COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Impacts of supermarket price decisions on the dairy industry

THURSDAY, 6 OCTOBER 2011

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SENATE

ECONOMICS REFERENCES COMMITTEE

Thursday, 6 October 2011

Senators in attendance: Senators Bushby, Colbeck, Ryan 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 on the Australian dairy industry, 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.

WITNESSES

GRIFFIN, Mr Chris, President, Australian Dairy Farmers

PEAKE, Mr Adrian, Chief Executive Officer, Queensland Dairyfarmers Organisation

TESSMANN, Mr Brian, Director, Australian Dairy Farmers; President, Queensland Dairyfarmers Organisation

TOOHEY, Mr Terry, Director, Australian Dairy Farmers; Chairman, Dairy Committee, New South Wales Farmers Association

Committee met at 09:31

CHAIR: Good morning and welcome to the fifth hearing of the Senate Economics Reference Committee's inquiry into the impacts of supermarket price decisions on the dairy industry. On 10 February 2011 the Senate referred this inquiry to this committee. The committee is due to report on 1 November 2011. To date the committee has received over 160 submissions and supplementary submissions, which are available on its website. These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera.

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 such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the grounds upon which the objection is taken and the committee will determine whether it will insist on an answer, having regards to the grounds which are 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, of course, be made at any other time.

I remind members of the committee that the Senate has resolved that 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.

I welcome representatives from the Australian Dairy Farmers and invite you to make an opening statement.

Mr Griffin: Thank you very much, Mr Chairman. I seek leave to make a short opening statement and also seek leave for my colleagues, Mr Tessmann and Mr Toohey to make short opening statements.

CHAIR: You do not need to seek leave; you may proceed.

Mr Griffin: Okay, thank you. Firstly, I would like to thank you for the opportunity to once again appear before this most important of inquiries. We appreciate the committee taking an ongoing interest in this issue and acknowledge the hard work of all the members of the committee. Back in March in my opening statement I made it clear that the core issue in this debate is that price cuts are unsustainable. That statement still stands and is becoming clearer by the day. As I said in March, milk priced at $1 per litre simply is not sustainable; there is not enough money to support all of the supply chain at that price. Some of the supply chain must suffer from milk that is priced at unsustainable levels and we have evidence that it will be those who supply the very product that the whole supply chain relies on—dairy farmers and their families. Processors and dairy farmers who supply the drinking milk market rely on the margin from branded milk sales for their profitability. Competition from unsustainably priced Coles home brand milk is taking market share away from branded products, thereby reducing the overall return on the fresh milk supply chain. This reduces the amount farmers receive from processors as an increased share of Coles home brand milk is being sold at little or no margin and less of the more sustainably priced branded milk is being sold.

Today we have representatives from two of the most affected states, Queensland and New South Wales. They will share with you the impacts in their states. The entire dairy industry is behind these states. I will reiterate that: the whole Australian dairy industry is behind this issue. Ultimately, milk priced unsustainably will have an impact on the entire Australian dairy industry. Dairy farmers across Australia are united against these damaging marketing and market distorting tactics. Coles is trying to spin the line that they are absorbing the cost of their unsustainable marketing tactic. Dairy farmers do not believe them and there are a whole host of experts in the consumer field who also do not believe them because this is not the effect we are seeing in the market. We believe dairy farmers and Coles's customers are paying the price.

Coles also continues to cite misleading and outdated statistics and provide commentary that is designed to divert attention from the key issue. In a letter to the committee dated 20 September, ADF refutes a few of the more outrageous claims made in Coles's latest submission. An ongoing example is the fact that Coles have consistently tried to confuse this issue by quoting southern state farm gate price increases when they know full well that the southern states chiefly rely on manufactured product and export markets, whereas Western Australia, northern New South Wales and Queensland rely on the domestic drinking milk markets.

As you will see, there are four fundamental impacts from milk priced at $1 per litre: (1) lower farm gate prices being offered to farmers or changing the mix of tier 1 and tier 2 milk, which both mean lower incomes for farmers for fresh drinking milk; (2) the direct loss of income for farmers in Queensland on Parmalat's and Pauls' Daily Access scheme arrangements due to increased sales of supermarket home brands at the expense of processor brand sales; (3) distorted markets where there is currently a shortage of milk production but retail prices are falling and farmers are being offered lower prices—it goes against the fundamentals of economics and the free market as the market has been corrupted by supermarket discounting; and (4) fundamentally devaluing fresh milk as a product right across the nation.

The dairy industry has also done modelling on the potential impacts of continued discounting. This modelling outlines a potential annual loss of $44 million from the value chain due to the shift to home brand products. This scenario may lead to a drop of 2c per litre in the farm gate price. For the vast majority of northern New South Wales and Queensland dairy farmers this would result in the loss of any profit margin on their milk. In another scenario the existing year-to-date shift to supermarket home brand products is annualised and processor branded products are discounted to maintain relativity with supermarket home brand prices in both supermarket and non-supermarket channels. This second scenario would see an annual loss of at least $227 million from the value chain with consequent significant impacts on the value chain. Scenario two would be catastrophic for all Australian dairy farmers providing milk to the drinking milk market, with a projected loss of 20 per cent of the farm gate price or 9c per litre for milk supplied on the drinking milk market.

Given the significant impact on dairy farmers, the sheer size of the supermarket duopoly and the disproportionate power they wield in the Australian marketplace, the majority of Australian suppliers must have some sort of ongoing commercial relationship with them. We are not asking for reregulation, far from it, but for a market that is transparent and that functions properly. The current situation is one of market failure and as such intervention is required and justified.

The United Kingdom has experienced this cutthroat discounting of milk and in response to it and other issues developed a Groceries Supply Code of Practice to deal with the practices of the major supermarkets there. These practices are now being imported to Australia by the UK executives at Coles. The United Kingdom Competition Commission found that there was a detrimental effect on customers resulting from the adverse effect on competition of the supermarkets' practices. We have the opportunity here to avoid similar impacts on consumers and farmers; therefore, it is important there is full transparency along the supply chain and that suppliers and farmers have access to timely and cost-effective dispute resolution processes. This highlights the need for action, and ADF has developed the following recommendations: the development of an enforceable and mandatory code of conduct for the dairy industry that covers the entire value chain from farmer to retailer; the establishment of a supermarket commissioner or ombudsman to investigate complaints and enforce the new code; amendments to the Competition and Consumer Act to help smaller businesses deal with entities with substantial market power, such as a duty of good faith and a definition of unconscionable conduct; and the examination by the Senate Economics References Committee of farm gate prices in the key drinking-milk markets annually for the next five years to gain a complete picture of Coles's unsustainable discounting and its impact on dairy-farming families.

As ADF has pointed out in previous submissions to the inquiry, stripping money out of a supply chain over time will build the pressure on the more vulnerable members of that chain to accept lower prices. Historically farm suppliers have borne a large part of such risk. Coles's move will result in lower margins and take significant value from the dairy supply chain. It must, and has already, put pressure back on current and future farm gate prices, incomes and rural communities. As we said back in March, we need to focus on sustaining our critically important food-producing industries, not on devaluing their products.

Thank you very much. I will now hand over to Brian Tessmann from Queensland to outline the impacts in Queensland.

Mr Tessmann: Thank you again, Senators, for the opportunity to present our issues and recommendations to your committee. As presented to this committee in March, at that time we believed the discounting of Coles branded fresh milk to a dollar a litre would have an impact on our industry. As presented in our latest submission to your committee, the impact and damage to dairy farmers and our industry is clear and the impact will continue to grow while the discounting continues. Since January we have seen processor brands lose significant market share to discounted supermarket store milk and, with this, processor margins have declined. Slide 1, on the papers we have handed out, illustrates that.

Also, a group of farmers who supply Parmalat under the Pauls Daily Access scheme, the PDA scheme, have suffered direct losses in their milk cheque every month since Coles initiated the price of a dollar a litre, as Pauls branded milk has lost market share to discounted supermarket store brands. Slide 2 illustrates that quite clearly. This group lost $767,000 to the end of July alone and will lose more than $1.5 million this year if the discounting continues. Another group of farmers, which supplies Lion, have had farm gate prices continue to be supressed after being severely reduced last year.

Queensland has been short of milk to meet the daily fresh milk requirements since January, following the impact of natural disasters. Slides 3 and 4 illustrate that point. From January to July we have been more than 44 million litres short in Queensland. But, unlike the prices of fruit and vegetables, where prices have increased dramatically with the loss of supply, milk is short but prices have actually dropped right through the value chain. That is the complete opposite. We see this as a market which is not functioning properly and is in fact failing. Our whole industry has suffered huge losses in Queensland due to natural disasters, which will cost our industry some $80 million this year in damage and lost production. On top of this, the last thing we needed was a milk price war, with Coles using fresh milk as a near or below cost marketing agent. This supermarket discounting has directly impacted our farmers and lowered confidence even further. The worst impact we have seen is that more than 20 farmers have left our industry since the price war started.

To meet future demand in Queensland over the next decade we will need 20 per cent to 25 per cent more milk. That is illustrated in slide 5, which we have handed out. With natural attrition continuing to reduce Queensland farmer numbers, quite apart from the matters we are discussing here today, farmers will need to double production over the next 10 years. To meet that production we will need additional investment by farmers. To do that we need sustainable prices now. In the current environment that simply will not occur. This leaves Queensland facing a future milk supply crisis. The market is failing and the situation needs to change urgently. That is why we need a whole of value chain code of conduct. I will now hand over to Terry Toohey, who is the chair of the New South Wales farmers Dairy Committee.

Mr Toohey: Thank you for this opportunity today to present concerns of the New South Wales dairy farmer members. I bring to this hearing the on-farm impact of the rapid increase in the supermarket power. As is common knowledge, supermarkets devalued milk on Australia Day at $1 per litre as a marketing strategy to entice consumers into their stores. The strategy appears to have worked and is evident by the rapid increase in Coles earnings jumping 21 per cent compared to 2010. We suspect that the increase in earnings is as a result of retailers' ability to use milk as a discounting product to attract consumers into their stores and increase the sales of other products.

In contrast, this devaluation of milk by supermarkets has been associated with the fall in the New South Wales farm gate milk price. We randomly surveyed 60 of our dairy farmer members across all of New South Wales recently. The survey showed that, from the 2010-11 season to the 2011-12 season, the milk price for New South Wales dairy farmers decreased by 1.4c a litre, taking the average milk price from 47.7c down to 46.3c a litre. In 2010 New South Wales milk production was approximately one billion litres, according to Dairy Australia's statistics. Taking 1.4c a litre from our milk price equates to decreasing earnings in the New South Wales dairy industry by $15 million or $18,000 per farm on average.

Coles claims that an upside of the devaluation of milk has been increased public consumption. We agree there has been an increase in total milk sales, according to Dairy Australia's statistics; however, the increase from February to June 2011 shows it has only been in line with population growth, roughly around 1.5 per cent. Over the same time supermarkets have increased their market share of the total sales by five per cent, presumably at the expense of the independent retailers.

Processors' bargaining power with supermarkets is being eroded due to the quantity of generic milk being negotiated. Continuation of this trend will result in supermarkets dictating the price to the New South Wales processors, making the dairy industry more susceptible to price manipulation in the future.

I would like to go to some examples around the state. Some major issues have arisen since one company lost their major sales contract in New South Wales. A collective bargaining group has been offered for the next 12 months 3c a litre less than their current 12-month contract. That group is a major supplier—over 50 million litres of milk—so it is not just two or three farmers; it is a large area. Another processor has said it will take one-third of a group but the other two-thirds of the group need to find a home for their milk because it cannot take it all. It is putting farmers against farmers now. Those two-thirds need to find a home for their milk. They have to take their current supplier's prices; they can have no negotiation. Even one supplier, which operates on a larger scale, has been asked to look at going elsewhere and if he does not go elsewhere then some of the new contract regulations will be increased and that will make him look at it and say, 'It's just not sustainable to stay with this company.' The processors are moving the shift back to the farmers.

Finally, tier 1 and tier 2 have been triggered with DFMC and Lion this year in New South Wales. Right across the state those contracts have come back another 10 per cent in their volume allocation. To give an example, I have been farming on the one farm there. I am the fourth generation; my children are fifth generation. That is 105 years on that farm. If I had the ability to move to another processor who is in my area but who has full supply at the moment and if I were to provide the same volume of milk to him, then there would be over $100,000 difference between the one processor who has a contract and the one who has not. So that gives you an idea.

We have farmers who have been there a long time and who do justice to the industry and who feed into the value chain across all industries and they are being jeopardised. It is the first time I have asked—and I am only one of a number of people around the state—'Why am I milking cows?'

With respect to the increased market power of supermarkets and the decreased sustainability of dairy farming, New South Wales Farmers Association recommends the following for you to consider. Firstly, that ABARES investigate the effect of enforcing the reduction of the size of the individual contracts offered by supermarkets to the processors on competition and efficiency within the marketplace. Secondly, that ABARES investigate enforcing effective and long-term contracts, five years or longer, between supermarkets and processors. Thirdly, that the inquiry adopt the recommendations in the Australian Dairy Farmers' submission.

Dairy farmers require a milk price that makes farming a worthwhile venture and a market that requires their milk not just now but well into the future. Farmers can then proactively plan for the future without the fear of having no market for their milk. New South Wales Farmers believes that, for dairy farm industries to be sustainable into the future, the market power of the supermarket needs to be altered. Thank you.

Senator XENOPHON: I wonder whether we can get a copy of that statement. I do not think it is in the material, is it? Is that new material?

Mr Toohey: I can provide that to you.

CHAIR: Thank you.

Senator XENOPHON: It would be better if I could get it sooner rather than later. Thank you.

CHAIR: Mr Peake, do you want to make an opening statement as well or can we move to questions?

Mr Peake: No. I am here to support the question and answer session.

CHAIR: Thank you for those opening statements. We will now move into questions.

Senator COLBECK: I would like to start with a focus on particularly New South Wales and Queensland because that is where we said at the outset the impact of this would be felt. It is obvious that that is where it is being felt right now. We had a discussion about a claim of an oversupply and the figures that you have given us indicate that there is currently a shortfall in Queensland, in particular for milk production versus packaged milk sales. How is that being met? Are you aware of how that undersupply is being met?

Mr Peake: The graph that you have in front of you shows the fall in production versus the packaged milk sales in Queensland since the impact of the natural disasters. So since January we have been short. If you look at the gap across that period, through to the end of July, it is about 44 million or 45 million litres. Our assumption at the moment—and it is a question for the processors—is that milk is being brought in from interstate to fill that gap. That comes at a higher cost. When we look at the actual transport differential costs of moving milk up the east coast we see that, to land it in the South-East Queensland zone, it ends up at a higher cost than sourcing it locally at current farm prices. That actually goes to the heart of one of our arguments that the current situation in South-East Queensland, in particular, is one of market dysfunction and failure.

Senator COLBECK: So, despite the fact that there are higher costs to provide that product in Queensland, prices remain the same?

Mr Peake: Yes.

Senator COLBECK: Because there is capacity to bring it in from other jurisdictions, even though it does create an initial additional supply cost into that market?

Mr Peake: One of our difficulties is the current contractual structures that the processors have with the retailers. If you look at the fruit and vegetable market you will see it is an open market where the prices are set each day through the function of that market. But the dairy industry market is not functioning in that manner because of the contract structures. The contracts are on either an annual or a two-year or three-year basis. The processors are actually wearing that additional cost to bring that milk in. We would like to see the ability for the processors to go back to the table with the retailers to actually renegotiate those arrangements and prices so they could respond to a situation such as the natural disaster in Queensland.

Going back to the days of regulation—a bit of a trip back in history—to before 2000 when the price was regulated in the domestic industry, each state had a dairy authority. Industry could sit down with the government and the dairy authority and discuss the price and an increment to deal with the shock such as a natural disaster. But at the moment we have a free market arrangement that is dictated by the contracts and the structure of those contracts is not allowing that market to function properly. So currently those processors are taking that additional cost to move that milk.

Senator COLBECK: So we pay 15 bucks a kilo for bananas when there is a shortage but we still pay a buck for a litre of milk, even though there is a shortage?

Mr Peake: That is the issue.

Senator RYAN: You cannot import bananas from Victoria.

Mr Peake: That is true.

Senator RYAN: We produce more milk than we can consume, which is different from bananas.

Senator COLBECK: That is not my point, though, and I will get to that in a moment. We are talking about the impact of a contract on a market. That is all I am trying to get to. You do not have to be too defensive, Senator Ryan, too early. I am making a comparison. There is obviously a shortfall.

Mr Peake: At the worst, we are probably short about one million litres a week and, in a double B-tanker movement, that equates to about nearly 30 tanker movements a week. So it is not an insignificant amount of milk.

So if we were to look at the other issues like the carbon footprint et cetera we see that it does not add up. It is not functioning properly. If we were to look at even the milk industry in New Zealand and look at Coles's own evidence in their submission and at the slides they have been trotting out around the nation—I will hand out this slide—they have used an example that they are discounting in the mid-range, when compared to European countries, the US and New Zealand. But what they do not tell you in this is that prices in Europe and those countries are subsidised. In the US they are subsidised. The price in the US is for a full gallon price, so it is not valid. The valid comparison in this graph is the New Zealand price. New Zealand exports 95 per cent of its milk to the world market in dairy products. Its current domestic price for fresh milk is $1.38. That gives you an example of what an open and free market is setting in terms of a fresh milk price. That is not occurring here in Australia because the major supermarkets are using milk as a near or below cost marketing agent.

Senator COLBECK: I want to ask one more question in relation to misleading statements by Coles. You made some mention of that and you have just referred to that in relation to this chart. In particular, there was evidence given to us of this process actually growing sales. I think, Mr Toohey, you also mentioned it to us a moment ago in relation to the volume of milk being sold. You said that it was growing in line with population growth.

Mr Toohey: That is correct.

Senator COLBECK: But that would not necessarily be the measure you would take? The measure that you would take on a broader scale would be the per capita consumption, would it not?

Mr Toohey: We have another chart that we would like to present to you to back up that evidence as to where we got it from and that will explain it. It is showing there is that consumption rise. However, with population growth it equals out. So it comes back to where they have stated that they are growing their demand. It is actually neutralising out because of our natural growth of 1.5 per cent. Yet their sales increase show it is five per cent, presumably by taking out the route trade, putting a lot of pressure on the route trade and that has given them increased sales.

Senator COLBECK: Really what we are talking about is increased sales with Coles, not increased consumption across the board?

Mr Toohey: That is correct.

Senator COLBECK: Looking at general consumption figures, it appears to me that the consumption itself per capita is relatively static, in line with historical trends?

Mr Toohey: That is correct.

Senator COLBECK: So it is not actually growing consumption in that context?

Mr Toohey: No.

Mr Peake: If I can just answer that. If you look at the monthly figures over the last three years there have been months where there have been increases, similar to what happened in January and February. That was without any discount war. There is another factor at play in terms of the pressure on our economy and that is people eating out less in restaurants and more at home. The grocery chains have picked up more sales with people eating more home meals.

Senator XENOPHON: Chair, with Senator Colbeck's indulgence, can I ask a supplementary on this. I think this question was raised previously—that of ullage, where people buy really cheap milk and then it spoils or they get another one. Is there that aspect as well?

Mr Griffin: That has certainly been shown. There has been a shift from the UHT back to the drinking fresh milk market. People can afford to buy extra and then throw some out. So we maintain all along that milk is an inelastic commodity within the consumer marketplace.

Senator COLBECK: You mentioned, particularly with respect to New South Wales, the triggering of tier 1 and tier 2 pricing and the supply in the broader market. One collective bargaining group has been prepared to take a third instead of two-thirds. Is there a significant oversupply in that particular market and are we seeing a settling out of that as part of this process? Or is milk coming in from other sources to actually fill the supply, based on cheaper core costs?

Mr Toohey: In relation to that collective bargaining group, the new processor, Parmalat, currently has a contract in New South Wales. It has gone around and looked to see where strategically the best place is to pull that milk out of. Naturally, quite a large number of groups have approached Parmalat. They have said, 'Geographically and economically it is better for Parmalat to take this farmer, that farmer and that farmer to move the milk than pick up a lot of smaller farmers.' They are looking at it as a business term. Lion had the previous contract and they took all that milk and moved it into other markets. Where they shunted that milk to, we do not know. This has enabled Parmalat to select farmer against farmer, which is straight down the line of the Tesco model in the UK, which has divided the farming sector.

Senator COLBECK: And which, effectively, breaks up collective bargaining processes?

Mr Toohey: It does.

Senator COLBECK: Which is a tactic we have seen used previously.

Mr Toohey: That is correct. In this case they have picked out four or five farmers, and said, 'We don't want to know about the other 20.'

Senator COLBECK: Are any commitments about potential growth being made to those who have been selected as incentives for them to come on board?

Mr Toohey: No, not at this stage.

Senator COLBECK: So they are just taking what their traditional supply has been but effectively restructuring that market as part of that process?

Mr Toohey: Yes.

Mr Griffin: The issue is that the price that is being driven down by Coles is impacting on the processors' ability to source milk at a price where they can maintain their margins as well. So it is impacting on the whole supply chain. This is why they pick and choose, because they are trying to maintain their own business as a result of this tactic of the supermarkets.

Mr Peake: What is happening in New South Wales in my mind shows a couple of things that are falling out of this supermarket discounting. On 26 January when Coles dropped their price to $1 so did all the other retailers. In fact Aldi dropped theirs even further. So that pressure is now playing out in the marketplace. Those processors have got less margin to play with and that dictates what they can offer for price back to the farm gate. In fact, Lion put in their submission that their EBIT has gone into a negative situation again. It is clear from our point of view that those impacts are happening right now.

The other impact that we see in New South Wales, which occurred in Queensland the previous year, is the transition of that volume of milk when the supermarket contracts change from one processor to another. What is happening in New South Wales in my mind is another classic case of market dysfunction, which we need to address. We are hoping to address this sort of issue through the code of conduct. Now we have got a group of farmers in New South Wales who are not represented by a collective bargaining group and have been dealt with by a processor individually under individual contracts. That is adding to the downward pressure on price in this situation.

Senator COLBECK: I am interested in the impact on farmers, what is happening to these farmers that are losing their supply contracts and the impact on farm exits potentially. I have another question but I will come back to it.

Mr Toohey: In New South Wales there is talk of farmers exiting the industry. That brings pressure back to the processors because of the volume of milk that is put through the plants. It puts pressure on the whole food chain. Farmers leaving the industry has a domino effect on employment in small communities. It is an ongoing effect. It is the first time that Lion has activated the tier 1 and tier 2 prices this year in New South Wales, particularly in the north. Farmers cannot just turn milk on and off. It is a three- to five-year program with breeding. If a farmer has got a number of heifers coming through, he has got to look to sell those animals off to somewhere else. A lot of farmers have got their own stock, so he puts them on the domestic market. To make a business decision we cannot just stop overnight and change the wheel to the opposite direction.

Senator COLBECK: What is the differential in the tier 1 and tier 2 in that particular market?

Mr Toohey: Ten per cent this year on the allocation volumes. Last year we took a hit of 13 per cent. So it is 23 per cent over the last two years.

Senator XENOPHON: I should disclose that after some blood tests I have been formally diagnosed as being lactose intolerant, but I am still a great advocate for the Australian dairy industry!

Senator COLBECK: That is a non-declaration of interest!

Senator XENOPHON: We are hearing from the ACCC later on today. Has the evidence you presented today been given to the ACCC?

Mr Peake: I do not quite know these dates off the top of my head. We wrote directly to the ACCC raising a whole range of issues. ADF has received a response. So we can actually provide that response on notice.

Senator XENOPHON: Sure, if you could. The ACCC will be here to give evidence, and hopefully some of you will be around to hear that evidence. But a number of questions were put to the Mr Cassidy of the ACCC several months ago about what they were doing to investigate these concerns. They reached a conclusion that there were no breaches. To what extent has there been an ongoing dialogue between the ADF and individual dairy farmer groups with the ACCC? We are hearing from the new chairman, Mr Sims, today as well. What information has the ACCC been given by your groups on this?

Mr Griffin: We have had a couple of forms of correspondence with the ACCC but there has not been a strong dialogue between that organisation and ourselves.

Mr Toohey: In New South Wales we met with representatives from the ACCC early in the piece. I could give you that information that was forwarded on to them.

Senator XENOPHON: If it is possible to get that information before the ACCC gives evidence this afternoon, that might be useful. I would find it useful to put those things to the ACCC in terms of how active they have been, what levels of investigations they have carried out.

Mr Peake: One of the key issues that we are concerned about is: has the ACCC actually established what the relevant cost of supply is, when the consumer picks the product up off the shelf?

Senator XENOPHON: This is the definition of 'relevant cost' under section 46(1AA)—the 'Birdsville amendment'?

Mr Peake: Correct.

Senator XENOPHON: And have you received a response from the ACCC?

Mr Peake: No, we do not know; that is what we would like answered by the ACCC. As an industry we wish to follow up with the ACCC on their investigation, particularly now that we have formalised the evidence that we presented to this inquiry at the end of last month. So we will pursue it.

Senator XENOPHON: Okay, if you could follow up that further information. I want to ask two or three more questions. What impact will this have in terms of a chain reaction for other states? I think Victoria is in a special category, because it has such a strong export market, but in my home state of South Australia dairy farmers that I speak to are concerned about making long-term investment decisions; they are not prepared to make those decisions, given what has occurred to the supply chain, particularly in New South Wales and Queensland. What can ADF say about the impact on other states—also in WA, which of course is quite a distinct market?

Mr Griffin: There are certainly impacts throughout Australia as a result of the strategy that is being undertaken. Even though Victoria has an export focus, the more milk that goes away from that export market at the moment, when it is really quite buoyant, to prop up the drinking milk areas of New South Wales and

Queensland, as we have heard, takes away export dollars, wealth creation, money that comes back into this country from exports—so you are reducing the amount of export product, and at a greater cost, because, as we have heard, we have to shift milk up to the north to fill those gaps, which is potentially taking milk away from your higher-returning export markets, which is a wealth creator for the nation and a good income for a lot of people.

Senator XENOPHON: Some dairy farmers in South Australia—and I speak on a regular basis to James Stacey, who is involved with the ADF and the South Australian Dairyfarmers Association—and others are giving me feedback that they are not prepared to make those long-term investment decisions. What impact will that have on productivity and related matters?

Mr Peake: If I could add to what Chris has said, we actually met with some young farmers in our industry in Queensland two weeks ago. One had a robotic dairy operation that had invested an additional $2 million about three years ago, and another had just put in a rapid-exit system. We asked those young farmers: in the current environment, would you be able to justify making that investment? They said no, they would not. So the fear for us is that we are already seeing the impact. In Queensland have lost some 24 farmers since the price war started. You cannot separate the impacts of natural disasters and the price war, but we talk to every farmer that leaves our industry in Queensland—we basically do an exit interview. The majority of them have said that the impacts of the price war and the outlook that this is creating was a contributing factor in them making the decision to exit.

Senator XENOPHON: Was it a tipping point though? I guess there is the causation test. Was there a causal link in this sense: but for the price wars would they still be in the industry?

Mr Peake: Some farmers would say, yes, that would have been a tipping point. We have actually had farmers move south to pick up new opportunities in the export industry and that has been very much a case of making that decision because they wanted to move away from the domestic market industry.

Senator XENOPHON: My final line of questioning relates to this, and I think, Mr Griffin, in your comments in your opening statement you alluded to this. You have talked about the UK practices and you are saying that what we have seen with the Coles management are the sorts of practices that they have been pushing in the UK. But in the UK there is a code of practice.

Mr Griffin: That is right.

Senator XENOPHON: How long has that been in force for? How effective has it been—this is from your counterparts in the UK—in terms of ensuring a reasonable price and a reasonable supply chain?

Mr Griffin: I would have to take that on notice. It is only quite new and it has been instituted recently over there as a result of the issues that they have faced. I would have to take that on notice to give you the length of time that has actually been in place.

Mr Peake: Senator, on page 38 of the Australian Dairy Farmers submission, which outlines the recommendations, there is actually a brief overview of the UK situation and the work on the code in the UK. So they have had a code but it has not had anyone there to enforce it and they have now put in place an adjudicator. But the new system is currently going through their legislative checks and balances, so the full structure of it is not in place at this stage.

Senator XENOPHON: Those recommendations are set out on page 39 of the briefing pack. You are also talking about individual contracts. What safeguards would you have? I think it is coalition policy not to have any individual contracts. Is that so? That went down like a lead balloon! I am just going by what the Leader of the Opposition said; that is all. What is your view on that and how do you deal with individual contracts? How do you stop people being picked off? If an individual farmer wants to contract with Coles, you are not suggesting that be prevented? What mechanisms are in place? What ones do you think there should be to allow for collective bargaining?

Mr Toohey: We currently have a group that have sent a letter off to the supermarket to see whether they can deal direct. That is only as of last week, so I cannot give you an update as to where that is. But the concern is what I picked up three years ago in the UK where it was farmer dividing against farmer. You could have two farmers equal and the only thing that divided their operations was the boundary fence. But the processor said, 'Well, when I send the tanker'—and this is the best efficiency for that processor—'I will take one and have it drive down the road closer to the plant and pick up two smaller ones that were not going to grow.' So it really divided farmer against farmer. How they do it over there is that they look at it and they get an independent person to come in and evaluate all the costs of production and everything related to producing milk and then they pay accordingly as to that. To me personally, I see that as a safety net but you are fully controlled by the processor with no room to grow. If they do not want to grow you do not grow. In my case, I have three children and if I wanted to bring them back onto the farm and grow it I might not have that opportunity if I went down the path of that model.

Mr Griffin: Currently in our industry Australian Dairy Farmers have negotiated to have collective bargaining groups as a way of giving farmers a bit stronger bargaining capability. Currently we have got 17 of those groups in place. But we cannot stop farmers from making their own choices. At this stage they should always be able to have choice. But an individual farmer negotiating with a large company is much more difficult than a group of farmers negotiating with a large company, and that is why we have been able to go along this collective bargaining route.

Senator RYAN: My concern with the discussion that has occurred through this whole inquiry, which will not surprise those of you I have spoken to, is that we forget the person who is walking into the supermarket to buy the milk. I would like to address a few points that various witnesses have raised. Mr Peake, you commented on your concerns about milk being brought in from outside South-East Queensland to supply that drinking milk market. Why should that be a concern?

Mr Peake: The concern is there on a number of fronts. The actual movement of milk into Queensland is not the first best option for the processor or the consumer at the end of the day.

Senator RYAN: Can I challenge you on that on that basis that, if the processors are continually doing it, are they not in a better position to determine their own interests than us sitting over their shoulder saying, 'No, it is much better for you to buy the milk from over there than it is to truck it up from New South Wales or Victoria'?

Mr Peake: I would agree with you in that context. However, I would add that, right at the moment, the frustration in our value chain is that the processor should be able to go back to the table with the retailer to renegotiate the arrangements so that the supply can be sourced from the best region or the closest region possible. That is not happening at the moment.

Senator RYAN: We cannot necessarily conflate the best and the closest, can we? That is an assessment that the person supplying the milk to Coles makes. I take your point about the tragedies in Queensland that have impacted supply in the course of the past year, but are you advocating that there be a mandated right for a processor to force Coles, Woolies, IGA or whoever back to the table and to say, 'We do not like the way that you are bringing milk up from New South Wales or Victoria so you have to sit down and allow us to renegotiate'? There is nothing banning this at the moment.

Mr Peake: There is nothing banning it at the moment; I would agree with that statement. I would suggest to you—this is probably more a question for the processors here today in later sessions—that the amount of market power that the supermarkets carry and the contractual mechanisms they have got in place are not allowing that market to function as we think it should. When we have got a shock in Queensland at the moment and we are short of milk because the market has not been able to respond to that shortage, the response is bringing milk from a further distance into the state—

Senator RYAN: But you are not short of milk in the sense that people can go and buy it from a fridge. A shortage of milk is defined by whether consumers can have access to drinking milk, which was the concern raised earlier in the year. We do not have lines on a map that are meant to serve as trade barriers. We are meant to have an internally free market. Victoria does not have bananas but it is cheaper dairying country because of climate and everything else. It is not necessarily an issue that drinking milk is available to a consumer in the same bottle from a different part of Australia.

Mr Griffin: The cost of getting it there is being tied to this $1 a litre, which is not sustainable. With the contracts that are being locked in now and the shift from branded into generic milk, the processors are bound to supply that milk and they are being absolutely squeezed. That then leads to farmers being offered and paid a lower price for their product. That is putting them under financial pressure as well.

Senator RYAN: This is where we get to the key point that no processor has yet given me or this committee a reasonable answer as to why these multinationals—it is hard to find tears for Lion Nathan or the other large multinationals here; in some cases they are bigger than Coles and Woolies and a lot bigger than farmers—keep supplying. If the tap was turned off to Coles and Woolies tomorrow for a matter of weeks and people could not buy milk, their supermarkets would be like ghost towns. This is the issue that I think we need to focus on more here. The processors have paid billions of dollars for brands that the consumers no longer value. The consumer has realised all of a sudden that they can pick up the generic light milk as opposed to REV or PhysiCAL. So the loss here is from the processors. I do not see why suddenly they are the victim of these contracts that they freely enter into.

Mr Tessmann: The problem the processors face is the same problem the dairy farmers have, Milk is a perishable product and it is very difficult to turn it off at any level through the value chain. It is very difficult for them to simply say, 'No, we are not going to supply.' There is milk coming in. Farmers have milk coming off the farm and the processors have milk they need to do something with. It cannot be simply put in a warehouse and stored; it is a perishable product. The thing is that in our market in Queensland, whether it is local or not, if you are the cheapest you should supply the market. To me, it is a situation of market failure when a dearer option is brought in.

Senator RYAN: To be fair, you are viewing the expense of doing something as the gate price, yet obviously when people are calculating the overall cost of something they look at the cost over time. It may be cheaper in the short term to import something than it is to develop a longer term commitment to its production in Australia. That is true for a manufactured good as much as for a primary product.

ADF advocates here a mandatory drinking milk market code of conduct. It is not regulation in the form that we used to have regulation, but it is regulation. If we have a mandatory code of conduct that does what Mr Peake suggests, that would mean that if a large multinational processor says, 'I want to force Coles and Woolies back to the table to renegotiate' then Coles has to come back. What else is supposed to be in this mandatory drinking milk code of conduct? If it is mandatory, I cannot see there is anything other than regulation.

Mr Peake: It is not the intent to have it as setting price at all. The intent is to have a code of conduct that covers the whole value chain. We are not just talking about between farmers and processors; we are talking about from farmers to processors and right through to retail. The biggest problem that we have at the moment is that the supermarket tactic of using milk as a marketing agent at near or below cost is dragging value out of our value chain, our supply chain. It is also the reason that in Queensland we are not getting a response in the marketplace to the current shortage of milk. It is also the reason that processors are losing market share from their proprietary brand sales. That is actually trapping investment. We are looking for a referee. It is not about disclosing commercial-in-confidence material.

Senator RYAN: Could a referee make binding decisions? Is that what you are advocating?

Mr Peake: The referee would have the ability to direct mediation or to arbitrate if necessary.

Senator RYAN: Let us be honest. This is regulation. This is setting up a means by which someone who is not party to a contract, whether it be the farmer, the processor or the retailer, someone who is not party to one of those two contracts, has actually got the power to arbitrate over issues, including price.

Mr Peake: No. We are saying that the parties involved with a contract in the supply chain will be the parties that would be covered by the code in that sense. We are not suggesting that everyone in the value chain horizontally and vertically would have the ability to look into everyone else's business. We are not saying that at all.

Senator RYAN: You have two basic parts to this overall in the supply chain in very general terms: the relationship between the farmer and the processor and what you are saying is the problematic part of the relationship between the processor and particularly the two large supermarket chains. This referee who can arbitrate would have the power to make binding decisions over one or two of those contracts. That is regulation, isn't it?

Mr Peake: Senator Ryan, what we are saying is that we need a mechanism—and this is what the UK is looking at—to provide guidance to the commissioner. We are looking currently at a sustainability gauge that the commissioner can use. What we are trying to get at is: we want an ability to have practices looked at if they are not sustainable for the value chain.

Senator RYAN: I want to nail this point. Can this arbitrator make a decision that is binding on two parties to a contract?

Mr Peake: This is something that still needs to be developed, but in my mind if there was a contract structure that was fundamentally undermining the sustainability of the supply chain then the commissioner should have the ability to address that.

Senator RYAN: This is the problem, Mr Peake. I am constantly concerned when I hear about protecting value with a supply chain. The reason I say that is particularly my concern with the behaviour of the processors here is that they have a huge vested interest in protecting the position of their branded product in the marketplace. The channel shift that is going from branded milk to generic milk—from proprietor milk to the stuff that is supplied cheap to Coles and Woolies—is not something that should be discouraged. We have government policies that actually encourage it for medicines, even though the taxpayer does not save a cent. Why is it a bad thing? Why should we be concerned that National Foods brands—PURA or something—are losing market share to a generic brand if the consumer is getting the same product and realises that the product is cheaper?

Mr Griffin: Provided there is a fair return to all those along the supply chain. Generic milk has been recognised as a bulk, less profitable product just to move it through. Because of the marketing tactics, the amount of milk that is being shifted into that market has increased considerably. We are seeing, as a result of the contracts that are being offered to farmers now, a reduction in the returns to dairy farmers because that milk priced at $1 is unsustainable. You need the transparency in the supply chain to make sure everybody is getting a fair return. It is all right to say, 'Let's just shift it all over there and suffer the consequences.' The consequences will be the dairy farmer getting a lower price and making it an unsustainable business for them to operate in.

Senator RYAN: Coles, Woollies, IGA and every retailer cannot basically open the doors to their supermarket without reliable access to fresh milk. I think that is a reasonable contention, but we have processors here with billions of dollars in the game. You mentioned earlier that they are not being encouraged to reinvest, but they are the ones who are losing it. If anything, isn't it true that they are using their market power over farmers to actually force down prices to you? The processors here are the ones being squeezed because in the long run Coles and Woollies need you guys to keep milking your cows.

Mr Peake: That is true, but I would argue that at the top end of the value chain we have a situation where the huge market power by the two large supermarkets is actually putting downward pressure through the value chain through their tactics. They are using fresh milk as a marketing agent. That is what is happening.

Senator RYAN: I am not challenging that whatsoever.

Mr Peake: Basically the value chain is paying for that advertising budget. They are also using their market power in what we see is an unconscionable way. We are saying that the current legislation is not working.

Senator RYAN: In your recommendations you talk about the definition of 'unconscionable conduct'. If we put aside the drinking milk market code of conduct and we put aside the effects test, because I think we would all concede that that is a much bigger competition law issue that sits outside this issue, isn't it true that, absent a couple of farmers that Mr Toohey mentioned earlier going to Coles or Woollies separately, an unconscionable test would really be of no benefit to you in your relationship with Coles or Woolworths, because you do not have one? Your relationship is with the processor.

Mr Peake: With respect, we are talking about catering for potential future scenarios. We have a scenario at the moment where the retailers are sounding out whether the farm sector is interested in directly contracting with the supermarket. You only have to look at what has happened in the UK to see examples of that. We need to make sure in the code of conduct that we are recommending that we can cater for those different scenarios as they may occur.

Senator RYAN: You are not advocating that supermarkets or farmers not be able to deal directly, are you?

Mr Peake: No, we are not.

CHAIR: I am interested in the Queensland situation because that seems to be the one that is at the forefront of people's minds in terms of how it is playing out, particular given you had a natural disaster earlier this year that reduced production. As I understand it, the shortfall in production in Queensland is being supplemented by milk being trucked in at a higher price. You say that that is a market failure. As I see it, that is the market working in a sense because the shortfall is being supplemented. They are finding in the short term an answer to meet market demand for the milk and are bringing it in at a higher price.

Surely in the longer term whoever is paying the higher price to bring the milk in will say, 'It is costing us more to meet this.' A rational buyer of that milk would increase the price paid to Queensland farmers so that they are not paying that premium to meet the shortfall. In the short term they have to do that to meet production, but a rational buyer would say, 'It is costing us more to do it this way. We will pay more to encourage greater production,' until you get to that marginal point just below what it is costing to bring it in.

Mr Peake: I understand what you are saying, but it is not just about meeting the shortage of supply from interstate. What is also happening is that the price and return to farmers is going down, and that is the real catch 22 with this. We have got different levels of impact. The Pauls Daily Access group is one direct example of impact happening right now. The other impact is that the farmers that provide the other major processor had a major cut in price last year, and they got a minor price increment this year which is way less than inflation, so you can basically say that price has been suppressed—it is going down. The difficulty is that by the time what you are saying may play out in those contract negotiations down the track, the damage has already been done. We are losing farmers already. There are not farmers or dairy cattle we can pull off the shelf to turn the switch on for production tomorrow.

CHAIR: I understand that. That surely is a part of a rational buyer's assessment process when they are looking forward. They would realise that if they continue what they are doing at the moment, if what you say is correct—and you say that 24 farmers have left the industry in Queensland—that is going to have an impact on their ability to buy milk in future and meet the demand of their buyers.

The other question I have concerns the 24 farmers that have left. What has happened to the farms that they were farming? Have they left the dairy industry and converted to other forms of production that are giving them a better marginal return, or have those farms been closed down and subdivided and sold off for residential blocks? What is happening as a result of this?

Mr Tessmann: Most of those farms have left the diary industry; they are losses to the industry.

CHAIR: A loss to the industry, but are they becoming productive elsewhere?

Mr Tessmann: A number of those people may still own the farms, while some have sold their farm into another industry. A number of them still own the farm but have then sought employment elsewhere to continue and, as Adrian said earlier, some have sold the farm to other operations and headed to Victoria to take up a dairying operation there. So it is a range of things across the board, but they have all been losses to the dairy industry in Queensland.

CHAIR: That is a relevant factor, something that we need to look at and take into account. We need to look at the overall impact on consumers and how that works for food security and all sorts of issues. We also need to look at the broader picture of how that plays out for the broader economy as well. If they are moving into other productive areas where that land is providing a better marginal return for the overall economy, that may be a good thing in a broader sense—though bad for the dairy industry and requiring adjustments. As you know, I am new to this inquiry and I am trying to get my head around it all as well.

Mr Peake: Our organisation in Queensland has met with Coles. Coles have been publicly stating about the new rise and fall clauses in the contracts with the processors. We have met with them and said: 'This is the impact on Queensland. It is quite clear that we are going to lose $80 million in lost production and damage to farms and we are losing farms right now. If there was ever a classic case to sit down with the processor and review those contracts, it is right now in Queensland.' We were giving them the reason to sit down and relook at their marketing tactics in the dollar-per-litre milk that they are using as a marketing agent. They have not responded to that. There has been no change to their discounting tactics.

CHAIR: We have an opportunity with the next witness to explore that a little bit maybe. In terms of rational buyers, there may well be reasons why they should be looking at that, and we will see whether there are.

Senator XENOPHON: Is it $88 million that has been lost so far?

Mr Peake: We have modelled the impact from the natural disasters in loss of production and damage on farm—

Senator XENOPHON: But the price wars—$44 million—

Mr Peake: Yes.

CHAIR: Thank you for assisting us with the inquiry today.

COMLEY, Mr Shane, Finance Director, Lion - Dairy and Drinks

JEFFREY, Mr Murray, General Manager, Milk Sourcing and Inbound Logistics, Lion - Dairy and Drinks

MAKEIG, Mr Duncan, Group Sustainability Director and General Counsel, Lion - Dairy and Drinks

[10:40]

CHAIR: Welcome, Mr Makeig and your colleagues. Would you care to make an opening statement?

Mr Makeig: Yes, I would, thank you. First of all, I want to thank the senators for having us back; we welcome your interest in this issue and we are grateful for the opportunity to discuss it further with you. This is the second time we have appeared before this inquiry. In our first appearance we anticipated a significant erosion of the value pool that is available to the participants in the white milk industry in Australia. Since that time we have seen this erosion occur and, if anything, at a faster rate than we had anticipated. We have details of that in our submission and we are happy to take questions on that.

The reduction of home-brand pricing since January has not grown the white milk category. It has not added any value to the industry; in fact, it has reduced an already challenging profit pool to what we believe are unsustainable levels by transferring volumes from the higher margin branded products into home brands and from the geographically diverse non-grocery channels into the concentrated grocery channel. Since the beginning of the year our fresh milk EBIT margin has deteriorated from what we predicted would be an already challenging two per cent to a negative margin.

Of course we understand the attraction of cheap white milk for consumers. However, the longer term impacts of this pricing on the diversity and choice available in the industry today have to be weighed up against the short-term benefits for consumers that shop at the large retail chains. In the longer run it may become uneconomic to provide fresh white milk to non-grocery outlets in Australia. It is clear that, unless something is done to address this, the dairy industry will undergo some serious structural change. There will be a lot of losers in that change—distributors, franchisees, small retail outlets, milk vendors, farmers and the Australian consumer.

At the end of the day, we believe consumers need to understand and value the benefits of having access to fresh white milk delivered on a daily basis across a country the size of Australia, and pay a price that allows the industry to be sustainable in the longer term. Thank you.

CHAIR: Thank you, Mr Makeig. We will go to questions.

Senator COLBECK: I will start with the growth in the category. We heard from our previous witnesses that there has not been any growth in the white milk category. I want to get a broader sense of this, rather than talking about any specific element of the category but talking about retail sales across the board in the milk market. The evidence that we had earlier was that the growth is basically in line with inflation, but there has been no growth in per capita consumption. Is your evidence concurring with the previous evidence?

Mr Makeig: Yes. In our earlier submission we have some ABARES data that showed that milk is very inelastic—people do not put any more milk on their Weet-Bix just because it is cheaper. I think there has been a variation in the consumption of milk, from branded to non and from the disparate vendors around Australia into the concentrated grocery channel, but there has not been any overall increase in the consumption of milk.

Senator COLBECK: The reason I ask that is that we got very specific evidence from Coles at their appearance earlier in the year that they were actually growing the category, and I think their figure was by about five per cent. But you would concur with Australian Dairy Farmers that that is in fact not occurring, that it was perhaps a natural variation over a selected time frame that gave the appearance of that occurring?

Mr Makeig: I am not sure what their matrix was. It was certainly over the volume of the consumption of house brand milk within the retailers. We do not have national census data on milk consumption. We would need someone to give us that. The data we have shows that increases in house brand milk as a consequence of this pricing has been lost through the non-grocery channel and through switching from branded to non-branded milk.

Senator COLBECK: I have to say that I agree with Senator Ryan in respect of where you sit in this whole process. In fact, I had that conversation with one of your then representatives back in February about where you sit in accepting the terms and conditions as part of this process. Now I realise that there are a number of players in the market and it may be that you have taken a particular stand that has influenced you in losing contracts, which we have seen particularly in Queensland, New South Wales and the ACT, which are three that come to mind immediately. How do you sit by and see your EBIT go from a projected two per cent to a negative as part of this overall discussion, and then, effectively, not do anything about it?

Mr Makeig: Well, very reluctantly. We are doing what we can. I think in answering Senator Ryan's question earlier, first of all, we would like to find a better solution than cutting off milk supply to Australia. The retailers are selling milk in a way that is perfectly legitimate in terms of driving their broader commercial strategies of bringing consumers in, but it is priced at a price that makes it very difficult for us as processors to make money. It is essentially that we operate almost as a utility, I suppose, in the sense that we provide milk through our processing and distribution systems to about 55,000 distribution outlets around Australia. It is very difficult for us to underwrite the cost of that, which is almost a utility cost for Australian consumers, to get fresh white milk all over Australia at the price that the retailers are selling the milk at. It is not inconceivable that $1 a litre—and it is very conceivable that the consumers like $1 a litre—is sustainable if you only buy your milk from the 1,000-odd large retail stores around Australia. You will not be able to find it available, and we cannot afford the cost to underwrite the distribution, in the 55,000 stores that currently sell milk around Australia. Our issue, Senator Colbeck, is that we are trapped in the middle where we have to process and underwrite the costs of the distribution that exist in Australia today, which I think the Australian consumers enjoy. I think it is way of life for Australians. We cannot afford to continue to do that and, in fact, we are losing money on it, which is why we have a negative margin at $1 a litre.

Senator COLBECK: In that context we know that there is a rise and fall clause in the contracts these days. My recollection is that it is triggered on an annual basis. Is that correct?

Mr Jeffrey: Yes. It is a moving forward mechanism, but also retrospective as well. For example, in a market like, say, North Queensland, if we were to put a 1c a litre increase to our farm gate, that would pass through to Coles for that year to come.

Senator COLBECK: But you do not have a contract in North Queensland so it does not affect it.

Mr Jeffrey: For Coles.

Senator COLBECK: You do have a contract in North Queensland for Coles. What is the trigger for that to occur from your side? Is it triggered from your side of the contract or does it have to be triggered from Coles?

Mr Jeffrey: That is from our side. Of course, it will have an impact on farm gate milk price in those states. I suppose the question might go to: why don't we give 10c and you can pass that straight through to Coles and we will all be happy. The reality is that there is the rest of the marketplace. Coles only makes up a small percentage of the total milk sales. We have to look at the full economics of that decision every year, and we review that consistently. In a market like Queensland it is very difficult, when we already have high negative returns, to put a higher price through to the marketplace knowing that we are just not going to get it back to the farm gate marketplace. We are not going to get it back on the actual sales marketplace.

Senator COLBECK: Let us not be silly and say 10c, let us say 1c or somewhere within the parameters of where farmers might like the market to be. I think they have suffered a 3c or 4c reduction in price in the current cycle. That is the current number as I understand it. If you also put 1c a litre price through, and if that were to flow back to Coles—I suppose it comes back to their pricing and they are not prepared to talk to us, so we cannot ask them the question—with their pricing policy of being a flat price nationally, does that feed into their retail price or does that get fed back into your branded product price?

Mr Jeffrey: That gets fed into the price that we sell that milk to Coles, but what they do on the shelf is really up to them.

Senator COLBECK: That is their business.

Mr Jeffrey: Just follow that if I can in relation to some of our current losses in Queensland. Because we have a national pricing matrix as $1 milk, we would have to increase our price in Queensland just for our own needs by about 10c a litre to get to a reasonable return before we could even pass it onto the farmer. It is really difficult situation in those northern states at the moment because there are substantial losses that processors are wearing as a result, and it is not just $1 milk but is the whole marketplace as it stands today.

Senator COLBECK: I am aware that you are carrying some farmers as part of the realignment of the market with Parmalat taking over the supply contract. I think you are maintaining the Far North Queensland guys them as part of your supply structure and utilising them somewhere else, which is obviously costing you some money, but that is a decision that you guys have made. I want to go into something that is a little bit out of left field. There was a report this week of Woolworths having a contamination issue from a cleaning agent in their home branded milk in New South Wales. Obviously you do not have the contract for Woolworths in New South Wales, as I understand it. That is part of the change in structure. As part of that report there was discussion about Pura milk having the same contamination. I was interested to understand how that actually came about, given that Pura is your brand and not Parmalat's brand, and obviously it is a process coming through a Parmalat plant that has caused that contamination.

Mr Makeig: It was part of the Dairy Farmers acquisition as a requirement of the ACCC clearance that we had to license some brands to competitors for a period of time to make adjustments to market share and brand ownership that then made the transaction acceptable to the commission, so Parmalat has the Pura brand in New South Wales.

Senator COLBECK: Is that for a specified timeframe?

Mr Jeffrey: Yes, it is for a timeframe.

Senator COLBECK: It does not affect any of your other supply contracts or anything of that nature?

Mr Jeffrey: The incident?

Senator COLBECK: I was just trying to understand whether they were supplying something that was effectively yours and the fact that you have to contract to them or let them use your brand.

Mr Jeffrey: It is their product. They just put our trademark on it.

Senator COLBECK: Is that for a period of time?

Mr Jeffrey: Yes, it was set for a number of years. I am not sure exactly how long. I think it is five years.

Senator COLBECK: It does not affect any of your other supply contracts like, for example, your supply contract for generic milk into Coles?

Mr Jeffrey: No, I would not think so. Obviously it is our brand so we are concerned about the brand damage that might be done as a consequence of it, but it is not our product and we do not control it.

Senator COLBECK: I was trying to get a sense of how everything fitted together into that market and whether or not that might be influencing the current circumstances of dairy farmers at the moment. But if it is coming through a different mechanism—

Mr Comley: We do not supply the milk for that particular brand in that state.

Senator XENOPHON: If I can go back to your evidence of 9 March 2011 and perhaps refresh your memory in relation to that. Back then you were asked about what impact this could have in the longer term in the marketplace. You referred to, 'That is the ghost of Christmas future,' where you said that there could be a circumstance where fresh white milk might be available, but it would 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. Is that still do your view following what has happened in the intervening almost seven months?

Mr Makeig: I think it is probably even nearer as a possible future state.

Senator XENOPHON: Do you think there will be a shift in consumption to long life milk particularly in some of those northern markets?

Mr Makeig: Well, I am speculating as to what might happen. Of course, with milk being a perishable product, if you are not close enough to a large retailer where you can buy milk on a daily basis, you will have to buy milk and some other form and I suppose it is longer life UHT. That is speculation on my part but that seems to be a reasonable assumption.

Senator XENOPHON: We are hearing from the new chair of the ACCC today, so if anyone from the ACCC is listening via this broadcast, they can take this as a question on notice. In March of this year the then chairman of the ACCC, Graeme Samuels, said on Sky business channel: 'I do think we have 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 net profits.' I think he was talking about processors such as you. You said then that you would not respond to Graeme Samuels. He is now no longer chairman so you can go your hardest. To what extent will you now respond to that? You said back then that it was increasingly unattractive in terms of investment and, 'We do want to invest capital in the dairy industry and about the one or two per cent margin is very difficult.' What has changed since you gave evidence in March both in the margins you were talking about then and also in terms of what the then chairman of the ACCC was saying basically that you were a mob of whingers and that there was no merit to it?

Mr Makeig: What has changed is that our margins have got worse. Everything we were forecasting as a potential future state seems to be transpiring.

Senator XENOPHON: What will they do for investment?

Mr Makeig: It is very hard for us to justify to our shareholder to invest in the Australian dairy industry in the way of differentiation or better product facilities when you have a negative margin. We are not here to ask the Australian government to bail out us as a large corporation. We understand how to run brands and we understand how to run our business model. I think the challenge, and what we would like to do in the way of educating the Senate and possibly the commission is that we operate a very large utility that the Australian consumer enjoys. We are not asking for sympathy; we are simply explaining to you that, on the $4 billion we have invested in this, we cannot sustain a utility whereby fresh milk is picked up and processed and distributed around 100,000 outlets in a country the size of Australia for negative margins. Our position is that we cannot continue to do that forever. We are currently doing it with the forbearance of our shareholder but there will be a point at which can no longer continue to do that. That does not mean that there will be no milk—we will not be cutting off supplies as we do not think that is an appropriate course of action as a corporation—but milk may be limited and may be more concentrated in terms of where you can acquire it in the future.

Senator XENOPHON: So consumers will have to travel further in some cases, depending on where they live?

Mr Makeig: At $1 a litre there will be a limited circumstances whereby we can produce it and sell it for $1 a litre.

Senator XENOPHON: And more long life milk?

Mr Makeig: The experts will comment on that, but it strikes me that if you cannot get fresh milk it will be UHT.

Senator XENOPHON: At what point will your company say we are either going to defer or cancel long-term investment decisions in this industry? Have you got to that stage yet or are you still weighing up your options? In other words, has there been any deferment of investment of taking on more workers or anything like that in terms of your company's profile here in Australia with milk?

Mr Makeig: I do not want to forecast decisions we have not made. I do not know if Shane would like to comment on whether we are deferring investment decisions, but in the longer term it is pretty challenging at negative margins.

Mr Comley: Certainly investment would be more focused around efficiency and cost reduction rather than investment in product differentiation or increasing production. We would look at all options and if we can get a substantial and fair return on that investment.

Senator XENOPHON: I was sent some photos this morning of a Coles supermarket which was just full of Coles brand milk. The other brands were tucked out of the way and quite difficult to access. This is just one supermarket—I am not saying it is part of a trend. But can you comment about whether it is more difficult for consumers to access your product in terms of the convenience of accessing it at the supermarket shelf in Coles and Woolworths? Secondly, as I understand it, the supermarkets have a practice of demanding discounts from processors, and they can do this not just with milk but with a whole range of goods. Has that been occurring with your branded products?

Mr Makeig: It is very competitive. It is being sold at $1 a litre. That is not a price we are comfortable with, clearly. That is what we are here to discuss.

Senator XENOPHON: And in terms of access to shelves?

Mr Makeig: The large retailer brands are the biggest brands in the market, so they are both a customer and a competitor of ours in that sense. We are competing against their brands and clearly they are doing very well. Their brands are very successful and growing and we are finding it more challenging to sell ours.

Senator XENOPHON: There were questions this morning about the volume of milk sold. Has Lion done any research on wastage, where people might buy two litres at $2 but do not use it all because they do not get to it? There is wastage. Have you done any work on that?

Mr Makeig: We have not, but certainly the category has been commoditised. At $1 a litre it is cheaper than water, so people will treat it that way.

Senator RYAN: Given that the market has been commoditised, as you say, it is fair to say, is it not, that consumers are increasingly seeing milk as milk, as opposed to seeing the value of different brands? That is expressed through the brand shift. That is a fair characterisation of what is happening at the consumer level of the market in supermarkets?

Mr Makeig: I think consumers see milk as milk. There are all sorts of different properties associated with different types of milk, with low fat et cetera. But what concerns us is that consumers are being educated—we think miseducated—to the extent that they think you can enjoy a fresh white milk industry in Australia in the long term at $1 a litre, and you cannot.

Senator RYAN: Your contention is that there will not be milk in certain markets at $1 a litre?

Mr Makeig: No, I have not said that.

Senator RYAN: Okay, I just want to clarify. You say 'an industry' there, which is different to what you said earlier. Your earlier comments were about maintaining an extensive distribution network, as opposed to an industry. I would contend that is different.

Mr Makeig: It will be a very different industry if it is an industry that simply produces milk for the large retailers to be sold in the large retail outlets. That is an industry, but it is different to the current industry.

Senator RYAN: Do you deliver milk at $1 a litre all around Australia, or is it only under contract to the major chains?

Mr Makeig: No, we do not deliver it. Shane might be able to comment on what our costs are to deliver it all over Australia, but the competitive set of it being available at the large retail stores for $1 a litre makes it very challenging for the smaller vendors to be competitive.

Senator RYAN: I have spoken to a number of smaller vendors. There are not as many milk bars as there were when I was a kid. There are no suburban dairies, as there were when I was a kid. My family used to have one. We have seen constant change in this industry as there has been consolidation, much larger distribution networks and national branding following deregulation. The smaller vendors put it to me that people stopped going to them for price a long, long time ago. If you were interested in cheap milk, you did not go to the local milk bar. The value proposition for selling it was convenience of location and, until probably 10 or 12 years ago, opening hours. So how is this any different? The fact is this is just further price competition to what was already a pretty substantial price differential in a deregulated market.

Mr Comley: I think that is right: we have seen a differential between the route market pricing and what was available at a major grocery store, and we recognised in our submission that we have seen a decline over time in both the local convenience and unstructured route anyhow, prior to the move. What we have seen since the change is an acceleration of that decline.

Senator RYAN: The point I am making is that we have seen this decline over decades. There were suburban dairies—in Essendon there was still a guy with a horse delivering milk bottles—as late as 1980, when I was a kid. So this is not something that has just recently happened. There has actually been a trend and a move towards much larger farms, much larger processors and larger retailers for a long time. How is this uniquely different, other than the fact that the value of your brands has been severely damaged by this particular marketing strategy by Coles and Woolworths?

Mr Makeig: I do not know if it is different. What we are trying to explain to the Senate is that if the political will and the population of Australia is comfortable with that accelerating from the position currently where 100,000 outlets sell milk to, say, 1,000 outlets and it is just an acceptable evolution of the commercial retail markets in Australia then we think that will happen.

Senator RYAN: What is your proposed solution to this? Presumably it is not regulating the price. Are you proposing a floor price at which the large chains can sell milk? I have not read that.

Mr Makeig: No, we are not proposing that.

Senator RYAN: This is where we get to the constant challenge when we come to allegations or assertions of market failure. There is no such thing as a perfect market. The truth is, though, that intervention by authorities usually makes them worse. What do you suggest would be the path to addressing your concerns about the sustainability of what is effectively a distribution network?

Mr Makeig: If we had the answers I suppose we would have put them in our submission. I think it is very challenging. You have competition regulation. Some of these issues are social policy issues, I suppose, for the parliament. We believe that, unless there is some change in the commercial mindset of the large retailers, left alone the commercial outcome will be as we have described. We do not have the answers. I think it will be a mixture of things. Some people have talked about an ombudsman. I think the previous speakers spoke about limiting the size of the very large home brand milk contracts. There are a number of ideas that are worth considering. I just think that left unchecked the commercial outcome—it is an acceptable commercial outcome; we are all big commercial players—will have a social consequence.

Senator RYAN: First of all, your lack of ability to distribute milk does not necessarily equate to the lack of availability of fresh milk, because alternative distribution networks could arise.

Mr Makeig: They could arise. It is possible but, given the benefits of scale we currently enjoy and then the costs of distribution across a very large country, I do not know anyone else who is going to be able to afford to distribute around the country.

Senator RYAN: I appreciate that. I will be brutally honest. My concern, as I said to one of the larger processors—I cannot remember if it was you—at our hearing in Sydney, is that you are not compelled to supply this milk. Years ago, when these generic brands were not that large you were not compelled to supply the milk. Given that the major interest of the processors has been to protect the value of their brands and that, as you said yourself, you are a customer and a competitor, whether or not the particular value of your brand is at risk is not to me an issue that is relevant to public policy.

Mr Makeig: We agree.

Senator RYAN: So how do we disaggregate your interest in protecting the value of your brand—it is quite legitimate; it is your job for your shareholders to protect that—versus what you are arguing now is some sort of utility that is worthy of different consideration in public policy?

Mr Makeig: We are not asking for any intervention around protecting our own brands. That is our business. What we are saying is: the shift from our branded margins to negative margins with home brand production means we do not have margin overall that allows us to sustain. If the home brand contracts were very profitable for us that would apply.

Senator RYAN: So why do you do it? I always come back to this question. Why do you do it?

Mr Comley: These contracts are 250 to 300 million litres, so winning or losing those can mean quite a dent in how you deal with your milk supply and with your farmers. It is a hard thing to turn on and off on a certain day.

Senator RYAN: That is more so at the farmers' end. They cannot turn the cow on and off. That is much more so at the farmers' end. I take their point. But I come to this issue: I am not advocating that you do not supply milk to Coles and Woolies, but if the large chains do not have access to a supply of fresh milk this whole marketing strategy, which your group and farmers groups have alleged is so important to Coles particularly, would collapse and, I put to you, would be of substantial corporate damage if there was no milk suddenly. You could not sell them the volumes that you have. You could simply supply your own brands. You could say, 'We are only going to supply a particular volume.' You obviously cannot coordinate your activities, but there are only three suppliers and this competitive tension is actually what is meant to happen. One of you, or more of you, is supplying milk. I fail to see how one can supply it continually, on an ongoing basis, and then at the same time say that it is killing their company.

Mr Makeig: I do not disagree with you at all, but the consequence, I think, which is for us to turn off 300 million litres of milk purchased from the farming community, is something that we as a corporation do not feel comfortable doing. Supply and demand here for these very large contracts is quite complex. It is not as straightforward as it should seem. Yes, commercially you are correct. If we are not making money we are not going to supply you and you would stop production. But with the flow-on consequences to these communities, with our corporation and the reputation of our corporation, it is not something we can do very easily. We agree that that would be your normal commercial way of resolving this inequitable margin sharing. But we have not done that and we are not proposing to that as a consequence that we foresee.

Senator RYAN: The only time I can remember there was a question over milk supply was in a milk strike in Victoria in about 1982 or 1983. I was young. If I recall correctly, the government, for the first time ever, actually use the Essential Services Act against Victorian dairy farmers.

Senator COLBECK: They sent the Army out to milk the cows.

Senator RYAN: I do not think it went that far, did it? It was of some amusement to us Liberals that the act was used against farmers but not people who had stopped electricity being generated. Anyway, there was a massive consumer outcry. This was not the sort of issue that was going to last weeks or months. This was something that was going to last hours or days. So I put to you that this should be something resolved through commercial tension and the fact that you have a product that these corporations are in desperate need of. That is a more appropriate place for its resolution than the parliament or politicians making decisions about how contracts are formulated.

Mr Makeig: Yes. But I just feel that if we took from this inquiry the best advice we could collectively come up with is that we should just cut off supply—

Senator RYAN: I am not suggesting that.

Mr Makeig: to motivate consumers to recognise the true value in milk—I think we put in our first admission that the first thing people wanted back in after the Queensland floods was milk—we do not want to do that. It might be what, commercially, we should do, but I think the consequences of it are something we have not felt comfortable contemplating.

Senator RYAN: I appreciate that there are issues other than purely commercial ones. I do take that point. That is all I have, Chair.

CHAIR: Can I just pick up from there. Senator Colbeck raised it and you have had a long discussion about this with Senator Ryan. If you are making a negative margin on supplying those contracts, you cannot do that indefinitely. It is not a rational thing for a company to do—to continue supplying milk if you are going to make a loss out of it. I understand what you are saying. As a statement, you are not prepared at this point to go out and say, 'We're not going to supply milk.' Presumably, your competitors are in the same position, where they are not making money out of supplying these generic brand contracts. But no company making a rational commercial decision would, on an ongoing basis, continue to sign up to contracts that lose money. Is that the case? Obviously, you are looking at saving costs and changing the way you do operations to turn that around so you are back into positive territory; but, if you cannot get back into positive territory, you cannot possibly, given the obligations you have to your shareholders, continue to lose money on these contracts.

Mr Makeig: Some contracts are break-even; some are loss making. A lot of the negative margin we do not enjoy but rather suffer as a consequence has to do with the large infrastructure that we have in place in terms of distributing all over Australia. But broadly, yes, that is right. We are continuing to operate with the forbearance of our shareholders. No-one wants to invest in companies that make negative margins.

CHAIR: Despite that, if you continue rocking up to Coles and Woolworths and saying, 'Yes, we'll continue to supply you,' even though you are continuing to lose money, they will continue to screw you—for want of a better way of putting it. They will think: 'We'll just keep telling them this is what we're going to pay for it and they'll keep on giving it to us. We don't really care whether they're making money or not. If they keep on giving us the supply, we will keep on selling it at $1.'

Senator COLBECK: It is their problem.

CHAIR: Yes, it is your problem. If they are making a rational decision and they are looking at the options with processors to supply their milk and they realise that, ultimately, these processors are not going to be able to supply them with milk at the price they are offering, they will have to think about their strategy and how they address that. But if they know that processors are going to continue to supply the milk, even if it is at a negative return, then they have no motivation, no incentive, to make any changes.

Mr Makeig: The retailers will always be able to source milk at very competitive rates. I think the broader point we are making today is that that is the nature of the milk industry in Australia in terms of how it is distributed more broadly through 100,000 outlets. That is where the pressure point is, that is where the economics are falling down—because of the pricing pressures on the large retailers and the fact that these disparate, smaller retailers have to compete with the chains. But, speaking to your point, yes, it is a very sensible thing for the large retailers do. They are getting very cheap milk.

CHAIR: Absolutely, but for the market to work they need to get the message that they are not paying an appropriate price to ensure a long-term, sustainable and secure supply for their supermarkets. If they are not getting that message then they are not going to make any changes.

Mr Makeig: Again, in fairness to the retailers, it is not their problem. They are not necessarily concerned with the 100,000 outlets that—

CHAIR: No, they are not concerned about the 100,000 outlets, but they are concerned about securing their supply—

Senator COLBECK: Their market share.

CHAIR: for their market share, but also for their marketing strategy, bringing people into their supermarkets so they can flog other things to them at a grossly inflated price, which, presumably, is what is happening. And the whole market strategy falls over if they cannot get that secure supply. They want to know that when people rock up to buy a litre of milk and walk through their doors, they will find that the shelves are full.

Mr Makeig: Yes.

CHAIR: And that is fine at that point. But what confuses me is that, if you are actually losing money on it, surely you would be better off putting your resources—the capital that is invested in Lion Dairy and Drinks—into alternative ways of making money, because you are not making money out of this. I would have thought that, not necessarily overnight, maybe not even in medium-term but in longer-term planning, you would be saying, 'Let's divert our capital into areas where we're going to make a return for shareholders,' and getting out of what you are doing. That is not a good thing for the overall dairy industry, but it would send a message to Coles that the strategy that they are employing is not going to work in the longer term and they need to look at changing it.

Mr Comley: There are big incentives for us to maintain contracts for this supply given the fact that we have milk supply that we cannot simply turn on and off. So there is a large incentive to try to maintain the relationship—

CHAIR: I understand that in the short- to medium-term, yes.

Mr Comley: and continue to have efficiencies through our factory and the like. What we perhaps did not anticipate was that the retail environment would change and we would all of a sudden see leakage of profit from more profitable brands into private label. It is difficult to forecast. That has eroded that value. It was also not forecasted at that time that we would see an acceleration of the leakage of profits move out of the route trade and into the grocery channel, which has further eroded profits. When we have attempted to lift prices in contracts since then we have lost those. We are not the only ones trying to negotiate a price. We are in a competitive tender for volume and—

CHAIR: But presumably your competitors are not in a position where they are able to negotiate with vastly lower margins and can undercut you in any greater way and still make profits. They have to make profits for their shareholders as well. Realistically, there is a bottom line that all three of the major processors cannot go below. They might be able to in the shorter term, but on a longer term sustainable basis your negotiating positions would reflect a point where you would be making reasonable earnings before income tax. That should be reflected in the longer term but it does not appear to be at this point. What I have heard today suggests that you are prepared to wear that for some time and cover it just to get the volume and keep the money flowing through the business to cover your capital costs.

Mr Comley: We would need to address that over the longer term. The change in the retail environment has been in the fairly near term. We would need to reassess that as those contracts come up for renewal.

Senator COLBECK: I would like to quickly follow on from that. I was specifically interested in your investment in innovation, which I am suspecting is not all that high at the moment. So the effect of this whole process is basically to dumb the industry down to be a basic commodity supply process.

Mr Comley: It is not that we do not invest in innovation, but it becomes harder to justify returns and so each opportunity needs to be assessed on its merits. It becomes a more difficult proposition as your branded products become smaller and smaller to justify an investment.

Senator COLBECK: I want to follow on from Senator Bushby and Senator Ryan. You made the comment that it is not easy to turn off or turn on 300 million litres. That is true from an on-farm perspective but it is also true from an infrastructure processing perspective. How much has the change in contracts that we have seen recently had to do with infrastructure movements over the last four or five years? You are where you are, you have the contracts and your domination in the national fresh milk market and generic market is largely because of a series of acquisitions you have made. You have already put to us this morning that your PURA brand in New South Wales, as part of a requirement of one of those acquisitions, is being managed by a competitor at this point in time. Obviously significant infrastructure went with that change in process. How much of this process is part of a shakeout of the industry as part of those acquisitions and change in infrastructure ownership?

Mr Comley: I certainly think that an element of the nature of bidding for those contracts is to make sure that you maintain a viable infrastructure for your business in each of those processing states. I cannot comment on our competitors' situation.

Senator COLBECK: But you would have a fairly reasonable sense of the overall infrastructure in industry nationally. I am coming back to where Senator Ryan has been during the morning and Senator Bushby to a certain extent and myself earlier in that there is a certain capacity within the market nationally. You guys are big players. If the change in contracts is part of an overall market shakeout, you guys are bigger than Coles in a broader sense. Having spent a lot of time in contracting, I know that occasionally there is an idiot in the room who is going to put in a lower price and you cannot do anything to defend that. That is the system and the way it works. Again I come back to the conversation I had with your company, not with any of you individually. I was talking to somebody else at that time about your capacity to influence this because you are a major player that is bigger than Coles and Woolworths. We know the situation in New Zealand is different because Fonterra is bigger than Coles and Woolworths and they say, 'This is the price.' It is not the supermarkets that dictate the price over there; it is Fonterra.

At what point in time does your ownership of a certain capacity of infrastructure within the system and does your own, hopefully, good long-term relationship with dairy farmers in the system put you in a position to balance this out a bit? That is effectively where the market settles at some point in time I would have thought. To switch on or switch off a large volume of infrastructure is going to cost a lot of money. I would have thought that, if a contract were to change hands with some sort of balance in the overall infrastructure, it would have to be factored in as part of the contract negotiations.

Mr Makeig: We are not bigger than the large retailers—broadly in terms of market but also their brands now in milk are bigger than our brands. We do not have the ability to set price clearly, because we are on the record as losing money at these prices.

Senator COLBECK: You also control supply.

Mr Makeig: We have these enormous fixed assets.

Senator COLBECK: That is why I asked the question about capacity. I see that as an important element in this overall process. I am more than happy to be put straight, if you like, to understand the overall capacity in the Australian market. You would understand that. You would know it pretty well. You have been around. You have purchased a whole heap of it. You have had to divest some of it because you have been told you have to. You would have a very good understanding of the capacity within the system I would have thought. You would understand some of these basics. At some point in time that is going to level out. As we have heard, it is relatively inelastic in drinking milk, so the growth is going to be understood. All those sorts of things would mix in investment decisions. At some point in time you have a position of market strength I would have thought. You would have to from just looking at the fundamentals of the business.

Mr Comley: I do not know that we can necessarily be compared to New Zealand in terms of the position of market strength—

Senator COLBECK: No, you are not. I accept that it is different here in Australia to New Zealand. That was the point I was making.

Mr Comley: You are right. We do have large assets and it is important we keep throughput to be able to keep those assets efficient. Our competitors would be doing the same thing. We have rationalised those assets that we have seen as surplus over time. We do have a program of rationalising our manufacturing footprint to address that.

Senator COLBECK: I am very aware of that. Let us look at where Coles decided to go with beer. One of your competitors said, 'We're not going to sell it to you.' I think you probably come under the category I referred to before because your approach was to sell as much as you possibly could at that point in time to try to grow your market share. It comes back to the behaviour of you guys in that position in the market really largely. You can have a huge influence on this overall process.

Mr Comley: Beer is a very different category with 20 days stock on hand versus 24 hours for milk, which is a perishable product.

Senator COLBECK: I get that. Thank you for your forbearance.

CHAIR: I thank Lion Dairy and Drinks for assisting us today.

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

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

van RIJSWIJK, Mr Gerard, Senior Policy Adviser, National Association of Retail Grocers of Australia

[11:30]

CHAIR: Welcome, Mr Cummings and Mr van Rijswijk. Please feel free to make an opening statement.

Mr Cummings: Thanks again for the opportunity to address the committee in regard to milk pricing. From a retail perspective—I think the Senate has seen this evidence come before it—the only way that low priced house brand milk can be maintained in Australia is by recouping the money that is being lost by processors from their other smaller customers. I think that, while that could go on, all processors were more than happy to continue to supply those contracts at the levels they were. To give you an example, our current list price on two litres of PURA milk is $3.08. The contract price to Coles would be somewhere around $1.50 for two litres of milk. We have contended from day one that that is an anticompetitive price discrimination that is taking profit from the small retailer and giving it to the large retailer.

I think the dynamics have changed in that processors did not think that house brand would get to the volumes it has at the moment. We can currently buy branded milk for around $1.85 for two litres in Western Australia. The processors cannot recoup from independent supermarkets the profits that they were losing in the supply of house brand milk. They are still attempting to recoup those lost profits from the smaller corner store and finding that more and more difficult to attain.

I think it is also important that we recognise—and we have been consistent in saying this going back to the grocery inquiry four years ago—that the problems that are in the dairy sector are indicative of what is happening throughout the whole of food manufacturing in this country. From our point of view, the dairy sector sticks out because it is a simple process: milk the cows, transport the milk, bottle it and retail it. We have seen a situation where canned tomatoes may no longer be canned in Australia. There is more and more pressure going onto food manufacturing and the farmers. We contend that it is brought about by the market dominance of the two major players and the push-down effect.

We are no longer anywhere near a level playing field and we have put forward in our submission, and we contend again, that the reintroduction of a prohibition on anticompetitive price discrimination would go a long way to levelling the playing field and giving small business a chance to get back the market share and the profit that is being lost to large corporations.

CHAIR: Thank you, Mr Cummings.

Senator COLBECK: I have a couple of questions. I want to pick up on the regional discrepancy issue that we talked about with the last witnesses. This is where I might have a fight with my colleague Senator Ryan. We are talking about 1,000 stores having access to $1 milk. I understand some of your members also do too. I certainly acknowledge Senator Ryan's discussion about growth in farm sizes, growth in business sizes and growth in processors over time. A lot of that has got to do with access to capital and being able to have the scale to actually deal with some of the issues that are facing industry. I recognise that as part of the broadening of the market and the capacity to have competition on a global rather than a local or a national level. That is one of the key drivers of all of this.

The other side of that in a social sense is the accessibility of this product, particularly in regional areas. Senator Ryan, being a city dweller, would perhaps have a slightly different perspective to someone who lives in a remote or a rural area where, if you do not have a Coles or a Woolworths supermarket close by, you effectively do not have access to this product. Therefore you do not have access to the price. I suppose my question is: how do you actually manage that when something like 65 per cent of what goes through the major processors goes into those particular supermarkets?

It is not necessarily a specifically economic question but it has a broader social perspective in relation to accessibility, more broadly, for people to get the benefit of a commoditised price for these products.

Mr Cummings: Without a doubt; coming from Western Australia, we are fully aware of that. Probably eight years ago we would try and promote Harvey Fresh milk, which was a local processor. One of the drawbacks was that he could not supply milk to everyone of our supermarkets throughout the whole of Western Australia. He drew a line of distribution that stopped at, I think, Bunbury, stopped at Northam and did go up to Geraldton. Kalgoorlie could not get Harvey Fresh milk delivered to them because it was not economically viable. Now, that will occur.

A similar thing happened when Coca-Cola used to directly deliver. Then they went through the warehouse and the same thing happened: the route trade became uneconomical for Coca-Cola to deliver to certain parts of Western Australia so they had to find alternative ways to get it there. On shelf-stable product you can get it; on fresh product you cannot get it.

I think the last time we gave evidence to the committee we agreed that, in Western Australia, the long-term outcome will be that fresh milk is not available throughout the whole of the state. It is a matter of somebody drawing the line. Is the line Broome, is the line Geraldton, is the line the northern suburbs of Perth? The line will be somewhere.

Senator COLBECK: Effectively what has been happening through the process at the moment is that the more economical areas of supply have been cross-subsidising the less economical areas of supply.

Mr Cummings: Without a doubt.

Senator COLBECK: At what point do you say that is not a reasonable model to operate?

Mr Cummings: To start off with, I do not think it is a reasonable to operate at all. If you look at milk, the people that I know in the dairy sector have said to me that the only efficiencies you can give to providing house-brand milk versus branded milk is down around 7 to 10c per litre, but we can see that the price differentiation is more like $1.50 or $1.60. That price differentiation is not justifiable. Going back to price discrimination, if you look at the rationale that Hilmer put forward in his review of it, what is occurring in the milk market is failing the two tests that he put forward. You cannot justify the price that is being charged for house-brand milk compared to branded milk. It is not a joy for me, as an independent business person, to know that every time I buy milk from National—I do not know who has the Woolworths contract, but Harvey Fresh will get the Coles contract in Western Australia now—I am actually subsidising the supply of cheap milk to Coles. That is what is occurring.

Mr van Rijswijk: I think there is a transfer of margin from the Independents to the major chains.

Mr Cummings: Exactly.

Senator RYAN: We have had many previous conversations about this. I object to the term 'subsidy'. It is the equivalent of saying that somebody sitting in row 38A on Qantas flight 487 to Sydney, who paid $200 for their seat, is subsidising the person sitting next to them, who paid $180 for their seat. Price discrimination, price differentiation, does not constitute a subsidy.

Mr Cummings: In that example, the reason why that $200 seat is there is because the guy is equalising his margin to build it up.

Senator RYAN: You are trying to maximise the yield, effectively.

Mr Cummings: Totally; I understand that. But what we are talking about does not pre-empt that. If we go back to the Western Australian example, Harvey Fresh's rationale in picking up the Coles contract is that through summer and winter there is an excess in some weeks of 250,000 litres of milk in Western Australia. And then they picked up the Challenge contracts when Challenge Dairy went broke, which was encouraged by the WA government—and there was a whole pile of reasons for that. Obviously they think that if they can continue to sell their brand milk at this margin, if they can take this excess of milk and sell it at a lower margin, through the low periods they might have to dip into the higher margin cost of milk to supply that contract but they are hoping that at the end of the day they will break even or make a little bit of money.

Senator RYAN: But that has not worked out so well for the other processors, has it?

Mr Cummings: It only works out while I am still prepared to pay the higher price for the branded milk.

Senator RYAN: I will tell you how it works out, Mr Cummings. It works out as long as the consumer, who we continually seem to forget in this discussion, walks into a store and picks up a litre or two litres of milk, because you only buy it on the basis that someone walks in the door.

Mr Cummings: Sure.

Senator RYAN: This is my constant concern. So I do not think that subsidy is the—whether a company is trying to maximise its yield or maximise its margins by discriminating on price, which happens in Melbourne from one end of town to the other, and despite the verballing of me by my Liberal colleague Senator Colbeck I actually do care quite a lot, but let us not get into price differentiation in suburbs in our own cities, let alone in regional areas and cities.

Senator COLBECK: I was asking a question, actually, as much as anything else—

Senator RYAN: My point is that this does not constitute a subsidy. I think that is an important term to get correct. It is definitely discrimination on price.

Mr Cummings: I take your point. I guess I was talking more from a retailer's point of view as the payer of the cheque. When I write the cheque out, I know that some of that money that I am writing the cheque out for is going to offset the loss that that manufacturer is making in supplying.

Senator RYAN: You just have to be honest that the best way is if someone is paying less for the same product. That is effectively a statement of fact. But I do that every time I shop at one Safeway versus another Coles or IGA. That happens to people going into every store in every city in Australia.

Mr van Rijswijk: In some instances, that is a competitive tension that is positive, and in some instances that is anticompetitive. The difficulty in Australia is that we make no distinction between the two.

Senator RYAN: That is a lovely segue, because I was going to go there. We were talking earlier—and we have had long discussions about this, so I am happy to be corrected if I have misconstrued what you have said—about the alleged anticompetitive price discrimination. You can get milk at a price that allows you to sell it at $2 for two litres in Western Australia. Our discussions around this previously have centred on the terms of contracts. Obviously, if I want to sell 10 million litres of milk that goes to two warehouses, then I can quite easily do that at a particular price that I might not be able to do if I had to do two million litres of milk going to the route trade. I am assuming you are not proposing that there is anticompetitive price discrimination going on between the contracts to Coles and the contracts to supply the route trade, because the cost structures of those are so profoundly different. I just was not sure if I misheard you earlier.

Mr Cummings: What I mentioned before was the Hilmer committee's recommendation on section 49 when it was taken out of the Trade Practices Act 1974, and this was in 1993. This was written in the report. It says:

There are two defences to s.49. The first is where the discrimination makes only reasonable allowance for differences in the cost of manufacture, sale or delivery resulting from the different places to which, methods by which or quantities in which the goods are supplied to the purchasers.

Basically that is economies of scale.

Senator RYAN: That is one thing. There is a second test—

Mr Cummings: Yes. The report says:

The second is where the discrimination occurs in good faith, to meet a price or benefit offered by a competitor.

Now, I would contend that, yes, the person is giving a contract to satisfy the second test, which is that 'the discrimination occurs in good faith to meet a price or benefit offered by a competitor'. Therefore—and these processors would know exactly what prices were going around, and Coles would tell them anyway—if I am told by Coles that the contract price is $1.50 in Western Australia and I am bidding for the one in South Australia, I have to go under $1.50, so I am doing the second test and that is not anticompetitive price discrimination. But the person who is giving the $1.50 is actually failing the first test because the differentiation does not make 'only reasonable allowance for differences in the cost of manufacture, sale or delivery resulting from the different places to which, methods by which or quantities in which the goods are supplied to the purchasers', when everybody I have spoken to in the milk-processing industry tells me that differentiation is worth about 10c a litre.

Senator RYAN: Since our previous conversation I have spoken to a number of people in this field. One of the other arguments they have put is that courts, commissions, bureaucrats or politicians are extremely poorly equipped to make an assessment on item 1 that you just mentioned. On the idea that we would have our courts and our politicians or regulators going through that: we cannot do it well for electricity and water in this country at the moment, where prices are going through the roof. When we have regulators like this, it tends to lead to higher prices to consumers because you tend to protect the loudest voices, who are the people with interests at the moment. You tend to forget the consumer interest because they do not have a loud voice at the table, and you tend to stifle innovation because you tend to reflect current practices rather than allow the development of new practices that can actually lead to efficiencies.

Mr Cummings: I take your point. Also we have pointed out, and I will point out again, that some companies actually do not have an anticompetitive price discrimination policy in their pricing, and they tend to be American based companies or English based companies which grew up in a jurisdiction that has such provisions in its competition law. Two companies that come to mind are Cadbury and Coca-Cola. We are not disadvantaged in Australia by Cadbury's block chocolates at any prices; we are not disadvantaged by Coca-Cola.

Senator RYAN: The key point for Coca-Cola is different here. I think every processor and farmer would agree that Coca-Cola is a brand not a commodity, and to a certain extent the consumer will not subsidise Pepsi for Coke. What we have seen with this pricing, but also probably as the inevitable result of deregulation, has been that consumers now view Coles, IGA or Safeway light milk as being almost a perfect substitute for Rev, PhysiCAL or whatever the domestic brand may be.

Mr Cummings: Senator, slow down.

Senator RYAN: And that is not true with Coke.

Mr Cummings: I spend every day in our store. Customers go to the one location to buy milk. None of them pick up a brand anymore. If I change Harvey Fresh for Pura or Brownes, they will just buy Brownes. The next day, if I put Harvey Fresh there, they will buy Harvey Fresh. Somebody said before about the supermarket with just house brand that nobody buys anything but house brand milk. But, interestingly enough, we have never sold a house brand milk. We have a simple little saying in our business—that is, I will do whatever a customer asks me to do. If they say, 'Clean your teeth,' I will go and clean my teeth. We have never once been asked for a house brand milk, and we serve 20,000 or 30,000 customers a week.

Senator RYAN: Yes, but you compete with them on price, don't you.

Mr Cummings: We sell milk at a competitive price.

Senator RYAN: Exactly. The point I am making is that, when you have any commodity product, price is usually the driving factor.

Mr Cummings: But I have been in this game for 28 years now, and we have sold milk at the same price as Coles and Woolworths for 28 years. That ain't going to change. Even if there were a prohibition on anticompetitive price discrimination, that would not change. We would still sell milk at the same price as Coles and Woolworths, or Coles and Woolworths would sell milk at the same price as us. The difference is: if I were to go and tell Coles what price I was paying for Pura milk, and it happened to be a lower price than Coles were paying them, do you reckon Coles would allow that to go on for one minute longer? They would use their market power. They would go to them and they would say: 'Listen, fellas, you'll either do this for us or we won't promote your cheese. You'll do this for us or you can forget about us facing your yoghurt the way we are facing it in the store. We will not pay one cent more than that bloke is paying for milk.' If I went there and I found out Coles's price and I went to Nationals and said, 'Excuse me, fellas, but you are selling Pura milk to them at 10c less than me; how about you sell it to me at the same price?' how far do you reckon I would go?

Senator RYAN: Probably not as well.

Mr Cummings: I would have thought so!

Senator RYAN: A statement of the obvious to you, but—

Mr van Rijswijk: But that comes back to section 46, on this market power issue. In the evidence coming from the previous people they were asked why they did not bump the price up—why is the price so low that they are not making any margin out of it? It is a question of the market power of the two bigger chains. Section 46 should be able to address that, but it is very difficult to prove under section 46 that market power is being abused. What happens overseas in competition law—and you go to the Treaty of Rome in 1957 and subsequent treaties and you go through competition law in the EU, the UK et cetera—where you have a clause that is equivalent to section 46, abuse of market power, the subsidiary clause to that is anticompetitive price discrimination, which is one form of discrimination which is encouraged by market power.

Senator RYAN: I understand that, but, to be quite frank, on virtually every measure, whether it is agricultural policy or competition policy, we are not really in a phase of copying what Europe is doing, for many reasons.

Mr van Rijswijk: No, it is not just Europe; it is the OECD generally.

Senator RYAN: What we call OECDitis, amongst some economists, is that, just because everyone else does it, we do it. Quite frankly, we are standing out from all those economies for other reasons at the moment too, and this may be a very, very small part of that. The challenge, though, Mr Cummings, is that, with that particular section, that first clause you read out from the Hilmer report, that can potentially lead to huge amounts of litigation, regulation and regulatory oversight, and that is one of the reasons it was removed. As well as it not being used—and I take your—

Mr van Rijswijk: That does not stand up, Senator, because there has never been a case—

Senator RYAN: I was about to concede that. I take the point that it was not used, but what has been put to me is that several of the reasons that it was not used—and I take your point that the regulators may not have been educated in its use—were that it is a very bureaucratic provision: it requires people who are not necessarily equipped to do so to sit down and start examining company accounts and determining, 'Is this a fair amount for transport or a fair amount for storage or a fair discount to be operated for a bulk purchase?' I will just finish on this point. If the processors are running around and saying that the only way they can justify cheaper milk for generic brands is 7c to 10c, I am not taking the view of those currently in the market to decide what is a fair margin. The problem with that provision is that you do not get the market signals that happen in the supermarket or in the milk bar.

Mr van Rijswijk: On the ground it works in a different way. I was in business at the time that the clause was actually in, and at that time I was working for an American company who had a good understanding of the law in America and applied the same law here. What they basically have then as a supplier is the capacity to provide some push-back to the major chains by saying: 'Hang on a minute; you are asking us for X discount. We can't give it to you because of XYZ, because the law says we can't.' At the moment—

Senator RYAN: And the consumer ends up paying higher prices.

Mr van Rijswijk: No, what you get is an equalisation of prices. You get a levelling of the playing field.

Senator RYAN: That is an optimistic view of the behaviour of corporates.

Mr van Rijswijk: No, it is not.

Senator RYAN: I take a sceptical one, as you do, on some points.

Mr van Rijswijk: I understand that, but you cannot say, in milk, that people who are paying a higher price for milk are paying a higher price for cappuccinos so that the chains can continue to have cheaper house brand milk. Not everybody—

Senator RYAN: Thank you for your indulgence.

Senator XENOPHON: Can I just go to that issue of the clause. You mentioned how it worked on the ground. Can you just elaborate on that. I think you might have been accused of optimism by Senator Ryan, but just in a practical sense how did you see it working and how would you see it working again in the current environment?

Mr van Rijswijk: At the moment you have a disparity of power between the chains and the processors. Although the processors have been allowed to grow bigger in Australia because of the dominance of the chains—that was one of the reasons they have been allowed to grow bigger—they still are in a situation, as was explained this morning, where they have a huge volume of milk coming through and need somebody to take off large chunks of it and therefore they are vulnerable to downwards cost pressure from the chains. With an anticompetitive price discrimination clause, they can say: 'Hang on a minute. The lowest price we can provide you with milk at is X, because when we provide you with milk at this level we already have to provide Joe Blow with the same price, given the adjustment for volume and all the other things.' It creates a benchmark below which they cannot—

Senator XENOPHON: There is the issue, though, of volume discounts. How do you deal with that? Would it then be rendered ineffective?

Mr van Rijswijk: That law has been in place in America since 1934, and they deal with it very well. You have to remember—

Senator XENOPHON: How do they deal with volumes? How do they deal with a corner milk bar—

Mr van Rijswijk: They look at the differential in cost that occurs when you are supplying a large volume—the actual difference in margin that you can give people because of that volume. The other side of looking at that, of course, is that what we are dealing with here in Australia is the problem caused by the absence of that law. Even the ACCC thinks this is no longer an issue. What you see in jurisdictions around the world, because they have anticompetitive price discrimination law in place, is that commerce is educated to that fact, so the sorts of problems that you are coming up with, saying, 'This will happen,' do not happen because, over a period of time, these guys become educated that this is the way you behave.

Senator XENOPHON: Say in the US, is it your understanding that the way the US law works is that the volume discount must be commensurate with differences in distribution—

Mr Cummings: In the costs of production—

Senator XENOPHON: Costs of distribution, or production costs as well?

Mr van Rijswijk: No, it can be. It can be—

Mr Cummings: They are all separate price breaks. Senator, just remember, we have lost the first part of it. It is anticompetitive price discrimination. You can still discriminate price; it is just that the outcome cannot be anticompetitive. You can still give a discount to a retailer if the retailer says: 'I will give you shelf position A. I will sign it. I will do all of these things'—so extra marketing. That is a reason why you give a better price to somebody. If they pay you sooner, you give them a better price. If they take a delivery in a certain way, you give a better price. That happens now. We can buy from a cereal company a prepacked pallet in a particular configuration that we can get a better price on than if we bought them individually. That is not an anticompetitive price discrimination; that is a marketing price discrimination. What we are talking about here is when the effect is: I can only sell this product to you if I sell it to you for a higher price. When I do that this person has got an anticompetitive edge over that person and can always sell that product at a cheaper price. So you do not have a level playing field. It is not just in milk in Australia; it is in electricity—it is in a whole pile of things. It is not just us as an association that says that this is a necessary thing to look at. It is also the Service Station Association; it is the Pharmacy Guild; it is the Retail Traders Associations; it is COSBOA. They are all saying: 'We ain't got a level playing field. This might go some way to level the playing field.'

Senator XENOPHON: How does this tie into what the former ACCC chairman Allan Fels said at a recent conference on supermarket issues when he suggested that an effect test be introduced into section 46? Is this effectively the same thing that you are arguing for?

Mr Cummings: Yes, indeed.

Senator XENOPHON: As I understand it, such an amendment would mean that, provided it met the other thresholds of section 46, the conduct which had an anticompetitive effect or was one of the anticompetitive purposes prescribed in section 46, it will be prohibited. How does what I understand Professor Fels to be suggesting tie into with what you have just been saying?

Mr Cummings: It ties in. If I can go back to the Hilmer committee. It came up with the following conclusion:

> The Committee considers that price discrimination generally enhances economic efficiency, except in cases which may be dealt with by s.45 (anti-competitive agreements) or s.46 (misuse of market power). To the extent that s.49 has had any effect it seems to have been to diminish price competition. The Committee does not consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is potentially to the detriment of the welfare of the community as a whole.
>
> The Committee recommends that a provision such as s.49 should form no part of a national competition policy and that the existing provision should be repealed.

So they are clearly saying that this anticompetitive activity would be caught by section 45 and section 46. I am aware of several cases that have been taken to the ACCC and the ACCC has in the past said: 'There ain't nothing we can do about it. It's not covered in law in any way.'

Senator XENOPHON: We have the new chairman of the ACCC giving evidence here in a bit over an hour. What would you say to the ACCC chairman in answer to the context of this and similar deep discounting?

Mr Cummings: We think two things and we have been consistent in both. We are encouraged by the new chairman of the ACCC and we are encouraged by where we think the ACCC will go to, but we have said for years that if you look at competition law in Australia you need two things to happen and it cannot be just one of them. The regulator has to gain some enthusiasm to regulate and if there are deficiencies in black letter law they should be identified and rectified.

Mr van Rijswijk: I think your point about section 46 is interesting in that the absence of an effects test makes it less powerful. It is interesting to note that section 45 has an effects test but 46 does not. It is an anomaly. Then you go back to section 49 and Hilmer's comment that section 49 is in some way an advantage to small business. But if you look at competition law around the world such as in the US and Canada, but steering away from the OECD or the European system, they will bring up the treaty of Rome of 1957 and subsequent treaties of the EU. They looked at anticompetitive price discrimination as core to running a level playing field in businesses across the board—big companies as well as small companies. It is not a factor that favours small companies; it just levels the playing field for everybody. This is the problem we have in Australia with section 49. For many years it has been seen as a sop to small business. It is not a sop to small business. It simply says: 'These are the rules of the game. You have to treat everybody fairly.' If you look at competition law literature in the US and Canada, even the basic material comes out of the Robinson-Patman Act. In the Patman literature on this he explains very clearly that this law is in place to create that basic level playing field. It has nothing to do with small business.

Senator XENOPHON: Would you mind providing the committee secretariat that material and any precis of that? I would find that useful.

Mr van Rijswijk: Yes, certainly.

Senator XENOPHON: What interaction have you had with the ACCC in the last few months, since this milk price war started?

Mr Cummings: We have met with the ACCC. We have met with the new chairman and a deputy commissioner. We have said that we think it is important that this be looked at. We have just put it on notice to say that we would like them to consider it, to see if it can be covered. The example I gave was the beer trade, where in New South Wales Coles and Woolworths liquor operations would go to the brewery. They would pick up beer at a deeply discounted price because they were picking it up at the gate. The supplier to the independent sector found out about this, went to that brewery and said: 'Listen, we have trucks. We will be first in line, second in line or third in line—whatever you want. You tell us when to be there and we will pick up the same quantity of beer. Will you give it to us at the same price?' They said, 'We can't afford to do it for all of you; we can only afford to do it for Coles and Woolworths. We can't afford to do it for you as well.' That instance was taken to the previous chairman, who said, 'No, there's nothing we can do about it—fair game.' That was taken to the previous chairman.

Senator XENOPHON: Have you taken it to the current chairman?

Mr Cummings: We were told clearly by the ACCC that there is nothing in the law that prevents that from occurring.

Mr Henrick: The point to be made about the section 49 repeal and its relationship with 45 and 46 is that the parliament was told that section 49 should be repealed because 45 and 46 would do that job. The regulator has never taken a single case, but the parliament has never said that anticompetitive price discrimination is acceptable conduct.

CHAIR: As I understand it, IGA also sells home brand milk at $1 a litre. Is that correct?

Mr Cummings: You can access house brand milk. In Western Australia we do not.

CHAIR: You do not in WA but in some of the eastern states?

Mr Cummings: In some of the eastern states, yes.

CHAIR: So they have matched the $1.

Mr Cummings: We are not here saying we cannot match the price.

CHAIR: No, I am just trying to clarify this.

Mr Cummings: No, they do. What you will find is most independent stores will make a decision about whether they go down a house brand track or have a favoured supplier. That might be a relationship with a vendor, the salesperson or whatever. They will cut a deal on that brand milk to sell that at a competitive price.

CHAIR: That is what you have done?

Mr Cummings: Yes.

CHAIR: You are selling it competitively with branded milk in Coles and Woolworths.

Mr Cummings: Yes. We sell our branded milk well below Coles and Woolworths. We consistently sell Harvey Fresh brand milk at $1.99.

CHAIR: For two litres?

Mr Cummings: For two litres.

CHAIR: Okay, so $1 a litre as well. If you do not mind me asking, are you making money out of that?

Mr Cummings: Yes, of course.

CHAIR: You are not using that as a market leader.

Mr Cummings: No. And, if we are making money out of it, you can bet your bottom dollar that Coles are making more than we are.

CHAIR: You also mentioned that the list price for Pura is over $3. Is that the price that you pay for it, or is that the retail price?

Mr Cummings: That is the normal listed wholesale price, but we would not pay that.

CHAIR: No, you would negotiate something.

Mr Cummings: They are forced to because we just say, 'We ain't paying that.'

CHAIR: You are aware that Coles is probably paying something significantly less.

Mr Cummings: I would think Coles house brand contract was $1.50 for two litres—75c a litre. That is the house brand. I do not believe that they would let the supplier get away with selling them a higher price. Also, without a doubt—and we have given this evidence before—in the whole dairy sector you are seeing the waterbed effect. The processor must recoup his lost profit from somewhere, be that in yoghurt, ice cream or cheese. The problem is the farmer cannot milk his cows and say, 'These 10 cows are going to house brand milk and these 10 cows will go to ice cream.' He just gets the one price.

CHAIR: Also, if you are in the non-processing states—

Mr Cummings: In Western Australia it is all drinking milk.

CHAIR: In Western Australia and Queensland you do not have the opportunity to recoup it through yoghurt, butter, cheese and so on. It does create that squeeze.

Senator XENOPHON: Chair, I have a question I would like to put on notice when you are done.

CHAIR: I was going to ask about the purpose and effects test, but you have already done that. Senator Xenophon.

Senator XENOPHON: You have raised this previously publicly but could you provide the committee with the studies you have done of Coles's prices. You have asserted that prices have gone up overall. Could you provide that to the committee? I am not sure if it was in your submission.

Mr Cummings: Yes, sure. What you are alluding to we did say before and I have said publicly. Without a doubt the strategy—and we are seeing it—is that a major chain will pick a commodity and go low on price on that and then inflate the price of other products.

Senator XENOPHON: If you have evidence of that—

Mr Cummings: We saw over a three-month period—and I see it all the time because we get it through price checks—Coles put down the price of 600 products and put up the price of some 1,800 products.

Senator XENOPHON: If you can provide evidence to the committee on that, that would be excellent. Thank you.

Mr Cummings: Sure. Not a problem.

CHAIR: Thank you very much.

Mr van Rijswijk: I would like to say one more thing. We said in our submission that a lot of this distortion that is taking place in the dairy industry is because these contracts are so large and these contracts are so large because the market is so concentrated. When Hilmer was doing his work back in 1993 the combined market share of Coles and Woolworths was less than 50 per cent and now it is around 80 per cent.

CHAIR: Presumably there were more processors as well.

Mr van Rijswijk: And there were more processors. Now the difficulty the processor has is that the contract is so big and has such a big impact. The whole problem we are seeing across the board in the grocery sector with a whole range of materials is the effects of market concentration. Milk is not on its own. It is something that is going to come up time and time again as a problem.

CHAIR: Thank you for that.

Proceedings suspended from 12:07 to 13:04

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

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

PHILIP, Ms Sue, Acting General Manager, Adjudication Branch, Australian Competition and Consumer Commission

SIMS, Mr Rod, Chairman, Australian Competition and Consumer Commission

CHAIR: I welcome the officers. I would particularly like to welcome Mr Rod Sims in what I believe is your first appearance before a Senate committee since taking on this position and possibly ever. It will be a good warm-up for estimates in two weeks, I am sure. We are looking forward to your evidence and welcome you here today. I invite you to make an opening statement if you would like.

Mr Sims: Thank you. It is an important issue and we appreciate the opportunity to feed into your deliberations. We do understand the concerns around this issue. We understand that, if you are producing a product that ultimately ends on supermarket shelves and the price gets pushed down at the supermarket level, you will have concerns about whether or not that is going to flow through and affect you. So we do understand what might be concerning dairy farmers.

With that, though, let me go to how we need to address this issue. We need to assess, and we are required to assess, whether or not the behaviour in question breaches the act. That is the approach we have to take. In looking at whether it breaches the act, the dominant clause that people think of is section 46—both the main part and obviously the predatory pricing part of section 46. In essence, at a high level, if you are going to prove something under section 46, you have to show that the relevant party, in this case Coles, has market power. I think most people would assume it is reasonably straightforward to show that. Secondly, you have to argue that the action in question involves taking advantage of that market power. That is an issue that has amused the High Court for many years, but let us assume you can mount a case to get around that. The key element of section 46, whether the main part or the predatory pricing part, of relevance here is that the action has to be one that was for the purpose of substantially lessening competition, and that is then reduced to the question of whether the action was taken for a prescribed purpose. Those prescribed purposes are three, but in broad terms they are basically: eliminating or damaging competition, preventing market entry, or preventing competition.

It is important to note that simply lowering the price of a good does not qualify into that. Those are quite clear purposes and the act is trying to differentiate between behaviour that is normal competitive behaviour versus behaviour that you do not want to happen. That is why the act is quite clear in prescribing the behaviour that you do not want to happen.

The ACCC did a lot of work on this issue to look at the purpose behind the actions and it seemed to us quite clear that the purpose of lowering the price of milk as well as other staples was essentially to give Coles the enhanced or better reputation for being a low-priced supermarket in its competitive battle with Woolworths—obviously other retail outlets as well but primarily Woolworths. In that sense, if they are lowering prices to position themselves as the low-priced supplier in their battle with other retailers but particularly Woolworths, that is clearly something that is not one of those prescribed purposes. Many would argue that that is doing something in the normal course of competitive behaviour, but, whatever view you have of that, the point is that it is not one of the prescribed purposes. While there are uncertainties in the law, there is enough certainty that it really does not qualify as a section 46 issue and nor does it qualify as a predatory pricing issue because, again, you fail at the purpose heading. The purpose test is the same whether it is predatory pricing or just misuse of market power. We looked at that quite clearly and, as I say, it did not fit section 46 because of that purpose issue. We then looked at issues such as misleading and deceptive conduct, and there was a range of things we could look at. At one extreme, one could argue it is misleading to say you are going to lower prices but then only keep them down for a very short time so people cannot take advantage of them. That is not true in this case; the price has stayed down for long enough for there not to be an issue there.

It has also been said that Coles were asserting they had not lowered the prices to dairy farmers, effectively—or processors, who are the people they deal with. As far as we can tell, Coles had not lowered the prices to processors. Obviously we are aware that Woolworths also lowered their price and that one of their processors pays dairy farmers on the balance of branded milk and private label milk and that therefore has disadvantaged dairy farmers. But, as far as Coles statement is concerned, we could not find anything misleading.

I think there is another issue there, when you are dealing with statements that are really at the periphery of the customer value proposition, whether or not they would constitute misleading and deceptive behaviour. The fact is that we could not find that those statements were not right.

The way we look at this issue, through the eyes of the act, is that this is really an issue of relative bargaining power. There is no doubt that, if you are producing goods that end up on supermarket shelves, there are two large supermarket players. If you are a supplier, there are a lot of other suppliers so you are in a relatively weak bargaining position. Under the act, the remedy for that imbalance is to come to the ACCC for authorisation, potentially notification, of collective bargaining arrangements, where the suppliers can get together—of course, in this case, they would be getting together with milk processors, because that is who they do the negotiation with—and collectively bargain to try and address the imbalance in bargaining power, which I think is the fundamental issue here. I suspect that, if there was no imbalance in bargaining power, your committee would not be taking up this issue. That is the essence of the issue. The way to deal with that under our act is to rebalance by collective bargaining.

To sum up, we do understand why people dealing with Coles and Woolies would be concerned if those supermarkets started pushing down the prices of their goods. But here it was not for a prescribed purpose, in our view. We think the real issue here is the imbalance in bargaining power and that using the collective bargaining provisions is the method to deal with that.

From the point of view of the act, that is all I want to say in opening statement. I imagine we will cover a few other issues when we get into the questioning. Thank you for your time.

CHAIR: Thank you very much.

Senator COLBECK: By a 'prescribed purpose', do you mean one of the tests under the act? Is that what you mean by that in this context?

Mr Sims: Yes. The essence of what amounts to substantially lessening competition is listed as three particular prescribed purposes.

Senator COLBECK: Going back to your comment about utilisation of collective bargaining power, in the context of this argument, what we are talking about is Coles saying to the processors, 'We're going to sell the product at this particular price.' We have been through all that and there is some argument about how much they said they were reducing prices by versus what they were really reducing prices by, and I am not sure that actually falls within your remit anyway; it perhaps comes through other areas.

Their advertisement said they were reducing prices from $2.47 to $2, which would be about a 23 per cent reduction in price. They subsequently gave us evidence that the real price reduction was from $2.09 to $2—not that that appeared in any of their advertisements. I am not sure whether that forms part of what you would consider misleading, but my view is that that was a misleading advertisement. I made that comment when Coles appeared before us last time. But, I agree, the remedy for the dairy farmers comes back to the capacity for collective bargaining, if they have nowhere else to go.

It is interesting that you talk about market power, and balance of market power, because that is the exact comment that I wrote in my diary about two years ago when I first got involved in this discussion: a market economy having a fair distribution and what rules we have in place to ensure that that is the case. I think that is fundamentally a right. The dairy farmers object to their product being used as a marketing tool by the supermarkets. They feel that they are being squeezed through the supply chain in what they are being offered, particularly those that are in the higher-cost band of production—Queensland, Northern New South Wales. I think that we have come to the conclusion that in the southern states, where the cost of production is cheaper, this process becomes a bit more viable, but in the other states it is very much different. But how do you actually, when there is no alternative to supply—which is effectively where things are at—maintain that balance of power, even through collective bargaining?

Mr Sims: Essentially, when you have a market economy, there are certain things you are not going to escape from—and there is a supply curve of dairy farmers, there is a level of demand for milk; those are going to intersect at a point and that is going to deliver an outcome which people in all sectors live with. Those demand and supply curves can change in ways that take an even well-functioning business and put it in an awkward position. That happens in every sector. That is just part of the cut and thrust of a market economy; it has its benefits and it has its costs. So there is not much, in an underlying sense, you can do when those forces of demand and supply are not with you.

But if the issue is more than about any given supply-demand balance and is a situation like, 'Actually, I've got much more of your product that I need and so I can pick and choose', that is a very difficult position to get out of.

But if the issue is one of simply imbalance of bargaining power, where there is one person you are bargaining with and many of you, then the collective bargaining provisions are there to deal with that position. But nothing is going to alter the supply-demand issue.

Senator COLBECK: Do you think that there is a good enough understanding, particularly within the dairy farmer cohort, of how these processes might work, which then gives them the capacity to interact in these negotiations and take advantage of the process so that they do get the benefit of the provisions that currently exist? It is an observation. The one party with the market power might be inclined to say, 'Let's try and deal with them on an individual basis rather than through the collective process', which is obviously permitted under the rules but, unless the farmers use the process properly, they are not going to get the full effect out of it, so having a good understanding of it would have to be important.

Mr Sims: Others either side of me might want to comment, but we have collective bargaining arrangements in place, one particular to the region you mentioned and one general umbrella agreement with the Australian Dairy Farmers. So those things are in place. I think they are pretty well understood. I won't say that everybody understands them, in a diverse industry. Obviously I am not saying it works absolutely perfectly. If you are in a position where you have an ability to sell your milk collectively to this processor or that processor you are in a better position than if there is only one processor. In addition, if there is only one processor it depends how that one processor wants to play it. If someone wants to really take an extreme position it is difficult when you have got a perishable product—there are natural limitations to it. But that works both ways: the processor has the need for the milk, just as the people who produce the milk have the need to sell it.

So I think it is fairly well understood. We have not had a lot of views from the dairy farmers that they have got major concerns with it, but I might let people who have perhaps been looking at this issue a little longer than I have make a comment. They may or may not also want to comment on the other point you made about the misleading price reduction.

Mr Cassidy: Collective bargaining is difficult to assess. The dairy industry is one of the industries that have made greater use of collective bargaining than perhaps some other industries and sectors have. On the other hand, in our grocery report in 2008 we concluded that a lot of dairy farmers have got a choice of processor. Unfortunately, the way these things go, in what you might call the more challenging areas that you referred to in Queensland and northern New South Wales perhaps that is not so much the case. But, given a number of dairy farmers have got a choice of processor, we might think that there could have been more use made of collective bargaining than there has been, even though there has been a reasonable amount.

It is a bit hard to get a terribly accurate read on just how well dairy farmers overall are informed about collective bargaining and think of it as a viable option for them; there is conflicting evidence, if you like. But certainly from our point of view, as the chairman said, we see that as one of the answers to the situation that dairy farmers perhaps find themselves in in dealing with processors, particularly when they have only got one to deal with.

Senator XENOPHON: You are putting it on the processors, are you? But if the processors have to deal with two big gorillas in the room that make up a substantial portion of what they produce, don't you need to see the whole chain of Coles, Woolworths, the processors and the dairy farmers? What Coles and Woolworths do can have a very direct impact on the dairy farmers because the processors will have no choice but to rejig for the way they do business. We have heard evidence today from Lion, formerly National Foods, that they are actually looking at a negative margin. That has all sorts of implications for their long-term investment in this country.

Mr Cassidy: That is true. When you talk about collective bargaining, of course, you can only talk about the two parties that are actually doing the bargaining. Having said that, I would have to say that in our view—and, again, this was in our 2008 report—processors overall have done quite well out of milk, particularly the sort of margin they have on the so-called branded milk. So, even within the scope of what the retailers might be doing, I think there are then separate decisions the processors—

Senator XENOPHON: You have seen Lion's latest submission, Mr Cassidy?

Mr Cassidy: Anything that was given to you today—

Senator XENOPHON: It has been on the record. You may want to look at that and reflect on that answer.

Mr Cassidy: Okay. As I said, if you are talking about collective bargaining, of course, you have got to basically focus on the two parties that are doing the bargaining.

Mr Sims: Senator, obviously Coles and Woolworths are in a very strong position. They have got a very high percentage of the supermarket share. If you are producing a whole range of groceries that need a mass market you have got to sell to them. There is no question they are a very strong position and there is no question that most business people in that position would do a fair bit to push down their supply costs and that would have consequences for those supplying them. I think those are just undeniable facts. What you do about it is where it gets tricky, but I would not want to deny the problem. Woolworths and Coles, in my experience even before arriving at the commission, are in a very strong position. As I say, if you are supplying to them then you had better make sure you are in the bottom half of the cost curve.

Senator COLBECK: Going back to the question on the advertisement, it quite clearly said $2.47 down to $2. Coles have since told us that the larger proportion of what they reduced in price was in fact from $2.09 down to $2. Did you have a look at that as part of this process?

Mr Bezzi: No we did not.

Senator COLBECK: Would it fall within your remit?

Mr Bezzi: It would, but we were focusing on the competition issues. We also looked more generally at the 'Down, Down' campaign. We have looked at that in the context of Woolworths' campaign and Coles's campaign. They have got similar campaigns. The Coles campaign we have looked at very closely and we have continued to monitor the prices for the products that are within the scope of the campaign. I think there are about 6,000 products within the scope of that campaign. Almost all of those products have remained at the low level since January. There have been some exceptions and we have taken the issue up with Coles, but essentially they do seem to have kept their prices down.

Senator COLBECK: In the context of that advertisement, what would trigger you looking at that specifically, other than in the broad context of the campaign?

Mr Bezzi: A number of things might trigger it. A complaint about it would. I do not think we have received a complaint about it from anyone and I am not sure that it was particularly drawn to our attention. Sometimes things are drawn to our attention by senators—

Senator COLBECK: I am drawing it to your attention now.

Mr Bezzi: Yes, and we can certainly have a look at it.

Mr Sims: Clearly we can when people misrepresent the extent of price reduction. We have had many cases—I am not talking supermarkets here; I am talking generally—where someone says it is X per cent off but the base is different to the one they are purporting. That is conduct we can have a look at.

Senator COLBECK: Fundamentally, I understand where Coles are at. They are trying to reshape their image in the market. They are trying to improve their competitiveness. So be it. That is part of the job and part of the role—value for shareholders and all that sort of stuff. The things that have got up my nose more than anything else through this process are things that I perceive to be misleading in respect of what they are saying or doing. They have put things before us where they will give us a clipped piece of information that provides a result that suits their argument. There is no question that they have a very well crafted campaign for this process. They have done the work so they can present evidence when things are questioned so that it gives the right impression. It is a very well prepared campaign. I give them credit for putting the background into it.

The reaction that I received when this first came to light was that there was a huge reduction in the price of milk. That became the discussion. The requests for comment from the media were about this huge reduction in the price of milk. Then we come to the nuts and bolts of the evidence that we got from Mr McLeod the day he arrived. He said the greater proportion of what they were selling was in fact a reduction from $2.09 to $2. We got to the point of almost asking, 'What are we arguing about?' The advertisement said $2.47 to $2. What stirred my mind up was that in a previous inquiry they had told me that their gross margin on milk was 22.5 per cent including all their in-store costs. This was a 23 per cent reduction. You do the basic maths and say: 'They have told us their margin is 22. They are reducing it by 23. They must be selling it below cost.' They have said they are bearing that cost. That is their business to deal with that, but that strung a whole heap of other things together that brought us to where we are today. They are the things that really irritated me about what we were being told. We were given information that was designed to give a perception that supported their argument rather than the reality.

Mr Bezzi: Could I just clarify something I said? You indicated that there had been misrepresentations made to you in the course of this inquiry and you asked me whether—

Senator COLBECK: That was my perception, though what I was asking you was whether you had looked at that specific advertisement.

Mr Bezzi: I would have to take that on notice, but my recollection is that we did not. I just wanted to clarify that, when you asked whether we had jurisdiction, I think we may have had some discussions with you in the past about the limits of our capacity to deal with representations that might have been made in the course of Senate inquiries. We cannot go there.

Senator COLBECK: I was not asking you to. If the committee were to refer something to you in that context, I would expect that you would look at it in that context. I am happy that the ACCC has been prepared to come before us, both earlier in the inquiry and again now, because I know it is not what you usually do. It is obvious to me that, post previous discussions we have had, you have been back and had another look, having got to a certain stage in the process. So I am content and happy that that has actually occurred. If nothing else, you, through this process, would have gained a much better understanding of what has gone on. You have talked to a number of people, and that was going to be my next question: what is the breadth of the industry that you have spoken to as part of this other consultation?

Mr Bezzi: We are a bit constrained, though, in dealing with representations that might have been made by Coles to you in the course of this process. We cannot take any of that into account.

Senator XENOPHON: Because of parliamentary privilege?

Mr Bezzi: Yes; it is a parliamentary privilege point: we cannot take it into account, even in a derivative sense, in any of our investigations. So that is a very real constraint that might apply in relation to that referral.

Mr Sims: To add to that: if there has been a representation that a price has come down by a lot more than it actually has, by signs outside the supermarket for example, then that is straightforward.

Senator COLBECK: I am sure I will have copies of the advertisement, and if I have not Senator Xenophon might have one of mine, anyway.

Mr Sims: We will have a look at it. The issue that was put to us originally was a misuse of market power issue, and that is the main focus.

Mr Cassidy: In terms of your further question, as to the work that we did, really we were talking to just about everyone in the supply chain, from the retailers back to the farmer organisations, in the investigation, if I can use that word, that we undertook. So it was fairly extensive in terms of the range of people we were talking to. And, to be fair, I would have to put on the record that we received full cooperation from just about everyone. Board papers and various bits of confidential material were produced. We did not have any problems, so far as we were concerned, in getting access to the sort of information we needed in order to consider the issues.

Senator COLBECK: I acknowledge that you contacted us about information that we had—

Mr Cassidy: That is true; we did.

Senator COLBECK: that we then cleared with Coles, and I am happy for you to provide it. So I think that is a point well made—that there appeared to me to be good cooperation through that process.

Mr Cassidy: Yes.

Senator XENOPHON: Thank you, Mr Sims, for being here and, of course, the other officers of the ACCC.

Mr Sims: It is a pleasure.

Senator XENOPHON: Could I just go to the ACCC's media release on this issue of 22 July 2011, headed 'ACCC: Coles discounting of house brand milk is not predatory pricing'. I do not know if you have a copy of that here—

Mr Sims: I do, somewhere here; I will find it. Please, go on.

Senator XENOPHON: Essentially, it said that there was no evidence that Coles had acted in breach of the Competition and Consumer Act. It makes a reference to section 46(1) and section 46(1AA), the so-called Birdsville amendment that Senator Joyce got through in 2007 with advice from Associate Professor Zumbo. So you have the release in front of you now?

Mr Sims: Yes, I have now.

Senator XENOPHON: If I can just take you to that: what does the ACCC consider to be the relevant cost of supplying goods or services under section 46 and, in particular, the Birdsville amendment, given that it makes reference to relevant cost?

How does the ACCC regard relevant costs in considering these matters?

Mr Sims: I will defer to my colleagues but I will make the preamble comment that—and this is a little understood point but a hugely important one—the Birdsville amendment still requires that there be a purpose much as I mentioned earlier. Once you find, even if there is predatory pricing, that you cannot show it is for a proscribed purpose then that is the end of the matter.

Senator XENOPHON: I do not want to put the cart before the horse, but isn't there a primary issue of relevant cost—that it must be below relevant cost? That is the threshold issue before you look at purpose?

Mr Sims: Yes, but for each of these things you have to look at the various components and know that you have to jump all the hurdles. I am going to pass to my colleagues here because I was not there at the time, but the essence is that if you have failed at the purpose heading it is in that sense by law frankly irrelevant whether they were pricing below cost.

Senator XENOPHON: I do not want to constrain Mr Cassidy, but that begs the question—

Mr Sims: He does seem eager, doesn't he?

Senator XENOPHON: There is always an eager interchange between Mr Cassidy and I. I would have thought that, in terms of consumers, small businesses, the processors and the dairy farmers, if there were a finding of below-cost pricing it would have, at least in a political sense—and I know that you are not concerned with those issues, but also in a public interest sense—a significant bearing on a public debate about this. If there were evidence of below-cost, leaving aside issues of purpose, that might beg a number of questions of the fairness of that within the context of the legislation and also the need for legislative reform.

One of the points made by NARGA in their evidence—I am not sure if you heard it, and it was certainly not a criticism of the ACCC; they are grateful, I think, for the input they have had with you since you became chairman—was that it is about having the enforcement tools but also the ACCC having a leadership role in saying, 'This legislation isn't working as it should be and these are areas where we can strengthen it.' You have a great role and, I think, an obligation to say: if there is below-cost pricing but it fails the purpose test, do we need to look at the purpose test through legislative reform? I just wanted to put that in context for you.

Mr Sims: I accept, and I have said so publicly, that we do have a role to look at behaviour and see whether the law is achieving what common sense demands it is trying to get at. In this case we looked at, as I said, the purpose. We also looked, at least briefly, at the alternative. If you want to think about what the alternative of the act might be, it could, instead of purpose, talk about the effect of lessening competition. Even that is a difficult one to establish here. There is an active debate about whether section 46 should be purpose only or 'purpose or effects'. That, I think, is a debate that people should have because it is a very important issue. Here we are not sure it would have got up even under an effects test.

Senator XENOPHON: Sure. But for my dairy farm constituents and for the small independent supermarkets in my home state—you use the word 'common sense', something that perhaps should be heard more often at hearings like this—wouldn't a commonsense test be also to determine whether the relevant cost issue is being dealt with? I will check with Mr Cassidy in a moment, but shouldn't we know whether it was being sold below cost in any event, notwithstanding issues of purpose? Isn't that a commonsense approach for the ACCC to take—to look at issues of relevant cost?

Mr Sims: I am in one second going to defer to the people who can tell you more about where we got to on that issue. But I would say that when you are looking to uphold the law the extent of your inquiries turn on whether you think there is some gold at the end of the rainbow that you are searching. I would have thought that, when you are talking about section 46—whether it is the main part of that or the Birdsville amendment—whatever action has been taken has to either have an anticompetitive purpose or, alternatively, have and anticompetitive effect. If it has neither of those then I am not sure, personally, that there is a public policy issue. There is a debate over the purpose or effects test. But I am not sure whether someone pricing in a particular way that does not have an effect of substantially lessening competition—

Senator XENOPHON: But 36B of the New Zealand legislation says that purposes may be inferred. It says, 'The existence of any of the purposes specified in section 36 or section 36A as the case may be inferred from the conduct of any relevant person or from any other relevant circumstances.'

Mr Sims: Correct.

Senator XENOPHON: Isn't below cost pricing a relevant circumstance?

Mr Sims: It is, but you have to judge whether you think that even if it was occurring it would have that effect in this particular circumstance. And we are not sure that it would have.

Senator XENOPHON: Perhaps I am getting a bit frustrated here, Mr Sims. Isn't it relevant to find out whether the price is below cost? Isn't that something that is a reasonable inquiry for the ACCC to make in the context of looking at these issues. Purpose may be able to be inferred by virtue of below cost pricing.

Mr Sims: I do not think that you would infer purpose out of below cost pricing. You would infer purpose out of what the effect of the behaviour was. I think that it turns very much on that. If you just simply start selling goods below cost, is that a problem? It very much depends on whether what you are doing is for the purpose of damaging competition or it has the effect of damaging competition. If it does neither, then I am not sure what the public policy issue is there.

Senator XENOPHON: Isn't there a public policy issue if it is below cost? That may or may not be a building block in a case.

Mr Sims: Absolutely: it is a building block. But if you know that you have stumbled at one of the foundation bricks then you have a problem. Let me ask my colleagues as to where they got to on that issue. I may ease your frustration.

Senator XENOPHON: Difficult, but thank you.

Mr Cassidy: Your generic question, if I can call it that, about relevant costs—

Senator XENOPHON: It is not a home brand question; it is a generic question.

Mr Cassidy: I am sorry: I did not mean it in that way! It sets up a little bit what you quite roughly called full cost—in other words, the cost of the product, the cost of transporting it, some contribution towards the overhead costs of the firm involved. Speaking generally here, if we were to take a case where someone was using predatory pricing and we got to court and the firm said, 'Hang on a moment: your calculation of cost has not included this and that,' we would probably be back out of the court again fairly quickly. So there needs to be a full cost or a total cost concept.

Senator XENOPHON: So in addition to the wholesale cost, there is the cost of transport, delivery, storage, refrigerating et cetera.

Mr Cassidy: Yes, that is right. With that in mind, and I know you have raised the issue of whether we checked the cost of selling fresh milk in Darwin and—

Senator XENOPHON: Kununurra.

Mr Cassidy: a few other far flung places—and I say that without intending any offence to anyone who might live in those places—the answer is that we did not go to the point of checking at each individual geographic locality, basically because of the reason that the chairman has mentioned, which is that from the evidence that we had we could see that we were not going to get a purpose in terms of section 46. There was, if a you like, a commonsense approach taken by us in terms of the resources that we would put in to establishing one leg in certain geographic areas when we basically knew that we did not have the required other elements.

Senator XENOPHON: So it is fair to say that in this case, because of what you and the chairman have said about the whole issue of purpose, there has not been a formal inquiry or a forensic examination of whether this was below the relevant cost or not.

Mr Cassidy: We spent a fair bit of effort on it, certainly in capital cities, regional centres and so on and so forth.

Senator XENOPHON: Was a conclusion reached as to whether it was below?

Mr Cassidy: Yes. We were confident that in many areas—in fact, we would say most areas—it was not selling below cost. But what I am saying is that if we get to geographically extreme areas, if I can call them that, we would not guarantee that it was not selling below cost. But then, if we did not, they would have the required other elements of the offence.

Mr Sims: We just expect markets to operate as well.

Mr Bezzi: We looked at the actual cost that they had, which included the distribution costs. There was a range of distribution costs, including refrigeration, transport and storage. The distribution figures are claimed to be confidential, so I will not read them out, but they went from a very small amount in metropolitan areas to a much larger amount in the remote areas. If you include the distribution costs in all those areas, except in very remote areas, it was very clear at the date of our analysis that they were not selling below cost. But it was not so clear for the remote areas.

Senator XENOPHON: Again, you did not take it further because of the purpose issue?

Mr Bezzi: We did not take it further. When you also look at it on a national basis, right across the country, they were not selling below cost.

Senator XENOPHON: But that is not the way you define markets under the act, so that is irrelevant.

Mr Bezzi: No, it is not. So we looked at it both ways.

Senator XENOPHON: Could you provide that to the committee—whether it is on an open basis or a confidential basis. I would find that quite useful. I can understand if there are commercial-in-confidence issues where that could be the basis of the analysis.

Mr Cassidy: We will first take that on notice and see what we can do to give you a feel for the geographic dimensions in terms of the cost price issue.

Senator XENOPHON: You said that you monitor the 6,000 items that Coles had as part of their 'Down down' campaign, which we all know is from a very famous Status Quo song—and I think the lyrics go on to say something like 'I know what you're doing and what you're doing to me', which I thought was quite apposite. NARGA, in their evidence, and in relation to the July edition of *Food and Drink Business*—and I do not know if you are a regular reader—

Mr Bezzi: I cannot say that I am.

Senator XENOPHON: Neither am I. But at page 10 of *Food and Drink Business* Silvestro Morabito, the CEO of IGA, stated that 'IGA regularly surveys a sample of 2,500 lines from its rivals and between 70 and 90 per cent of these products are in fact seeing a steady price increase.' I understand that the ACCC has been monitoring the 6,000 items that are part of the 'Down down' campaign, but to what extent has the ACCC monitored the other 12,000 or 18,000 items there might be at a supermarket?

Mr Bezzi: We have not done any monitoring of the other items.

Senator XENOPHON: I think Coles and Woolies are still doing quite well. I think we have Coles's spin doctor outside listening in, and he is very welcome to come inside if it wants to be part of this. If they are doing quite well in terms of their overall margins, that begs the question of whether there has been some cross-subsidising and deep discounts on some staples. Is that relevant overall in terms of the welfare of the consumer?

Mr Sims: I will have a start at this and then others can have a go. I actually think this is a very difficult issue. If you go to your local corner store and they say they have discounted a product and they are accurately portraying the discount of the product, you do not know whether they have increased the price of other things to compensate. Frankly, I am not quite sure that there is a competition and consumer issue over whether they have not. In this case they are saying they have lowered the price of their milk, but they may have upped the price of bread and newspapers in the local store to compensate. They may have judged that milk is the main item that gets people through the door. If all they are saying is that they have reduced the price of milk then it is not clear to me that there is a consumer issue there. I make that issue just by way of a general statement. On the second issue about monitoring supermarket prices, I just point out it is rather difficult given the number of items, given the small increments of change and given that inflation occurs—

CHAIR: You could try to set a up a grocery choice website!

Mr Sims: That is a very original idea. We will give that some thought. I think we have just got to accept it is a complex thing to do.

Senator XENOPHON: You have said that if they are deeply discounting something and they are sticking to their word on that then I can understand—

Mr Sims: I was just giving you a comparison with the corner store.

Senator XENOPHON: Sure. Where it is an overall campaign, such as the 'Down, Down' campaign for Coles, and most consumers are seeing 'Our prices are going down and staying down' so that they are actually going to Coles to save money, if overall the price for a typical basket of goods has gone up or has not gone down overall, would that be relevant in terms of representations made? In other words, can it be implied that representations made in respect of milk or bread go beyond that because of the overall marketing campaign to entice people into stores? Is that something that the ACCC has looked at?

Mr Sims: I think it very much depends on how it is worded, but I am going to let the people who have got the best chance give you an answer.

Mr Cassidy: It really depends on the representation. If the representation is that this set of prices has gone down and is going to stay down then whether other prices have gone up is not relevant to the representation being made.

Mr Sims: On the other hand, if they said, 'The goods you typically buy have come down,' and those goods that you typically buy, by a common-sense understanding of what that means, have not, it might be relevant. So it very much depends on the words I think.

Senator RYAN: They do have footnotes and references on slogans, Senator Xenophon.

Mr Sims: You have got to be careful of the footnotes if the fine print does not help you. There is a serious issue. If we think customers are being induced to do something through misleading statements that is to their detriment then we will act and we will act very strongly.

CHAIR: There can be no doubt that Coles's intention is to give the impression that they are bringing their prices down across the board. I imagine they would be careful and take careful legal advice on the wording that they use when they do it, but that would be the impression they are trying to create.

Mr Sims: The only reason they are doing it is ultimately to increase their profit overall.

CHAIR: Absolutely. I do not hold that against them. That is their job.

Senator COLBECK: One of the claims that was made as part of this overall process was that they were reducing price inflation by a certain percentage. That was part of the arguments that have been put as part of this overall campaign. They made the claim to us as part of the first round of hearings that they were reducing price inflation by a certain percentage. They have made that claim publicly, which gets around the other issue that I might have had a problem with earlier. If they are basing that claim on those 6,000 products and there is another 15,000 or 18,000 that they can then make it up with on the other side—I think the broad numbers say that they are doing okay at the moment; they have increased their profitability and they are getting more people through the door—how do you actually judge that? If they are saying publicly that this campaign is reducing price inflation by X per cent—I cannot remember what it is, so I will not try—but they have got an offset mechanism, how do you judge that as part of the overall process? I was going to ask the same question: have you had a look at any of the other 15,000, 18,000 or however many there are to make the judgment about the claim they are making about the effect of their campaign?

Mr Sims: I am going to pass it to the people who were there at the time. All I am going to say is that, if we judge that people are making statements that mislead consumers and bring about consumer detriment, have no fear we will act.

Mr Bezzi: The representations were very focused on particular types of goods. That is why we focused our investigation in relation to that issue on those goods.

Mr Cassidy: Even in an inflation representation the way the ABS does the CPI is based on a fairly wide basket of goods. I do not know whether Coles has gone to this trouble or not, but they may well have done a calculation on the basket of goods within the ABS CPI measure.

Senator COLBECK: I did acknowledge earlier that it was a very well designed and focused campaign and I gave them credit for that.

Mr Cassidy: Again, you have got to look at the representation that is made as to (a) whether it is factual or misleading and (b) the overall impression that is created in the mind of a consumer.

Senator XENOPHON: Has the ACCC examined the UK market and what happened there in relation to supermarkets and drinking milk to assist in the ACCC's investigation? I am not holding this against them but the current management of Coles have got a long history of a deep involvement in the UK market. I do not know whether that would be relevant. I am just saying that they have come from that market where there was a certain lack of competitiveness; is that something that the ACCC looked at?

Mr Cassidy: We are aware of what has happened in the UK both in terms of what happened in the market, including in relation to milk, and in terms of what the UK government has subsequently done.

Senator XENOPHON: But have you been in contact with your equivalent number with the regulator in the UK about these matters?

Mr Bezzi: We have had discussions with the UK OFT and in fact some staff from the Competition Commission about grocery issues more generally. But I cannot tell you that we have specifically had discussions with them in the context of this investigation. We have certainly had ongoing discussions with them about—

Senator XENOPHON: Perhaps you might want to take that on notice. I will move on. Given the ACCC's growing expertise and experience of predatory pricing—your release on 22 July is an indication of where you went through all the steps and the Birdsville amendment—is the ACCC now in a position to issue guidelines regarding section 46 in the same way as it has released guidelines in relation to section 50 of the merger section?

Mr Cassidy: This is a question which is often raised with us by Senator Joyce.

Senator XENOPHON: I am channelling him today!

Mr Cassidy: We do not have guidelines out on section 46 at the moment.

Senator XENOPHON: Are you planning to?

Mr Cassidy: As I have said to Senator Joyce previously, we would really like to get some judicial interpretation of section 46, particularly the aspects of it that have been amended.

Senator XENOPHON: But that is in the pipeline, isn't it?

Mr Cassidy: I cannot guarantee that these are going to translate into court actions but in recent times we have had a pickup in our section 46 investigations which we would expect would translate into more cases going into court in due course. But, as I have explained to Senator Joyce, we need to be very careful about putting out guidelines about what the law actually means, particularly if we are doing so without having any judicial guidance on what the law means.

Mr Sims: I am on the record as saying I am very keen to find cases on both section 46 and the Birdsville amendment if we possibly can. My judgment would be that we need to find those cases. We need to run them up the flagpole. Putting out guidelines, I would not want to run any risk that we would be limiting our capacity to take the cases. We are trying to act, if I can put it this way, in Senator Joyce's interests in trying to find cases and run with them.

Senator XENOPHON: I have two more quick questions. NARGA in their evidence today referred to the old section 49 and what Professor Hilmer said back in his 1993 review. NARGA said that they were told perhaps by the ACCC or informally that sections 45 and 46 are supposed to pick up on section 49. I think that seems to be the stated position. Given what has occurred here and given that you have had a whole range of groups—although by itself that is not a determining factor—such as COSBOA, NARGA and other smaller retail groups say that a section 49 approach would level the playing field even in an effects type of test, is that something that the ACCC has done any work on with a view to advising government?

Mr Sims: I will leave it to Brian to answer the factual questions. Because I have only been here two months, he will go back further than I can. The real issue here is to get section 46 right. We need to test it. We need to make sure it works. If it does not work, we need to be out there saying why it does not work and what legislative change is needed, and I am quite determined to do that. Section 49, which deals with whether or not you can supply goods at different prices between different players, is a very difficult area to go into. I have had the discussion with NARGA. We had a very free-flowing discussion. They were talking about supplying electricity to different entities at different prices. We then got into a discussion about what could lower costs if you are supplying someone who is demanding a lot of electricity versus someone who is not. It is a very complicated area. I think if what one is interested in is competition, then we have to make section 46 work, in my judgment, Senator, but I will pass over to Brian.

Mr Cassidy: We have given a lot of thought to section 49 including looking closely at the overseas law on this. We thought fairly hard about how it might apply in the milk situation. I will say briefly, because I am conscious of time, but I am happy to elaborate if someone wants me to, that we are not quite sure how section 49 would have 'helped' in relation to milk.

Senator XENOPHON: My understanding of the evidence that was given from Lion, formerly National Foods, and from Dairy Farmers and NARGA—and I am sure someone will correct me if I am wrong—is that, if there were a section 49 type approach, it would mean that the processor could say, 'Sorry, we've got to give the same price to everyone else.' It would have taken the pressure off the processors in their negotiations with the big two.

Mr Cassidy: That is what I do not quite understand. If you look at the old 49 it applied to people selling goods and discriminating in the price. So, it would apply to Woolworths and Coles selling goods to their customers and discriminating in price. It would apply to processors selling milk to Woolworths and Coles and discriminating in their price. In all the evidence we have there was no price discrimination as a result of the Coles $1 a litre because it was not passed back. We cannot see how 49 would apply to the processors dealings.

Senator XENOPHON: Can you take on notice the issue of the whole supply chain, which Senator Colbeck has raised, being affected. That is what dairy farmers are concerned about and are saying that someone is going to cop it in the end. There is evidence out of Queensland that a number of dairy farmers have left the farm directly as a result of this and some for other reasons such as natural disasters. That has been a factor and there is a concern that that will grow.

Senator RYAN: I want to explore that point that you were covering then, Mr Cassidy. To clarify: when Coles commenced the $1 a litre promotion on 26 January there was no pass through of the contract of that cut to the processors contracts. You just stated that a section 49 provision would not have been any use because there was no price discrimination.

Mr Cassidy: I have it in front of me. The old section 49 says in the introductory sentence: 'A corporation shall not discriminate between purchases of goods of like grade and quality.' So, think of processors, it says that they are not allowed to discriminate between people who are purchasing milk from them. But, as I say, following the Coles $1 a litre campaign, there was no discrimination because there was no processor.

Senator RYAN: It was a unilateral action by Coles in this case, then matched by others.

Mr Cassidy: Which did not affect the price that processors were selling the milk to Coles, Woolworths or other retailers. I cannot see how the old 49 gets into that.

Senator RYAN: Whereas, if Coles had, for example, or any retailer had done what Target announced last week and asked for a five per cent rebate on discount from suppliers—and let us say that was a provision in their contract—that could trigger a price discrimination because that would impact upon the processor in this case that was supplying Coles with the milk if the price had changed to them.

Mr Cassidy: Yes, potentially, but it gets into the inducement provisions of the old 49. Sure, there would be something there to look at.

Senator RYAN: I have said it before that my concern with some elements of this has been that the word 'consumer' is not mentioned as often as I would like. The consumer is benefiting quite substantially from cheaper milk. Is it fair to say that price discrimination is actually an important element of competition?

Mr Cassidy: Indeed. In the old section 49 it was not just about the price discrimination, it was that price discrimination had the effect of substantially lessening competition. It did not say that price discrimination was bad. Quite often price discrimination can actually be pro competitive and pro consumer. The old 49 was about price discrimination that substantially lessened competition and therefore harmed the consumer.

Senator RYAN: It would be hard to illustrate that, if the consumer was benefiting through lower prices, would it not? In order to meet that test, would you have to prove the consumer was suffering a loss? Theoretically you could have an anticompetitive situation where the consumer was still benefiting.

Mr Cassidy: The actual test is a substantial lessening of competition test. That is what we would have to prove, which is the second leg of my response to Senator Xenophon. If you had the old 49 and then you applied it to Coles and Woolworths, and to other retailers selling milk at the discounted price, again I am not quite sure how we would get a substantial lessening of competition out of that.

Senator RYAN: If everyone matches it and there appears to be—

Mr Cassidy: That is right. They were all doing the same and there has been some shift from the so-called rout trade to the major retailers. From what evidence we have, that shift has not been major, so whether you get a substantial lessening of competition out of that seems to me highly questionable.

Senator RYAN: There have been a number of inquiries into competition in the grocery sector and it has been an issue of some public discussion. In fact it would be reasonable to assert, would it not—again, looking at the consumer end of this, what happens to the person buying the milk—that what has happened over the last 10 months in this space has actually illustrated there is some competitive pressure in the retail space, in the sense that neither Woolworths nor anyone else had the market power not to match Coles's price cut?

Mr Cassidy: My straight answer to that would be yes.

Senator RYAN: On this issue of section 49, we heard from NARGA earlier and had similar conversations with Mr Sims. One of the concerns I expressed was that if a regulator—parliament, courts—had to start going down the path of determining what was a reasonable discount for, for example, buying twice as much milk as your competitor and having it delivered to one place, we are looking at a fairly intrusive regulatory mechanism in looking at company balance sheets and cost structures, aren't we?

Mr Sims: Indeed. You are going to rule out behaviour that, if you want it, you would actually welcome in a market economy.

Senator RYAN: It does tend to prevent innovation, doesn't it, because it tends to look at current behaviour rather than drive people towards new behaviour that might be more efficient?

Mr Sims: That is right. I am not sure how many conversations the three of us have collectively had on this, but that is why I would argue that if someone is misusing their market power to substantially lessen competition we can get them under section 46. If the way they do that is some form of manipulation of price, then we can still get them under section 46. If we cannot get them under section 46, the fact that they might be selling differential prices, for whatever reason, I am not sure is a problem.

CHAIR: Just following up firstly on the section 49 issue discussion you were having, I take your point. The purpose of this inquiry, which is the drop to $1 per litre, may not have triggered any of those issues. I am just playing devil's advocate here a little bit while you are in front of us. Certainly the evidence we had this morning was about a broader level of price discrimination that is not based on scale or volume or those sorts of things between Coles and Woolworths and other competitors in the milk market. The proposition that was raised is that this is occurring and, I guess, that in the context of this inquiry that has an impact on the competitive environment within the retail milk market, which, when you overlay the reduction to $1 a litre over the top of it, is causing a problem. I presume that is not the direction you have looked at it from. You have looked at it specifically from the $1 a litre for milk type of issue, not from the existing issues that occur and potential alleged competitive problems that already exist in the market.

Mr Cassidy: Certainly from the point of view of the $1 a litre issue. But more generally—and this is not the first time, of course, that section 49 has been raised—each time we look at it and think about the law, we come to a position where, for price discrimination to be effective (in other words, to be, say, anticompetitive), you end up needing either the firm involved to have market power or more than one firm involved and, therefore, having an anticompetitive agreement. Now, misuse of market power is covered by section 46 of the act and anticompetitive agreements are covered by section 45, so you end up looking at conduct, or potential conduct, and saying, 'Righto, this may be anticompetitive price discrimination, but it falls within the ambit of either section 46 or section 45.'

CHAIR: Are you talking about section 49 when you say it was of no use?

Mr Cassidy: Yes.

CHAIR: I was thinking about what we heard this morning. The allegation was that the processors are selling to Coles and Woolworths at a price that is substantially lower and not wholly accounted for by volume, freight and other relevant factors, and therefore section 49 would assist them in a more general sense within the milk market to compete with the big guys; and that, when you overlay the $1 a litre thing, it just complicates it and makes it even worse for them. They were not raising it in the context of the $1 a litre being the catalyst but more that there is a general problem.

Mr Cassidy: I think there are two answers to that. Firstly, it is perhaps something we will need to take on notice and give you a confidential response to. But, on the basis of the evidence we have, I am not sure whether that proposition is factually right to start with, in terms of price at which milk is being sold to various retailers by the processors—

Senator XENOPHON: Mr Cassidy, do you want to go in camera? Is that what you are suggesting?

Mr Cassidy: No, I think we can do it by giving you a confidential answer on notice—

Senator XENOPHON: Sure. You probably need to get that information as well; you would not have it here.

Mr Cassidy: Secondly, the more general proposition I would make to you is that, if you had the old section 49, you would have to establish not only that the milk was being sold at different prices through different retailers, which obviously it is, but also that that was having the effect of substantially lessening competition.

CHAIR: Which the argument we heard is saying it is. But I guess there are checkpoints you have to tick off and you need evidence to be able to prove that. I will leave it at that point.

Mr Sims initially went through the approach you have taken and the various different angles from which you have looked at the issue, and you concluded, on the basis of the evidence you have, that there has not been any transgression of the act at this point. I note that the ACCC, particularly under the last, most recent chairman, have been prepared to come forward and say they believe the act should change, price signalling being the obvious one—and we have had discussions about that in the past as well—where they believe there is mischief out there that the act does not properly address. So my question to you is: despite the fact that, in your opinion, the act has not been transgressed at this point, is there a competitive issue arising out of the current behaviour in the milk market that you think would warrant changes to the act in order to address?

Mr Sims: My answer to that would be on the basis of what I have come to understand: no. As I mentioned earlier, I think there is an issue about the purpose or effects test of section 46, which I think is worth debating. I do not personally have enough evidence yet to come out one way or another on that, but I think, whichever way you look at it, in this particular case it would not breach section 46 and therefore I do not think there is an issue for the act.

CHAIR: Okay. You don't think that the way that section 46 is written needs any adjustment? I am trying to work this through. Do you think you would need judicial consideration of that section before you could make a call on that? Does the fact that it seems very hard to find a suitable case to put before a court suggest that the wording of the act is not quite right yet?

Mr Sims: I will make a quick answer and give my colleagues, who have probably been looking at the issue longer, a chance to answer as well. My own view is that we do need to find more cases to test that. We have to jump the hurdle of 'we have reasonable grounds to believe' but, if we can jump that, I think we should be trying to take those cases. It is a convoluted section, but my own view is that the biggest issue is whether it should be a purpose test or a purpose or effects test. To me, that is where the rubber hits the ground, and that is, I think, a legitimate issue to debate. Do you others have a view?

Mr Cassidy: Section 46 has been changed a fair bit, as you know, following various High Court decisions by the previous and current governments. So I think we do, as the chair said, need to get some cases before the courts. I am reasonably hopeful that, with the pick-up in in-depth investigations of section 46 issues we are now having, that will happen. We have not had a complete hiatus, in the sense that we had the case against Cabcharge recently which was successful and straddled the legal changes. That gave us the largest penalty we have had in relation to section 46. We are awaiting judgement on the Cement Australia case. So, as I say, there has not been a complete hiatus but, apart from any issue with an effects test, I think it is an issue that is still at large, if you like. I think we need some judicial interpretation and rulings on the substantially changed section 46 before it is possible to say whether the changes have been effective or something else needs to be done.

CHAIR: I might be wrong, but I think I read somewhere in the last 24 hours somebody quoted—I think it was you, Mr Sims—talking about how, I think in respect of ACCC, you have a near 100 per cent success rate in your cases. It was you that was quoted?

Mr Sims: Yes.

CHAIR: And you said that you believed that possibly the ACCC has been a bit risk averse and needs to take on a few more cases where it is not so absolutely clear that you are going to win, to test the law a little bit.

Mr Sims: Correct, yes.

CHAIR: I presume that perspective would apply to section 46.

Mr Sims: That would most certainly apply to section 46.

CHAIR: I wanted to ask a question about collective bargaining. We heard evidence this morning from Dairy Farmers. I have misread it but my interpretation of their presentation was that they were not overly enamoured of the concept and were at least slightly dismissive about getting everybody within the tent, essentially—when you are dealing with a whole bunch of individual farmers it is very easy for some of them to break off, go out and undermine the collective bargaining effort. I guess, unlike unions, they do not have the same sort of power, the pressure that can be brought, to keep people within it.

You indicated that you thought that real problem was the imbalance of bargaining power and that this was the remedy for it. Do you think that this remedy is sufficient given the concerns that I heard this morning from the Australian Dairy Farmers—and they had other concerns about it—and are there alternative ways to address the problems that arise from imbalance of bargaining power that would still deliver a good outcome for consumers?

Mr Sims: Imbalance of bargaining power is going to exist, obviously, in many parts of the economy, and it is something that you cannot completely stamp out. When you are thinking about addressing it, obviously—at the risk of stating the obvious—you have to think about the costs and benefits of the action you take. Having discussed this, my view is that collective bargaining can be made to work to do that. It depends on the particular things people ask us for in the context of collective bargaining, but I think it has the right balance. If they are asking us for authorisation, it must pass through a cost-benefit test. That allows us to look at the issue quite widely and gives us quite a lot of discretion. We have the ability not only to approve collective bargaining but to do so with conditions. I suspect the envelope could be pushed a little bit more by the applicants. I think it is the right answer. I think it has the right mix of cost and benefits.

Senator XENOPHON: It is always dangerous to ask a question when you have no idea where it is going to take you, but—

Mr Sims: Now you have me scared, Senator!

Senator XENOPHON: This relates to a complaint. Some photos were sent to me of a supermarket, I think it was Coles, and I am not sure in which state, where you could see wall upon wall of Coles milk and the other branded milk tucked away and harder to get to. Where you have a situation where you are not talking about brands competing equally and where the retailer is also the wholesaler in a sense, because it is their own brand, does the ACCC have any role in terms of that precious shelf where there is that competing interest between their home brand and alternative brands?

Mr Sims: I am going to ask—

Senator XENOPHON: Including rebates, where the big supermarket chains get rebates not just from milk but from a whole range of things.

Mr Sims: Now you have introduced another element. If I can just stay with shelf space for a while, the supermarkets are in the business of housing the branded products and selling the unbranded products. If there are things to do with the way the shelving is organised I certainly could envisage situations where that could constitute a misuse of market power under section 46, depending on how it is done.

Mr Bezzi: Absolutely; I would agree with that.

Senator XENOPHON: Okay. You may want to take my next question on notice. Your predecessor said on 8 March 2011 on the Sky business channel in relation to this whole milk price war:

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 the processors. My question to you, perhaps on notice, is: given the evidence we have heard today from National Foods in their submission, and what has transpired since March, do you share the healthy scepticism of your predecessor?

Mr Sims: Scepticism in relation to?

Senator XENOPHON: In relation to saying that these protestations are about processors, rather than dairy farmers, keeping their bottom line.

Mr Sims: The protestations coming from the processors?

Senator XENOPHON: Yes. He said, and this was on the 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.

Mr Cassidy: We will take it on notice, because obviously we need to look at what has been said from today—

Mr Sims: And I am struggling to understand what he was saying, to be honest.

Senator XENOPHON: And perhaps, in fairness, to look at it in context.

Mr Cassidy: Yes. Our concern has been with the consumer at the one end and the farmer at the other end. Just about every other player in this story is capable of looking after themselves, if I can put it bluntly. I think what the then chairman was saying there is that perhaps some—I do not want to be too harsh—of the players, and this is understandable, in putting their own particular view or interest were dressing it up as either being a failure for consumer interests—

Mr Sims: If I could just say, and this is not related to the statement because I am seriously struggling on that, that I think healthy scepticism is always useful for all statements because most players are looking at things through their own particular interest. But I do think the players that are in a very strong position here are the supermarkets. They are the ones that are sitting in the best part of this particular supply chain.

Senator XENOPHON: Yes. Although, in response to Mr Cassidy, the evidence of Lion, formerly National Foods, is that they are getting negative return. At some point they are going to decide whether they may want to keep doing this in the future, which has huge implications for farmers.

Mr Cassidy: Quite so.

Mr Sims: And thus my point about who is in the best position in the supply chain, Senator.

CHAIR: Thank you very much for assisting the committee today. We anticipate tabling our report on 1 November, and this is our last hearing.

Senator XENOPHON: There may be some questions on notice to the ACCC.

CHAIR: Yes. Thank you again.

Committee adjourned at 14:23