, that there is a little white lie in the argument by Coles that Senator Williams has just been talking about. They are obviously selling at a loss given last year's figures. Is it reasonable, in determining the real cost, to allow for the processor offsetting their cost by lowering to a minimum standard the protein and fat content of

a milk and using the excess—which is happening in generic milk—for cheese and yoghurt? Is that legitimate?

The other thing is that I obviously have a list here of, I usually say poor bloody farmer, but this is a poor bloody milk vendor who has been expected to buy generic milk for \$2.77 and expected to resell it into various outlets from \$2 to \$3.50 at a real loss. That also could be seen to be subsidising the market.

**Prof. Zumbo**—What you have explained there is price discrimination. It adversely impacts on those independent retailers, which means that over time those independent retailers will go out of business and will not be able to provide any competitive tension to Coles and Woolworths. Coles and Woolworths will just increase their dominance of the market. There are a couple of issues when you talk about the real cost. One is that there appears to be a quality issue that has just arisen. The ACCC raised the issue of quality. If that home-brand milk is watered down in some way then that may be significant because in the minds of consumers they believe that home-brand milk and branded milk are essentially the same product. If there are some games being played in which the quality of milk is being lowered, and the quality of home-brand milk is less than branded milk, then that would be something that consumers would be very mindful of. The other issue about cost is that the supermarket chains will also get rebates and what have you from processors and suppliers. Those rebates have to be taken into account because that may reduce the relevant cost in the particular situation.

**Senator HEFFERNAN**—So the legal requirement for a minimum standard in milk can mean, depending on whether you have jersey cows or Friesians or whatever, that there is considerable scope to cream off a bit of the protein in milk, which is seen as a silent subsidy to the market.

**Prof. Zumbo**—There could be games being played as to the quality of the home-brand milk that is being sold.

**Senator HEFFERNAN**—I can confirm that there is, certainly.

**Prof. Zumbo**—And if there are those games that would raise a consumer issue about whether consumers are being misled about the quality of the milk they are getting.

**Senator HEFFERNAN**—In a contract for this particular milk vendor—I better not identify the vendor, he might lose the job from the processor—the contract was written on 28 February 2011 and he is required, because the processor determines the price for the outlets, to buy the milk for \$2.77 for two litres and sell it for \$2.10. Is that not as plain as the nose on your face that that ain't going to work?

**Prof. Zumbo**—No, it will not.

**Senator HEFFERNAN**—Another one of 28/2/2011 is \$2.77 and he is required to sell it for \$3.01.

**Prof. Zumbo**—It just shows that those independent retailers are coming under serious challenge from the behaviour of the major supermarket chains and, if you lose that competitive

tension that independent retailers do and can provide, that is even further bad news for our consumers.

**CHAIR**—Senator Heffernan, we are going to have to quit and we will go to Senator Ryan.

**Senator RYAN**—Professor Zumbo, not that it has been proposed but I just want to clarify from the previous discussion around the potential powers of a commissioner of some sort that there would be a problem at the Commonwealth level in giving a commissioner like that—obviously you could not give them anything that resembled a judicial power with our courts' views on that, but also with respect to—

**Prof. Zumbo**—But Senator, that is not an issue at state level.

**Senator RYAN**—No, agreed, but there is also an issue at the Commonwealth level that it would have to be based on one of the heads of power, presumably the corporations power, but even that has limitations with respect to its impact upon trade, does it not?

**Prof. Zumbo**—Yes, but it could be the interstate trade and commerce power or the corporations power.

**Senator RYAN**—It is not an easy power for the Commonwealth parliament to craft and fit within our powers, though.

**Prof. Zumbo**—Well, they have done well in other areas, and I suspect they could do well in this area. At the end of the day, because there is not that element of coercion and it is simply a mechanism to assist the parties—

**Senator RYAN**—I agree with you on that.

**Prof. Zumbo**—that makes it less objectionable from that point of view, but I think there would be sufficient constitutional power to deal with that issue.

**Senator RYAN**—Sure, I understand that. It was more the coercive effect with price-setting powers. With respect to the recommendation you make about supermarkets greater than 2,000 square metres publishing, in short is there anything you want to add to your submission? I was talking before to one of my colleagues here and I imagine that if it is anything like press releases being put on websites, the most often visited sites are actually used by their opponents. I imagine the most regular visits to the Woolworths site would have been by Coles. I wonder whether or not the regulatory burden imposed by that is actually much better for the consumer? We know they send people to each other's supermarkets. This is just to allow it to be done offshore.

**Senator HURLEY**—I think that was your argument for not having the fuel information on—

**Prof. Zumbo**—The problem with Fuelwatch was that it was an organised cartel.

**Senator RYAN**—Yes, I agree with you there.

**Senator WILLIAMS**—The grocery one was better, wasn't it!

**Prof. Zumbo**—I was thinking that you are making that recommendation based on the experience in the United Kingdom, where the mySupermarket website allows people to shop. The particular issue you have raised—that the players will just copy one another—has not been a problem in the UK in the sense that you go on that website and there will be legitimate pricing differences.

**Senator RYAN**—I was not saying they will copy; I was talking about the regulatory burden versus the information benefit to the consumer. There is no way that they will not copy each other—they will use it as a way to differentiate—but the information is actually going to be of most use to the competitor, and I do not know how often consumers are going to find it particularly useful to check the price of vegemite or something.

**Prof. Zumbo**—You would have to assume that Coles and Woolworths already check each other's prices on a very regular basis; they may even be swapping price files. Who knows? We do not know, but there may be bodies out there that do conduct price checks on behalf of the supermarket chains. So they get that information, but the problem is that the consumer does not get that information. A consumer could go onto this website and get the information that the two competitors and others may get through price-checking services that they can afford, but consumers do not get the benefit of that.

It is a bit like informed sources and petrol. The petrol companies and major retailers have the benefit of informed sources in near real-time, but motorists do not get the benefit of that. If motorists could get that same level of information, we would not have needed the Fuelwatch scheme.

**CHAIR**—Thank you very much, Professor. We appreciate your appearance this afternoon.

**Prof. Zumbo**—Thank you.

[4.08 pm]

**MAKEIG, Mr Duncan Harold, Group Sustainability Director and General Counsel, National Foods**

**MENTIPLAY, Mr Keith, Director, Technical and Business Development, National Foods**

**WALSH, Mr Peter, Manager, Government Relations, National Foods**

**CHAIR**—Welcome.

**Mr Makeig**—I will not simply summarise our submission, but I will take the opportunity to frame up how we have approached and welcomed the inquiry. Successful commercial activity in the dairy industry is a partnership between all the participants. It is one that delivers reasonable returns, provides scope for reinvestment, ensures the supply chain is sustainable and underwrites food security. That applies to the retailers, the distributors, the processors and, most importantly, the farmers. In the present circumstance, when you consider the four participants in the chain and milk retailing at \$1 a litre, we do not think that is a sustainable proposition going forward. Some of you on this committee are farmers. You will understand the complexities of producing milk, collecting milk from thousands of farmers, processing a product that contains live cultures and delivering that fresh-quality product to around 75,000 customers a day through a chilled distribution system. It is hard to imagine a product that is more removed from the simplicity of bottling water and yet we find that fresh white milk is sold at a discount, compared to the price of bottled water, in the retail sector.

If you take all the emotion out of it—it is a very emotional area—the practical reality is that, if this pricing persists, all players in the supply chain will have to make some commercial decisions about what that means for a changing marketplace. The result will most certainly be a reduction in choice, availability and further structural change to the farming sector.

I recognise that there is not a lot of sympathy for large corporations, but I do want to take the opportunity to clear up some misinformation that is around this inquiry. We are prepared to put on record that National Foods anticipated that it would deliver a profit margin of less than two per cent this year, and this is before the recent spate of discounting. Overall in National Foods, all of our dairy and juice businesses combined, including the milk-processing business, make a return on capital of around five per cent, which is half of our whack. No consumer goods manufacturing business would find these returns attractive and, typically, sustainable businesses would deliver well in excess of that whack.

We are already seeing a shift from the non-grocery channel to the supermarkets and from branded milk to generic. The recent discounting has accelerated that shift and it has potential to make many businesses unviable going forward. At the same time, fresh white milk gradually leaves the economics of the supply chain in the non-grocery channel undermined. The cost to serve 75,000 small businesses in the non-grocery channel is very high, as you can imagine—much higher than it is for the grocers; DCs deliver into 700,000 across the country—and it may make it uneconomic to distribute to some retailers in geographic markets beyond the large

grocery channel. As white milk is a traffic driver for small retailers, this has the potential to impact their wider offering.

Ultimately, profitability or a lack of it drives commercial entities to make decisions on where they will invest their capital going forward. This is, of course, appropriate—these are commercial players and they make those decisions quite rationally and openly. But I think for this inquiry the consequences of those decisions, however, may lead to a very different dairy industry, and it is appropriate the Senate considers whether that change is in the best long-term interests of Australia. We are happy to take any questions you have.

**Senator COLBECK**—I appreciate the fact that you have been prepared to put on record that the EBIT for the dairy section of your business is projected to be under two per cent. I think the figure that we saw yesterday was that the spread of difference between generic milk and branded milk in the supermarkets has increased by about 11.2 per cent since this whole process started. That was the evidence put on the record by Ms Marino yesterday. What sort of impact does that have on that margin given that Coles have clearly said that you guys are making too much money and their objective as part of this process is to drag back some of the profit that is being made by the multinational processors and return that to the consumer?

**Mr Makeig**—I think our margin on generic is closer to zero; two per cent is a blended figure, which includes our branded margin. It is a little early. We have some fairly recent data, which Keith or Peter could give you, but we do note Wesfarmers themselves quoting that their milk volumes increased by 15 to 20 per cent, which would be their home brand. That will be at the expense of the non-retail sector and branded milks. We are seeing some drift from our branded into home brand, and it will certainly be coming out of the non-grocery channel.

**Senator COLBECK**—Have you done any numbers yet on the impact on your EBIT as part of that process? You said it was projected or planned to be less than two per cent prior to this campaign starting. Have you looked at the crystal ball to see where that might be heading? It is interesting that you note that your margin on the generic product is effectively zero.

**Mr Makeig**—It is closer to zero. Our margin will certainly deteriorate from two per cent. As to exactly where it will land, I am not sure, but, when you consider it in the context of our weighted average cost of capital being around 10 per cent, whether it is two per cent or 1½ per cent or one per cent, it is very unsatisfactory.

**Senator COLBECK**—You say in your submission that the milk supply is effectively inelastic. So all that is happening as part of this process is the transfer of supply from one product to another as part of this overall campaign. That is all that it will achieve. What is the longer term impact on the capacity to supply other products or the capacity to supply a generic product at this price if it becomes so much more of the market sector? That effectively means that you might be getting a gain right now but in the long term these prices are simply not sustainable.

**Mr Makeig**—I think they are not sustainable now. Certainly there will be a drift towards home brand from branded and our margins will deteriorate. Perhaps the vendors' association might be able to speak to this. The ability to distribute to 75,000 retail outlets across Australia outside of the grocery channel will become very difficult at \$1 a litre. As you can imagine, the

distribution costs far and wide across Australia to hospitals and schools and things are very different from those of the large supermarket chains and their distribution centres.

**Senator COLBECK**—Coles are telling us that they are bearing the cost of this at this point in time and, therefore, there is no need for the effects of this to be passed back through the supply chain to farmers. We have already heard evidence that in Queensland—and it is with a different processor, I acknowledge—there is a link between the milk going into the generic product and the branded product. There is a significant price variation of between 10c and 14c. Do you have any of those clauses with any of your supply contracts?

**Mr Mentiplay**—All the milk that we buy to go into bottled milk, whether it is generic brand, home brand—

**Senator COLBECK**—Bottled milk! There is an old-fashioned term.

**Mr Mentiplay**—I am talking about plastic bottled milk. Most of the milk sold these days is in plastic bottles. Milk for drinking we pay tier 1 price for. We pay one tier 1 price. We do not have differential pricing for milk that goes into house brand or branded milk.

**Senator COLBECK**—I acknowledge that it was with a different supplier. Are you seeing any impacts in the supply chain at this point in time from the current campaign that is being run by Coles and matched by their counterparts?

**Mr Mentiplay**—When you say ‘impacts in the supply chain’, I am not exactly sure what you mean. But, just to back up Duncan’s point before, we are seeing a shift out of branded into house brand in the grocery store. We are also seeing a shift from the non-grocery channel into the grocery channel as well. Our numbers are firming up. We really want to wait and see where the whole thing settles. You mentioned a figure of 11 per cent that somebody gave some evidence about yesterday. We are not quite that high. We are not seeing that sort of differential at the moment. It is more around eight per cent at this stage.

**Senator COLBECK**—That is probably categorised. I am aware of one supplier in Tasmania who has lost 20 per cent of their branded product into Coles, 18 per cent into Woolworths and 10 per cent of their business overall. You have a slightly different market position, perhaps a stronger market position. I do not know. But that 11.2 per cent is obviously made up of those broader numbers. What about impacts within your distribution chains?

**Mr Mentiplay**—Again, as you are aware, and as Duncan said, we supply supermarkets either directly or into their distribution centres. That particular channel we are putting a little bit more milk through. In the other channel, the non-grocery channel, where we have a variety of distribution centres around Australia who we supply into, we are seeing some small drops in the amount of milk we are handling in that area. But, again, it has only been going since Australia Day. It is six or eight weeks or so. We are just getting a handle on how that is going to affect our costs.

**Senator COLBECK**—Coles tell us that the place of murkiness is between the processor and the dairy farmer as far as price is concerned. That is obviously not my experience. It is not difficult to find out what people are paying farmers for milk. Basically all you have to do is ask a

farmer or a farmer organisation and they will be more than happy to tell you that. The real murkiness, from my experience, is between the processor and the supermarket.

We heard some evidence this morning that was provided to us through a somewhat roundabout route. It said that a wholesale price out of one of the suppliers in Western Australia is about \$1.50 per litre. That brings me back to a processing cost. I am talking about picking up from a farmer, processing, packaging and delivering back to the supermarkets for about 32c. That seems pretty low compared to the other information I have had before, which would put it closer to 40c. Are there a range of processing prices? Do you vary your process price based on individual products that you are selling into the market? How does that all work?

**Mr Mentiplay**—The cost of the products that we make obviously vary for the inputs and the variety of operations that we run. For instance, as you know, we pay different amounts of money for milk in different states. In some of those states we have high-volume manufacturing facilities. At some of those facilities we make our own plastic bottles in a joint venture that we have. In other states we have smaller processing facilities and we buy bottles et cetera. So the costs are different and vary by manufacturing facility. Then there are the distribution costs. The costs to get it to the customers also vary depending on whether it is a large state, small state or whatever. So there are a range of costs of manufacture. There are a range of costs of distribution as well.

**Senator COLBECK**—Having been through several of these inquiries, we know that you have a process where you break the milk down. You standardise it. Let's use that terminology because it is one we all understand. So all of the products that you make effectively go through some sort of processing to standardise them. There is a base cost that is there. How broad is the spread of that processing cost? Are we talking about a 20 per cent difference across different suppliers? Is it 40 or 50 per cent? One of the other questions that we tried to work through with the ACCC is finding out what these base costs are. We have had evidence from Coles about what their margin is. How do we get to determining some of these intermediate costs that help us try to determine a result from this inquiry process?

**Mr Mentiplay**—I did not come here prepared with notes to cut up every piece of the supply chain that we handle by state, but I will answer your question about whether there is a variance. One of the prime costs we look at is a conversion cost: the cost of producing a litre of milk into a package minus the package and minus the milk. It is all the other prime costs. Depending on the size of the operation and the amount of milk we put through that factory, there can be up to a 20 or maybe even 25 per cent difference in that conversion cost.

**Senator COLBECK**—I understand that there is a difficulty, for commercial-in-confidence reasons, to provide this sort of information to the committee, but I might ask a question on notice to provide us some information that we could have in camera so that we do get an understanding of this. Could you give us an understanding of what some of those costs are? I put that question on notice so that we can potentially have a look at that. You can make a decision yourself how you provide that.

I have one more question that goes to the nub of the public argument about this. How do these prices actually impact on the price being paid to the dairy farmer? There has been plenty of evidence given to us by various dairy organisations, dairy farmers and suppliers groups. Is there

enough money for everybody in the supply chain to get a quid out of \$1-a-litre retail price for milk? Is that sort of price inevitably going to impact on the dairy farmer in your view?

**Mr Makeig**—Very generically, there is not enough money in \$1 a litre. You are shuffling deck chairs around between the four participants in the supply chain. Keith can probably answer more specifically, but inevitably that will impact everybody in the supply chain.

**Senator COLBECK**—The evidence that we have on the public record to date, including from a previous inquiry, is that Coles were charging \$2.47 for a 2-litre bottle of milk. Their margin on that was 22 per cent according to their evidence to us. They have reduced that price by 23½ per cent on pure margin terms, which means that on the basis of the evidence they gave us there is no gross margin at all. It is basically going in and out of their store. You are telling us that your effective margin on that product is zero. So there is only one other person left in the supply chain. There is only one other place to go, and that is the dairy farmer who is not telling us that they are making great strokes out of it either, bearing in mind there have been a whole series of difficult circumstances. The evidence starts to stack up that, as a lot of us have been saying, this price of \$1 a litre at retail is, effectively, not sustainable.

**Mr Walsh**—Last year the business, in a number of public forums, went on record as saying that, whilst milk was retailing at \$2.08, we came to a conclusion as a business that that was not a sustainable price. We are in a different scenario currently. Prior to the discounting arrangements of this year, that was our position of last year. In terms of the question that you raised about what impact this has on farmers, as a business there is a short-term impact, a medium-term impact and a long-term impact. Because of the perishability of this product, the typical means by which we procure milk is through a minimum of a one-year contract That enables the dairy farmer to plan for the amount that they are contracted for. The business also has a range of two- or three-year and longer contracts. Other processes have different arrangements as well. In terms of a sustained period where milk is priced at the equivalent of \$1 a litre, it is our assessment that, as those procurement arrangements arise, this business will attempt to establish a margin for itself that is commercial to the business.

**Senator HEFFERNAN**—Doesn't that mean the cows finish up in the saleyards, then?

**Mr Walsh**—If sustained, National Foods will have to act in a commercial way that delivers the business a return. Having said that, our procurement team are incredibly mindful of the way they construct their pricing strategies. One of the very foremost considerations is sustainability for National Foods as a processor.

**Senator COLBECK**—And the bottom line of all that is that, unless the milk is retailed at a sustainable level—it does not matter which particular product market it is—it may mean the restructure of the whole fresh milk supply of branded. But, if branded becomes such a small part of the market that it cannot play its part in meeting whatever the process requirements are for a return on investment, the price of the generic milk is going to have to rise to a level that provides that or there will be some parts of the dairy industry in certain parts of the country that will have to decide that they do not go down that track anymore, because their base cost of production is too high to fit within the parameters of the price.

**Mr Walsh**—There are different views that I have heard even today about the pricing differentials between branded product and the home brand product, but ultimately, to go back to Duncan's opening statement, the business across the board makes an inadequate return on the milk across the board.

**Senator HEFFERNAN**—Who are the baddies? Everyone says they are a goodie. Who are the baddies in what is happening? If it is not sustainable and eventually the cow will finish up in the saleyards, who do we blame?

**Mr Makeig**—I am not sure if there are any baddies. There are four participants and they are all pursuing commercial activities—

**Senator HEFFERNAN**—But the outcome is that it is not viable.

**Mr Makeig**—The consequence of \$1-a-litre milk means this is not a viable and sustainable business.

**Senator COLBECK**—I just want to finish on a couple of points. I mentioned during the discussion with the ACCC that you have received an increase in price from Coles as part of your recent negotiations for that generic product. I asked that question, and I just wanted to build it into the equation I had before about margin, price and where everybody is at.

**Mr Makeig**—Just to be clear, that is why I was able to say that generic for us principally is zero. It was loss-making prior to that.

**Senator COLBECK**—Okay, so that clarifies that point. You say in your submission that supermarkets account for in excess of 65 per cent of white milk sales. Do you have any sense of how much of that would be in the majors, Coles and Woolworths?

**Mr Makeig**—As opposed to the non-grocery, which I think the majors would include.

**Mr Mentiplay**—In our business we consider 'grocery' Coles and Woolworths.

**Senator COLBECK**—Okay, so 65 per cent of the national white milk sales goes into Coles and Woolworths in your—

**Mr Mentiplay**—In our terminology.

**Senator O'BRIEN**—In terms of the trade of the supermarket brand milk, do you consider that that effectively is discriminating between purchases of goods of like grade and quality in relation to the prices charged for the goods?

**Mr Makeig**—Sorry?

**Senator O'BRIEN**—By selling Coles and Woolworths, for example, whoever you sold it to—milk at whatever price you sell to them versus your other brand of milk, which you sell to other retailers—does that discriminate between purchases of those goods of like grade and quality in relation to the prices of goods?

**Mr Mentiplay**—What we can say is that the buying power of the two big majors is such that they have demanded a better price than the smaller ones.

**Senator O'BRIEN**—You do not offer that price to other businesses?

**Mr Mentiplay**—For generic milk?

**Senator O'BRIEN**—Yes.

**Mr Mentiplay**—I work on the other side of the business. I could not exactly tell you about the exact pricing. It is my understanding, being in the company for a long time, that, no, they do not get the same pricing.

**Senator O'BRIEN**—And it is a systematic thing: you do it day-in day-out, week-in week-out, month-in month-out? That is the behaviour of selling the same product for two different prices—or more than two different prices?

**Mr Makeig**—The scale of the customer drives the engagement between us, yes.

**Senator O'BRIEN**—I think what you are suggesting to us is that you think that will ultimately lessen competition in the market and drive some out of the market.

**Mr Makeig**—Our view is it is certainly impacting on our margins, so despite our scale it is causing us some concern. It will certainly cause the smaller distributors and franchised distributors that service the multiple outlets around Australia some challenges.

**Senator O'BRIEN**—Do you think it will drive businesses out of the market?

**Mr Makeig**—Again the vendors' association is better able to speak to this than we are, but the white milk underpins their ability to make drops. So if you are not dropping white milk to these far-flung newsagents, you are probably going to struggle to make those marginal distributions.

**Mr Walsh**—Further to that point, and we have put it in our submission, as a business our distribution network extends well beyond the reach of what the grocery market is. There is a cost in that distribution because a lot of that distribution is to areas in regions where in fact supermarkets are not servicing the marketplace. We do have concerns for the viability of that distribution system. It is almost a universal service at this point in time; you could almost draw some analogies with—not completely—the postal service that is currently provided. There is an expectation by Australian consumers across the country that they should have availability of fresh clean safe milk irrespective of where they are.

**Senator O'BRIEN**—So there are two aspects. Firstly what you are talking about is a cessation of supply, not about competition but a simple cessation of supply because it will not be economic for you to distribute as widely as you do because of the fact that you will not have the effective margin to continue to do that.

**Mr Walsh**—Further to that, if you want to decline that as a marketplace, as a business we define the marketplace as wherever milk can be sold. We are not myopically focused on large regional centres where the grocery trade is. Well we are, but our definition goes beyond that.

**Senator O'BRIEN**—I guess what I am trying to get at is the fact that you supply at price A for supermarket branded milk and price A-plus for your own brands whatever they are and in different varieties, and that you supply your own brands to businesses other than those supermarkets, and the share of the market back to the supermarkets for their branded milk. Does that mean that that will lessen competition in the marketplace? That is the question I am asking.

**Mr Makeig**—I certainly think you can see a circumstance where fresh white milk might be available but it will be available in a small number of very large supermarkets across Australia and it may not be available as it is currently in 100,000. That is the ghost of Christmas future, I think.

**Senator O'BRIEN**—It sounds like a diminution of competition but you do not want to say that.

**Senator HEFFERNAN**—If there are any cows left to milk.

**Senator O'BRIEN**—Let us not worry about how many cows. I am asking about competition at the moment.

**Senator HEFFERNAN**—I have got to tell you it comes from the cow. A lot of people think it comes from the carton.

**Senator O'BRIEN**—Is that right? We learn something every day, Senator. I am still pursuing an answer to the question I asked.

**Mr Makeig**—There would certainly be a competitive response. It may mean milk is not as freely available as it was. I leave the inquiry to draw their own conclusions to what might happen subsequent to that.

**Senator O'BRIEN**—I have been using the old section 49 of the Trade Practices Act provisions to see whether in effect you would agree that what is happening would have been a breach of that provision if that provision remained. Obviously it is something you have not looked at. I was not going to ask you whether you had looked at section 49, I was asking about what I consider were the operative provisions.

**Mr Makeig**—No, I have not looked at it, but I think those circumstances may fall under what you are describing.

**Senator O'BRIEN**—I might add that entering into any transaction that to someone's knowledge would result in receiving a benefit of a discrimination that is prohibited would be illegal, so it would be illegal for the major supermarkets to contract with you as well.

**Mr Makeig**—I do not think I can really comment on that. We can foresee, as I have described, circumstances where commercial pressure will be put on some of the distribution in Australia and that is a potential consequence of that.

**Senator O'BRIEN**—So you think there will be less places selling it and you invite us to draw the conclusion whether that is a reduction in competition.

**Mr Makeig**—I think that probably something we would consider likely but the vendors associations might have some views on that too. But we probably would agree with that as a possible outcome, yes.

**Senator O'BRIEN**—Do you envisage circumstances where the Parmalat model of striking different levels of payment depending on whether milk finds its way into supermarket brands or your own brands for the future is a way of managing your business?

**Mr Mentiplay**—We certainly do not discriminate; it is fresh white milk. My simple view is that if you do discriminate against it it gives advantage to the house brand milk, the lower cost base than the branded price. So I do not see where our business would consider that.

**Senator O'BRIEN**—I ask the question because the evidence yesterday was that Parmalat has A and B, A being their own brands and B is manufacturing milk plus the generic supermarket brands and therefore already a shift in value because of the shift in volume between A and B, therefore 12c a litre difference in the price paid for whatever the shift in proportion was.

**Mr Mentiplay**—I cannot comment on Parmalat's pricing, only ours.

**Senator O'BRIEN**—Sure. But you do not envisage entertaining that in the future.

**Mr Mentiplay**—I cannot see how would it would benefit us or farmers, quite frankly.

**Senator O'BRIEN**—It might not benefit farmers. I do see how it might benefit a processor. Obviously Parmalat do too because that is what they have done.

**Mr Mentiplay**—I will leave you to draw your own conclusion, I guess.

**Senator O'BRIEN**—It is not something that National Foods are considering?

**Mr Mentiplay**—We are not considering it, no.

**CHAIR**—What if there is an increasing percentage of generics in the market? Where does that leave you financially in the end?

**Mr Makeig**—It is already very high. If it continues to grow—and we are seeing, as a consequence of a dollar a litre, that it is—our margins will deteriorate even further. They are already very unattractive.

**CHAIR**—And they will become increasingly unattractive.

**Mr Makeig**—Yes, increasingly unattractive. Also, we do want to invest capital into the dairy industry. It is important to build your technology and your capital and it makes it very hard to get capex up against a one or two per cent margin proposition. Any corporation allocating scarce capital will not allocate it to the dairy industry, which we think needs it.

**CHAIR**—But if it continues to go up as a percentage it is not sustainable from a business point of view. You would agree?

**Mr Makeig**—Probably even prior to this recent pricing initiative we found it very difficult to think it was sustainable. This has just expedited it.

**CHAIR**—We are on the margin of being out of time again, but go on, Senator Xenophon.

**Senator XENOPHON**—I will be as quick as I can. I might ask the witnesses to give short answers if they can, or take questions on notice. The Chairman of the ACCC, Graeme Samuel, said yesterday on Sky business channel:

But I do think we've actually got to start looking at others in the supply chain, and treat with a healthy scepticism some of these protestations about concerns of the farmer, when it may well be that the primary concern is for these major corporations' bottom line, their profits.

He was talking about processors such as you. What do you say about Graeme Samuel's comments?

**Mr Makeig**—I will not respond to the chairman, but I think it was important that we went on the record that our margins are two per cent, blended across generic and branded. We are not flippantly concerned about the dairy farmers. If the dairy farmers are not making sufficient margin to stay in the industry then we cannot stay in the industry either. So I think the whole supply chain has to make reasonable returns.

**Senator XENOPHON**—The Managing Director of Coles, Ian McLeod, in a letter to Senator Eggleston dated 18 February—and I think in a letter to a few others—said:

Processors profit margins are already higher than our own in any event.

He also said:

Accusations that the price reduction on private label milk will destroy the milk industry is ludicrous.

He went on to say:

In any case, multinational milk processing companies—

I think that includes you—

have a range of options to respond to greater competition from private label milk rather than take the easy option of cutting farm gate prices for raw milk.

What is your response to Ian McLeod?

**Mr Makeig**—I do not know how to respond to that other than to say that we are being very transparent. We do not have a lot of margin to share. To the extent our margins are pressurised from two to one to zero, there is not a lot to share with the farmers, but we recognise that the farmers need to have a sustainable business proposition as well. Other than that, I do not know how to respond to that, because I just disagree with it.

**Senator XENOPHON**—Finally, Mr Walsh, you talked about the need to rearrange contractual arrangements if this keeps going. I think that is a fair summary of what you said. What do you mean by that? Are you saying your business model will be unsustainable if this continues?

**Mr Walsh**—I think what I was referring to was the suggestion that at this point in time the current discounting arrangements have no impact upon the dairy farming base. I was indicating that the nature of our procurement with our farmer base is through longer term contractual arrangements and the impact of a sustained discounting arrangement that is beneath what last year we were saying was an unsustainable price will only be fully felt by the suppliers that supply milk to us when those contractual arrangements fall due.

**Senator XENOPHON**—Is this commercial-in-confidence or can you say how much of a drop there has been in your company's branded milk since this price war?

**Mr Walsh**—I think it is a couple of per cent at this point in time. There is a bit of a delay in getting accurate data, but we have had a fairly material impact on the drop-off.

**Mr Mentiplay**—I can repeat what I said before: our branded milk has gone down a couple of per cent, but we have also seen the supermarket milk go up by about eight per cent. There has clearly been a swing out of the non-grocery sector into the grocery sector.

**Senator RYAN**—Do you supply private labelled milk to one of the two major chains at the moment?

**Mr Mentiplay**—Yes.

**Senator RYAN**—Excuse me for asking such a general question. Having participated in this for a couple of days and read the submissions, I presume that you do not do that at a loss?

**Mr Makeig**—Our margin is close to break even on that.

**Senator RYAN**—But you do not do it as a loss. Explain to me why you do it. It drags down your average margin, presumably. In short, why do you do it?

**Mr Makeig**—That is a very good question.

**Senator RYAN**—It is a question that is sort of at the nub of this inquiry! I plan to ask everyone who does.

**Mr Mentiplay**—Since farm gate deregulation in 2000, house brand milk has become more and more of a reality. As Duncan said before, the volume of milk is pretty inelastic. Consumers in Australia drink 102 litres per head per year or thereabouts. As more and more milk has transferred to house branded over time, we have large manufacturing facilities which need scale and volume. We also have contractual arrangements, which Peter was talking about—longer term contractual arrangements with farmers. If we do not pick up house brand contracts and do not continue to supply house brand—

**Senator RYAN**—You have a volume management issue.

**Mr Mentiplay**—it is a volume management issue and it is a cost issue for us as well.

**Senator RYAN**—I understand, particularly the need to use high-capital expenditure equipment.

**Mr Mentiplay**—Correct.

**Senator RYAN**—There is no prohibition on you offering the same price that you offer whoever you are supplying—Coles or Woolies—to any other parties, is there? There is no prohibition on you offering the milk at that price.

**Mr Mentiplay**—No.

**Senator RYAN**—You also consciously choose not to lower the price of your own branded milk to compete. Is that true? You sell that at a higher price. When we talk about average margins, I am assuming there that it is higher than what you sell the house brand for all. And that is not just factoring in marketing, transport and other supply chain issues. That is true, isn't it?

**Mr Mentiplay**—I think the slippery slope these questions might lead us to is directionally the wrong way to go. We are very unhappy supplying milk at a break even price.

**Senator RYAN**—With all due respect, I understand you might be unhappy about it, but you do it. A lot of people might say that they want to do something but they do not do it. I could probably eat slightly healthier, but I do not live up to my own aspirations. You might not like it, but you do it. This is the point I am trying to nail down. You could lower the prices of your private branded milk to compete, which might not address the price issue but it may well address the channel issue—that is where people are buying their milk and what brands they are buying.

**Senator COLBECK**—I might give the North Queensland example as a model of what happens when you try to get off the merry-go-round and satisfy Senator Heffernan at the same time. My perception would be that you actually tried to do that in north Queensland, Canberra and some of those other markets and somebody else decided to be dumb enough to price underneath you. It is a very hard merry-go-round to get off.

**Senator RYAN**—With all due respect, Senator Colbeck, you and I chat about this a lot. I am interested in hearing from National Foods.

**Mr Mentiplay**—I am struggling a little to understand this. We make a zero to two per cent margin on blended as it is. To reduce the margin, as slim as it is, and reduce our branded milk as well—

**Senator RYAN**—The point I am making is that one of the legitimate concerns here that has been raised by a number of the players, because of the blended payments to farmers, has been the shift from branded milk to generic milk. Over time that could lead to fewer brands in the market and therefore fewer competition points for the consumer. The only point I want to ask here is: you do not sell your branded milk at the same price as you sell your generic milk and you could do so, couldn't you? It would obviously reduce your margins—or, as Senator Colbeck said, someone could come in and undercut you—but that happens in other markets as well.

**Mr Mentiplay**—I would like to answer you. You are right. We could; we have chosen not to at this stage. But you have to remember: our pricing model to farmers does not distinguish between house brand and branded, unlike the Parmalat milk.

**Senator RYAN**—I appreciate that. There are assumptions here that prices cannot be moved around by more than one player—the generic product at the moment. I will put my other questions on notice.

**Senator HURLEY**—I would like to follow on to that, in a way. In your submission you talk about a number of brands: PURA Milk, Dairy Farmers, Berri, Yoplait, Dare, Big M and Farmers Union. What are your margins on those other products, such as Big M and Farmers Union? Are they higher than the white milk product?

**Mr Makeig**—Yes, they are higher. There are multiple brands and there is different profitability associated with each, so we tried to explain that by saying 'our overall margin'. For all of the National Foods business combined, our profit margin is about five per cent. Some will be more than that and some will be less, but overall, outside of white milk, which is zero to two per cent, it is five per cent.

**Senator HURLEY**—Those kinds of products would go on the same distribution chain that your white milk products would go on.

**Mr Mentiplay**—All of those products are sold through supermarkets. A lot of them are also sold through non-grocery outlets. Some of those products are carried through the same distribution system that we use to distribute white milk; others are not.

**Senator HURLEY**—But if there were no white milk being distributed, you would still distribute your other products.

**Mr Mentiplay**—If we were not distributing white milk outside of grocery—if you are talking about that—it would be very difficult to justify the extent of the distribution system we have got today. I think Duncan was mentioning that before. That would really put a lot of pressure on cost in that system, and either the cost of all those products would have to increase dramatically or they might just not make their way to so many outlets.

**Mr Walsh**—It is quite a unique distribution system, in that it is a cold chain, it is a refrigerated distribution system that delivers to over 70,000 outlets over five days a week.

**Senator HURLEY**—Yes. We had NARGA here saying that supermarkets are making more money on things like ice cream and butter, or implying that they must be, because they have brought their milk prices down. I am just wondering if that might apply to processes as well, that you might in fact be making up for a drop in income from white milk with the other milk products that you supply.

**Mr Walsh**—Most of the other products are very competitive marketplaces, so the return that the business makes on them is an outcome of the competition within the marketplace. A very large amount of the revenue of this business is through the white milk marketplace, and it is a very integral part of our business and our business model. The competition aspects within the white milk are unique within the white milk market at present.

**Senator HURLEY**—Have you had any discussions with Coles and Woolworths about price, since the discounting?

**Mr Mentiplay**—I can say that certainly Coles and Woolworths were spoken to about the impact of the price.

**Senator HURLEY**—You have spoken to them, you have had meetings with them. What about the ACCC?

**Mr Makeig**—We are not aware that we have.

**Mr Mentiplay**—I do not think we have spoken to the ACCC.

**Mr Walsh**—With regard to the ACCC, we have had some discussions with a range of organisations that have informed us that they have made submissions or made representations to the ACCC.

**Mr Mentiplay**—I must clarify what I just said. We have spoken to the big retailers about the impact of the price. We cannot talk to them about what they retail a price at.

**Senator HURLEY**—Obviously not, but the impact on you and your long-term future.

**Mr Mentiplay**—Correct.

**Senator HURLEY**—Were they satisfactory discussions?

**Mr Mentiplay**—I did not personally have them. I am not sure but they were robust discussions, I can tell you that.

**Senator WILLIAMS**—Mr Mentiplay, did you say earlier that Coles demand milk at that price?

**Mr Mentiplay**—I did not say that.

**Senator WILLIAMS**—When you have negotiations over price with your customers such as Coles, do you offer them a price or do they tell you, ‘We want it at this price’?

**Mr Mentiplay**—They tender for a price; we put a price to them.

**Senator WILLIAMS**—How many litres of drinking milk does National Foods sell a year?

**Mr Mentiplay**—Good question—I think it is about one billion.

**Senator WILLIAMS**—And you have no doubt, Mr Walsh, that this will lead to lower farm gate prices if these prices stay at \$1 a litre? Would I be correct in saying that? Put it this way—

**Mr Walsh**—Can I answer that?

**Senator WILLIAMS**—You have been selling your generic brand milk at a loss and you have had a price rise from the big end of town and now you are making perhaps a small profit. Is that correct?

**Mr Mentiplay**—Yes. Small to nothing.

**Senator WILLIAMS**—You were making a small loss and now you might be coming out square or making a little profit. If these prices continue at \$1 a litre—and you obviously want a return on your investment—will that leave you in a position where you will have no option but to negotiate lower price contracts per litre at the farm gate with the dairy farmers?

**Mr Makeig**—I do not think we can say that. We can certainly say they are not going to go up—they are certainly not going to improve the returns that dairy farmers are enjoying. We have not made any decisions as to how we will engage next round, but it is not going to improve returns.

**Senator WILLIAMS**—But you are obviously not very happy with your return on investment, from nought to two per cent. That is not good business return.

**Mr Makeig**—That is not good business for us.

**Senator WILLIAMS**—Suppose Coles keeps this price war going and is followed by Woolworths, Aldi and Franklins, and these prices stay for a year or two years. If you want to lift your profit margin, don’t you only have one option, which is to pay the dairy farmer less?

**Mr Makeig**—I can see that is something we would have to consider, but we do recognise that, if the dairy farmers then go out of business, we do not have a business either. There is not enough money in the supply chain for everybody to make a return.

**Senator HEFFERNAN**—What is going to happen to the Atherton Tablelands dairy farmers, given that carting it to Darwin is hardly a proposition?

**Mr Mentiplay**—The amount of milk that we buy at tier 1 on the Atherton Tablelands was reduced in September last year on the back of us losing the Woolworths contract. We tried to

negotiate with Parmalat to contract pack that milk so that it stayed in the area. We could not come to a commercial agreement on that; hence we lost that volume of milk.

**Senator HEFFERNAN**—So, as to the argument that you collectively bargained with the Atherton Tablelands farmers, they might as well go and have a swim in the Coral Sea.

**Mr Mentiplay**—No. When we lost the contract we had already negotiated with the farmer group up there and contracted the volume of milk.

**Senator HEFFERNAN**—I understand that.

**Mr Mentiplay**—So we have been paying for that volume of milk that would have gone into Woolworths all year anyway.

**Senator HEFFERNAN**—But that is not sustainable under the present system.

**Mr Mentiplay**—No, that is exactly right.

**Senator WILLIAMS**—Perhaps you could take my last question on notice. Please provide the committee with the prices at which you are selling the generic brand to Coles, Woolworths et cetera for two litres and what you are wholesaling your Farmers Union brand at. You can do that confidentially if you like. Give us the figures at which you are actually selling so that the committee know what you are selling new or generic brand milk for compared to your branded milk and we can see the difference in competition and how the branded milk industry can perhaps survive. Would that be a problem, as long as it is confidential?

**Mr Makeig**—We are very open to provide whatever information we can. We are very mindful that with the large contracts with our customers, if they are confidential, whether it is in camera or not we could not breach that confidence without their permission. I think that you can infer from our margin, which is close to zero, what our pricing might be.

**Senator WILLIAMS**—We are hearing that Coles are paying \$1.50 for two litres of milk. That is the figure being thrown about by NARGA and other—

**Mr Makeig**—We are happy to take it on notice and see what we can provide.

**CHAIR**—They have said they will take it on notice and come up with some sort of answer within the bounds of confidentiality. Thank you very much for appearing. We appreciate your being here today.

[5 pm]

**LAWSON, Mr Colin Wayne, Manager, Industry Relations, Amalgamated Milk Vendors Association**

**PATON, Mr Robert Arnold, Secretary, Amalgamated Milk Vendors Association**

**CHAIR**—Welcome. I invite you to make an opening statement.

**Mr Paton**—We have heard a lot of evidence today, some of the things relative to our sector were probably not spot on the mark. I will make one comment about the ACCC before we start. No wonder they are considered jerks by most people out in the community, with the way they answered some of your questions today. But, in defence of the ACCC, they have to work under the guidelines, the rules and the act they have at the moment and they just do not have enough power.

We are here today to provide senators with a better understanding of the milk distribution part of the business because some things that are being said on the radio just are not quite correct—how it is affecting milk vendors and things like that. So far we are getting mixed results from some of our guys in different areas. The ones that are close to supermarket chains are having a lot of trouble. The ones in shopping complexes where the supermarkets are are having more trouble than elsewhere. It has taken awhile for some of this information to filter through to us but a lot of our guys now are saying that their corner shops, the convenience stores and things like that are being affected.

Since we hit deregulation of the distribution sector in July 1998 we have seen membership of our association in New South Wales decrease from around 1,200 to 360-odd today. That has been a direct result of the pricing policies of the supermarket and the home brand. We are not competitive any more and the price we pay in the market is substantially higher than what other outlets are paying.

At the moment we have some preliminary information from some of our guys that discounting by Coles and Woolworths is having a dramatic effect in some areas. These reports are indicating that some of the coffee shops, restaurants and outlets in shopping centres are buying some or all of their milk from the Coles, Woolworths, Franklins or whatever supermarket is in the shopping centre. That means there is a transfer of the purchase of branded product by those outlets to the generic Coles or Woolworths brand.

We have some figures which are probably confidential, but I do not mind sharing them anyway. Four supermarkets in the Wollongong area in the week ending 23 January this year purchased 34,326 litres of generic product. The branded product for those same supermarkets was 3,674 litres. As of 27 February this year, after the discounts came in, the generic volume increased to 46,566 litres and the branded product reduced to 2,682 litres. If you work out the figures, that is a 35 per cent increase on the generics and a 27 per cent drop in the branded product. What we do not know is where all that trade has come from. What types of outlets they

are we just do not know. But that is a substantial increase in that area for the home-branded product.

Col's job at our place is industry relations manager. He can give you a very, very good synopsis of the distribution sector, the pricing and that type of stuff so that you have got a better understanding of what the milk vendors actually do and how we fit into the picture.

**Senator COLBECK**—You have given us a bit of an impression. Do these figures move around in various parts of the country? You have given us some pretty specific stuff on New South Wales. What about impacts in other areas of the country?

**Mr Paton**—So far we do not have any specific impacts elsewhere.

**Mr Lawson**—Tassie certainly have had a big impact. There has been a big shift from branded into supermarket generics.

**Senator COLBECK**—I have been talking to some players in the Tasmanian market, where there is currently a restructure underway. The information that I get out of there is that this process is causing significant disruption, to the extent that, where contracts might have been signed for the purchase or the takeover of businesses as a part of the industry restructure in Tasmania, buyers are wanting to hold off on sale of businesses because they are worried about the short- to medium-term impacts even of the sale. I spoke to one player who was negotiating at a figure of about \$180,000 for their business, and the most recent offer was something in the vicinity of \$40,000. It appears to me that it is having the impact—particularly at a critical time within a restructure of the industry in Tasmania—of significantly devaluing the businesses of the vendors. Obviously that would vary depending on the circumstances that you have mentioned, Mr Paton—whether they have got a route that is close to or takes in significantly a major supermarket area. But that is an immediate effect that is being felt now, a month or so after the announcement of this process. So it is not necessarily contained to Coles saying, 'We are bearing the cost of this.' The cost of this is having an immediate and fairly significant effect for some people right out through the market chain straightaway.

**Mr Paton**—Yes. I would agree with that.

**Mr Lawson**—Absolutely. People generally have a habit of picking up their milk wherever it is most convenient. What we are seeing now, with such a difference in price, is that they are going out of their way to go to a supermarket to pick it up. The volume of smaller shops—newsagents, mum-and-dad corner stores—has been reduced by up to 20 or 30 per cent because people are not shopping there; they are shopping at Coles or Woolies. The effect that has on our guys is that our volume is down and our profits are down. Our viability becomes less because we have got to get more money to get to those outlets to deliver that volume of milk. If the trend keeps going, I can see the point where it will be a bit like National Foods mentioned before. We have got to monitor this over the next two to three weeks.

**Senator XENOPHON**—That short a period? It is that critical?

**Mr Lawson**—Yes, absolutely, because we do have a diverse range of losses in this. We have some members that have quoted 45 per cent.

**Senator WILLIAMS**—Of the value of their business?

**Mr Lawson**—No; of the turnover of their business. This guy has particularly a lot of the small buying group stores, like Campbells group, that have banners of their own but they are just a small corner store. They have been affected because people are just not buying their milk there anymore; they are buying it at the supermarket.

**Senator WILLIAMS**—Just on that point, if they have had a 45 per cent reduction in their turnover, they could be in a situation where they are not even running at a profit. Therefore their distribution business is probably valueless. They have lost the value of that as well.

**Mr Lawson**—Every milk distribution business in the country has been affected as far as the value of that business is concerned already. What I was going to say, though, is that whilst we are sitting back monitoring this and wondering what is going to happen, it is getting to a point where as an association we will be approaching the major processors to keep our blokes more competitive. Right at the moment there has not been a change in the price that we pay for the milk where it is, but if we then go back and say, 'Well, we are going out of business here, we will be need to be made more competitive by our companies,' that is going to take a heap more money out of the marketplace as well.

**Senator COLBECK**—And if there is no money in the supply chain, you have just heard the evidence from one of the major processors there is not a lot of place that they can go to find anything to tip into your pocket. Effectively that means that you potentially become a casualty of this whole process by virtue of the fact that there is not the money in the supply chain to provide it.

**Mr Lawson**—Absolutely. As the National Foods submission to the inquiry suggested, they would put branded milk, they may have to put branded milk up. That is just going to make our distributors less competitive and put us out of business.

**Senator COLBECK**—So what does this do to supply in some of the outlying areas? You are almost building a two-tiered economy where if you are close to a supermarket that sells milk at this sort of price you can get it cheaper but if you are not or are in an outlying area you are going to pay a heap more for it or you are just not going to be able to get it.

**Mr Lawson**—In a way milk is subsidised by the supermarket deliveries to outlying areas. Coles' attitude towards the whole dairy industry now is that not only are they discounting the milk to an unsustainable level but our members delivered Coles milk into regional areas of New South Wales: Orange, Dubbo, Wagga and those areas. Before Christmas Coles notified National Foods that they would no longer require distribution of their products into those stores, that they would be demanding that they put it into their general cold chain warehouse. Hence we will lose distribution of that milk.

**Senator COLBECK**—So again the vendors' businesses are being devalued as a direct result of Coles saying, 'We are not going to use that service anymore.'

**Mr Lawson**—We are not only going to lose the value of our business but the viability to deliver to small towns outside of the supermarket dominance, because that payment we got for

distributing that made us viable to deliver to the smaller shops, the smaller towns. Everything is going to come under pressure and, as I said, we would then be looking back at the company to give us a more competitive price to compete with Woolies and Coles and what we have been doing for the last 10 years anyway.

**Senator COLBECK**—So it actually threatens the whole entire distribution network.

**Mr Lawson**—Absolutely. As they said, it is unique, the vendor system that survived deregulation, which is National Foods' cold chain distribution and Parmalat's, Fonterra's and Norco's, Riverina's—whoever you want to look at, they have all got their own contracted independent distributors, call them vendor's franchise owners. But milk is a stable part of the business and we have a range of other dairy products plus juice and other stuff that help us make money out of getting that milk into those areas. That is going to be undermined by this unfair competition, absolutely unfair.

**Senator HEFFERNAN**—And what proportion of your vendors, like this bloke here to which there are umpteen outlets, are actually selling at, as he says, up a 43 per cent loss on his margin?

**Mr Lawson**—It is happening but it is not exactly right. Across the board we pay around \$2.70 for a two litre of milk. We probably sell to the market, to 60-70 per cent of the market, below that \$2.70 mark. We are assisted by the processors with a margin to deliver that milk at a cheaper rate. Your guy that was quoted as saying he buys for \$2.77 and sells for \$2.30, he does not actually lose that but he gets a lot smaller margin for selling at that price. He gets a rebate from the company.

**Mr Paton**—Just to clarify: there are a number of different categories of customers these days that we service. There is a category of customer where the vendor buys the milk and resells that. He determines his own margin for that. So he would be buying milk at 2.77 and then he can sell it for whatever he likes to his other customers. There is a part of the market where our guys do a delivery only and they get a commission from the processing company for doing that run.

**Senator HEFFERNAN**—Can I just quote to you from this document? 'Here is a printout of the pricing of two-litre milk we sell through our shops for lines six to 100'—or whatever it is, and it is one particular processor—'and are locked into our system by them. These prices are negotiated by National Foods with the customer.' So that is this hidden subsidy, is it?

**Mr Paton**—As I was saying, there are three types of customers: there is the customer where the vendor serves in his own right, buys the milk and resells it; there is the customer where the company bills the customer, the vendor gets a margin for delivering that; and then there is another type of customer which is held by the vendor but some of the pricing is negotiated by the company because that might be under threat for competitive reasons with one of the other processors. Let us say it is a National Foods customer that the vendor is servicing. National Foods might say to the vendor: 'Look, we'll help you out with the price on this outlet, and for that we'll give you a rebate to make certain that you still make a profit. You're not going to make a full profit, as you were before, but you still make a profit. So effectively it reduces the price to those customers.'

**Senator HEFFERNAN**—But in this case, some of these people to which this guy supplies the milk, once the \$2 a litre came along, whether it was the coffee shop or whatever, they have gone direct to Coles to get the \$2—

**Mr Paton**—Some have gone direct to Coles.

**Senator HEFFERNAN**—and so as a consequence of that, this bloke loses the business and Coles are now saying: ‘We’ll save you coming to the supermarket. We’re going to deliver it in a refrigerated truck to your outlet.’

**Mr Paton**—Correct.

**Senator COLBECK**—For nine bucks a delivery.

**Mr Paton**—That is happening in some cases, yes.

**CHAIR**—Choice have called for a comprehensive and coordinated national food policy to be developed and for a supermarket ombudsman to be established. The government have also formed a national food policy working group to develop a national food plan. Do you consider the current arrangements of various government agencies and regulators are working effectively? What do you think should be included in a national food policy, if there was one? What powers and functions do you consider a supermarket ombudsman would have? Choice has also suggested that the ombudsman should be based within the ACCC. Do you have a view on that?

**Mr Paton**—I would certainly think that from the dealings we have had over the years with the ACCC and how they react to these things in the market that the definitions we must have for abuse of market power or what market power means or predatory pricing—the general community thinks that the ACCC is not doing its job because it does not get any prosecutions on these; it just keeps going on. There has to be something wrong with what is in the act as far as the general community is concerned, and I agree with that. It seems to me like Coles are using bullyboy tactics to get what they want out of this. Whether they are just trying to build up the bottom line in their business and then refloat it on the stock market, who knows what their endgame is. No-one would know. It mimics what they did in England years ago—not Coles, but what the English market did years ago according to some of the studies we have seen. About the other parts of your questions, I am not sure.

**CHAIR**—When you talk about the English market, do you mean Tesco specifically?

**Mr Paton**—The New South Wales dairy industry conference sponsored a group of people to go on a study tour of England a couple of years ago. The information that came back from the farmers over there was that the same sorts of tactics that Coles are using here now is what was employed in England to almost bring the dairy industry to its knees over there.

**Senator WILLIAMS**—You would reckon they had learnt over there, wouldn’t you?

**Mr Paton**—Well, you would think so.

**Senator HEFFERNAN**—‘Now I’ll get my \$38 million bonus and head back to Scotland, if you don’t mind!’

**Mr Paton**—It seems odd that Coles have now employed some executives from England and they are going down the same track.

**CHAIR**—It is not odd. It is Tesco who is advising them, I think.

**Mr Paton**—On the ombudsman angle, we do not really have much of a view, except that, listening to what Professor Zumbo said earlier, it probably could be a very good idea.

**Mr Lawson**—I think that there has to be some control. I know that at a previous Senate inquiry we suggested that a farm gate price be reintroduced. I still think that is the only way to rectify the situation completely. While you have got the power of Coles and Woolies and the needs of the processors, our whole pricing structure out in the market is just set by whatever Coles and Woolies can negotiate with the major processors for their generic brands.

**Senator HEFFERNAN**—Wouldn’t you have to disaggregate the market, though, to take effect of the exports?

**Mr Lawson**—It does not affect our market. At times when the export market is going through the roof and farmers are getting a better price, we have got to try and go out and get a better price out of our market, our route trade market, the branded milk market. Every time we do that, the processors have got to pay the farmers more. Every time we do that, we lose volume because we have got to push the branded price up to try and counteract world market prices. That is why I believe we have to have a farm price for our market, the drinking milk market, which is totally separate to the export markets or the food service—cheese or whatever it is. It is just totally different. You heard Mr Mentiplay, I think, almost say that the supermarkets demand a price out of them. Pretty much that is what happens.

**Senator HEFFERNAN**—That is what you call market power, but it is not a monopoly.

**Mr Lawson**—When that price is set, then the rest of the market has to pay for the fact that they are not making any money out of that.

**Senator RYAN**—I just want to clarify something. You said you were keen on the introduction of a farm gate price. I assume that is set by someone as a regulator of some variety, which I assume would be either a minister or an agency of some variety. Do you have any particular ideas on that?

**Mr Lawson**—I think industry could do it, but we would have to have a relaxing of trade practices laws.

**Senator RYAN**—With all due respect, we have moved away from industry being able to do that for about the last 30 years.

**Mr Lawson**—Well, we will not have an industry.

**Senator RYAN**—I accept the logic that Coles or Woolworths or one of the big chains can just make price demands and bring milk below the cost of production at the farmer end. If you reintroduced a farm gate price, wouldn't they just do it to the processor? Wouldn't they just do it to the person delivering it? Wouldn't we then have to regulate margins for marketing, margins for the delivery and margins for cold chain security? Aren't you just proposing to have a government price set for milk?

**Mr Lawson**—Well, do we want an industry? What we are talking about here is—

**Senator HEFFERNAN**—As long as he can get cheap milk, he doesn't give a rat's.

**Mr Lawson**—The whole thing of this is: have we got a sustainable dairy industry or not?

**Senator RYAN**—It is no surprise to you that we might differ on that, but the point I was trying to get to is: if we regulate one end, the logical conclusion is that these people, if they can do it to the farmer, can probably do it to someone else; so what you are proposing in effect is probably a chain of regulation that affects different stages of the food. That is what I want to clarify.

**Mr Lawson**—No. I do not think so. The problem we have got is that the processor can always go back and get a better price out of the farmer once he has negotiated a position with the customer. That is what has been happening in the industry since 2000. I think it was commented by the professor here that, in 2000, when the farm gate price dropped, Alan Tooth from Dairy Farmers went in and undercut the rest of the processors by 20c a litre and picked up a national Woolworths contract. And we have not recovered from it since then.

**Senator RYAN**—You might have been here, but I asked National Foods why they supplied it if they did not like it.

**Mr Lawson**—That is right. I think there is a change of attitude happening within National Foods now that it is being basically run by Lion Nathan: 'Do we really want to sell milk at no profit?' Because that is a totally different theme to what the whole business of Lion Nathan revolves around—you do not sell something for nothing.

**Senator HEFFERNAN**—It is a con job because this bottle of water, depending on whether you paid \$2.50 or \$3 for it, you can fill 1,200 or 3,400 times from the tap for what you pay for the bottle of water. There is 3.3c worth in the bottle.

**Mr Lawson**—That is right. I do not say it is easy or it has not got lots and lots of problems to set up a farm gate price again, but what happens if we do not have some form of protection for the farm gate price? Everything flows on from the farm gate price. Once that price is set, there is only a certain amount of margin in each part of the cold chain. Whether it is the processing side of it, the delivery side of it, or whatever, there is a cost to it. Whether it is us doing it or it is someone else doing it, there is a cost to it.

**Senator RYAN**—So what you are basically proposing is some form of regulation being introduced that actually guarantees a margin for people in this industry?

**Mr Lawson**—No, for farmers.

**Senator RYAN**—For farmers?

**Mr Lawson**—That is right. If we do not, every time we have this boom-bust situation where the farm gate price drops either because of a world market slump or because a big contract has been let to one of the other processors that did not have it before—and this is what happens: when a Woolworths or Coles contract is won or lost it is because the other has gone underneath them on price—

**Senator WILLIAMS**—And who do they screw down?

**Mr Lawson**—Then they go back to the farmer and say, ‘In the next contract we’ve had to do this to get this contract.’ If you look at Parmalat, for instance, if they pick up a major contract like that they will go back to the farmer and say, ‘A big part of our profit is coming out of generics so we’re going to have to pay you on generic price now.’ And then they go back to the distributor. I have been in the situation where they have come back to us and said, ‘We need a reduction.’

**Senator RYAN**—This is the point I am making. If they can do it to the farmer then they will actually apply the same pressure through other parts of the supply chain.

**Mr Lawson**—But the farmer is the one where it all stems from. He cannot go anywhere else. He cannot do anything else. The rest of the chain can, there is more than Coles.

**Senator RYAN**—We have heard from others. There is not a great deal of use for the big cold supply chain that is currently in place for milk. There is a lot of invested capital in that. Just as entry and exit into dairy farming is capital intensive, entry and exit into distribution, as your submission outlines, is also quite capital intensive. I will leave it there, but I do not accept the logic about it just happening to farmers. They will apply the pressure elsewhere, so I do not accept that logic. The logic flows that they will then turn the screws elsewhere in the supply chain. So we will be proposing not just a farm gate price but, eventually, we will have another hearing into how the cold chain or the distribution chain is being screwed down and we will end up regulating the whole thing.

**Mr Lawson**—But it has been a screwed down for years. It has got itself into a competitive position where it can compete with whatever else is out there. We have exclusive distribution of milk before 1998. That went. Half of our vendors are gone. We had to get bigger and more efficient. We have competed with whatever is out there—the Linfoxes and Tolls of the world—and we will continue to do that. We have not got a problem with that. The problem we will have is when we have not got branded milk and we have not got enough to go around, so we will not have a product to deliver anymore if the farmer is not getting a return.

**Senator HEFFERNAN**—You can only squeeze so much out of the cow, mate!

**Senator RYAN**—Bill, I have sat here listening to you all day and I would care for you not to characterise the questions I ask.

**Senator HEFFERNAN**—Righto.

**Mr Lawson**—There needs to be a cost-plus margin so that they can sustain that supply of milk.

**Senator WILLIAMS**—Putting it all back to the market theory: let half the dairy farmers go broke, lose their export dollars to our nation, then see the price of milk going to \$4 a litre in five years time in the supermarkets. Is that an alternative?

**Mr Lawson**—You will have a couple of supermarket brands. You will not be able to buy milk in the route trade. A lot of the small outlets that currently sell milk—and it is a reason for their customers to go there and buy other things while they are there—will disappear, so we will not have a market for the branded milk. And it will eventually be a position where the supermarkets are the only ones that sell milk, as it is in the UK.

**Senator WILLIAMS**—But in the UK can't a dairy farmer actually sell bottled milk out the front of their little farm? I have been told they can shortcut it that way. A British bloke told me last night that some dairy farmers bottle their milk and sell it out on the street. You cannot do that in Australia because it has to go through processing, with the FSANZ regulations et cetera.

**CHAIR**—It has to be pasteurised.

**Mr Lawson**—In the UK most of the farmers are under contract to the supermarkets.

**Senator XENOPHON**—Direct?

**Mr Paton**—Direct.

**Mr Lawson**—They have taken the processor right out of it, so they have taken brands out of it. They contract the farmer to supply the milk. It goes to the processing plant contracted for Tesco. You go into Tesco supermarkets and they have Tesco milk.

**CHAIR**—Do you see that as the most likely future?

**Mr Lawson**—If we do not do something about it here. This has been on the cards for the last few years. So many study groups have been to the UK to have a look at what is going on. They come back and they say, 'This is what has happened over there. Supermarkets dominate the industry.' Coles and Woolies have been doing that gradually here for the last 10 years, since deregulation of the farm gate price. If we do not stop it, we will have the same results as they have had in the UK. They import fresh milk.

**CHAIR**—How do you stop it, though? What is your solution?

**Mr Lawson**—Protect the farmer. That could be through an ombudsman who somehow regulates the industry. There needs to be some form of regulation to protect the farm gate price.

**CHAIR**—Regulation—somebody said that yesterday.

**Mr Lawson**—There needs to be some form of regulation. I know I am out on a limb there, but if we do not do it we will not have a dairy industry as we know it today. We will not have fresh milk in some of these country areas.

**Senator HEFFERNAN**—I can assure you Mr McLeod does not worry. He will be like Sol Trujillo. He will get his \$38 million, go back there and have Coles ready for Tesco to take over and Bob will be your uncle.

**Senator XENOPHON**—I have a couple of questions on notice. You made reference to the UK market and that you have had a couple of delegations going over to the UK. Could you provide on notice reasonably promptly what your understanding is of the market. Obviously the committee will do its homework on that, but could you tell us what your perspective is of the UK market and what impact that had on the equivalent industry in the UK. I think that would be quite useful. You have been going since 1930, since the height of the Great Depression. You have been going for 80 years.

**Mr Lawson**—Yes.

**Senator XENOPHON**—Will you be around in the next 80 years?

**Mr Lawson**—We will if we have a say in it. But if we go down the track of not just the industry but government kowtowing to the supermarkets then, no, we will not. A lot of other small business will not either.

**Senator XENOPHON**—Finally, if you could access milk for the same price as Coles and Woolworths are getting it, would that give you a fighting chance of survival?

**Mr Lawson**—Absolutely.

**Senator WILLIAMS**—Good luck!

**CHAIR**—Do you have anything more to say that you wish to put on the record?

**Mr Paton**—Just one thing. Professor Zumbo mentioned this. In the USA they have what is called the Robinson-Patman Act. I do not know whether the senators are aware of that.

**CHAIR**—We are.

**Mr Paton**—That was introduced in the Great Depression in the USA to counteract the types of things that Coles and Woolworths are doing today in our market. Whether it is worthwhile looking at that I do not know.

**CHAIR**—This committee is very concerned and has been for a long time about competition issues and market share issues, so that is probably something that this committee would regard as a sensible piece of legislation. We need something like that in Australia.

**Senator HURLEY**—Speak for yourself, Chair!

**CHAIR**—Thank you, senators and witnesses.

**Committee adjourned at 5.34 pm**