

Chapter 8

Relative bargaining power and other issues in the supply chain

8.1 The dairy supply chain is characterised by the dominance of a few very large participants in both the processing and retail sectors, and a large number of smaller farmers. Due to the nature of the drinking milk market and the imbalances of bargaining power throughout the supply chain, the negotiation process for prices and conditions between participants in the industry can be significantly affected.

Collective bargaining

8.2 Collective bargaining is when two or more businesses negotiate a deal for the sale or purchase of products or services with a common customer or supplier. The rationale behind collective bargaining can be put as follows:

In some industries a number of competing small businesses must bargain with big business. Individually, the small businesses may lack bargaining power and so may seek to join together and bargain collectively, thereby exercising a degree of countervailing power to that of big business. Collective bargaining at one level may lessen competition but, at another level, provided that the countervailing power is not excessive, it may be in the public interest to enable small business to negotiate more effectively with big business.¹

8.3 While such conduct would ordinarily raise concerns under the anti-competitive conduct provisions of the *Competition and Consumer Act 2010* (CCA), a process is available for businesses to gain immunity from legal action in order to collectively bargain. The Australian Competition and Consumer Commission (ACCC) may grant authorisation to businesses for them to engage in conduct that may be anti-competitive where it is satisfied that the public benefit from the conduct outweighs any public detriment.²

8.4 The ACCC notes that since 2002 there has been an Australia-wide authorisation granted to the Australian Dairy Farmers for dairy farmers to collectively

1 Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, January 2003, p. 115.

2 A more streamlined process—collective bargaining notification—also exists. This process is available if each party to the collective arrangement expects that the total value of the transactions it will conduct with the target over a 12-month period will not be greater than \$3 million (or higher amounts as set by regulations).

negotiate with processors within their relevant geographic area.³ On 4 August 2011, the ACCC announced it had reauthorised this arrangement for a further ten years.⁴

8.5 However, the Chief Executive Officer of the ACCC opined that while these forms of collective bargaining arrangements have been used:

... I think it could be used more, to be quite honest. The dairy industry is just one of a number of industries where, in our view, there is not as much use being made of collective bargaining as there could be, even though there has been more made in dairy than perhaps in some other industries. Given processors have an interest in reaching agreement with farmers for the supply of milk, if they have certain overhead costs then the nature of processing is that they require throughput so it is a situation where dairy farmers would be well placed in getting together and collectively bargaining with processors.⁵

8.6 Mr Cassidy also acknowledged the benefits of collective bargaining would be limited for some producers in areas where they did not have a choice of processor:

... the situation with dairy farmers does vary between geographic areas, although in most—I would not say all—areas there is more than one processor operating, so the majority of dairy farmers would have a choice.⁶

8.7 During the committee's previous dairy inquiry, a significant amount of evidence was received about problems in the operation of the collective bargaining process, particularly in light of the Tasmanian experience in 2009.⁷ In its 2010 report, the committee concluded that it was:

... disappointed by the behaviour by National Foods while negotiating with dairy farmers in Tasmania. The Committee is concerned that this behaviour has not been confined to Tasmania but has extended to other dairy regions within Australia.

... The Committee considers that the ability of large companies to 'walk away from the table' undermines the collective bargaining provisions of

3 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 39.

4 Australian Competition and Consumer Commission, 'ACCC extends dairy farmer collective bargaining arrangements', *Media release*, NR 136/11, 4 August 2011.

5 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, pp. 39–40. Similar sentiments were expressed by other government officials: Mr Simon Murnane, General Manager, Livestock Industries and Animal Welfare Branch, Agricultural Productivity Division, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 10 March 2011, p. 24.

6 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 40.

7 See chapter 5 of Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010.

the ... [Competition and Consumer Act] and enables the more powerful participant in a negotiation to dictate the terms of trade.⁸

Committee view

8.8 Based on the evidence received and discussed in this report and this inquiry's *Second Interim Report*, it is apparent to the committee that many of the broad issues regarding negotiations and relative bargaining power were also examined and reported on as part of the committee's 2010 inquiry. The committee remains concerned about the effects that imbalances in bargaining power throughout the supply chain may be having on the industry, and is disappointed that the Government has not formally responded to the recommendations the committee has previously made on these types of issues.

Recommendation 6

8.9 The committee recommends that the Government review the effectiveness of collective bargaining laws and arrangements for agricultural industries, with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and to otherwise improve their operation.

Current dispute resolution mechanisms for grocery suppliers

8.10 Part of the terms of reference for this inquiry required the committee to examine the suitability of the framework contained in the Horticulture Code of Conduct for the Australian dairy industry.

8.11 The committee's *Second Interim Report* outlined the evidence received regarding this issue—in short, no significant support was given to extending this type of arrangement to the dairy industry, largely because the issues dealt with by the Horticulture Code were not relevant.⁹

Produce and Grocery Code and Ombudsman

8.12 The Produce and Grocery Industry Code of Conduct was also examined by the committee. It is a voluntary code (originally known as the Retail Grocery Industry Code of Conduct) created after the Joint Select Committee on the Retailing Sector released its report *Fair Market or Market Failure?: A review of Australia's retailing*

8 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 71.

9 See Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry: Second Interim Report*, May 2011, pp. 56–7.

sector in August 1999. Notably, rather than a voluntary code that committee called for a mandatory code to be introduced.¹⁰

8.13 The Department of Agriculture, Fisheries and Forestry described the primary objective of the Produce and Grocery Industry Code as being to:

... promote fair and equitable trading practices among industry participants. This is achieved through the encouragement of fair play and open communication between industry participants as a means of avoiding disputes. For unavoidable disputes, the voluntary code provides a dispute resolution mechanism. The voluntary code is intended to cover all industry participants (except consumers) in the Australian produce and grocery industry. These participants include primary producers, processors, wholesalers, distributors and retailers.¹¹

8.14 The code is administered by an industry-funded administration council, with a government-funded ombudsman in place to assist in disputes.¹² The Produce and Grocery Industry Code Administration Committee submitted to the committee that the code covers the dairy industry and is 'a successful code that has helped reduce disputes within the produce and grocery industry and to improve behaviour along the supply chain'.¹³

Use of the Produce and Grocery Industry Code

8.15 How effective the Produce and Grocery Industry Code and its Ombudsman have been may be open to question. In 2009–10 and 2010–11, the Ombudsman received 20 and ten enquiries respectively.¹⁴

8.16 The administration committee for the Produce and Grocery Industry Code submitted that dairy farmers have access to the dispute resolution system established by the Produce and Grocery Industry Code.¹⁵ However, the Queensland Dairyfarmers' Organisation informed the committee that they have been advised that dairy farmers:

... cannot take action through the Ombudsman directly with retailers as they do not contract directly with retailers but rather with processors.¹⁶

10 Joint Select Committee on the Retailing Sector, *Fair Market or Market Failure?: A review of Australia's retailing sector*, August 1999, p. xi.

11 Department of Agriculture, Fisheries and Forestry, *Submission 116*, p. 9.

12 Produce and Grocery Industry Code Administration Committee, *Submission 57*, p. 3.

13 Produce and Grocery Industry Code Administration Committee, *Submission 57*, p. 1.

14 Produce and Grocery Industry Ombudsman, www.produceandgroceryombudsman.com.au/reports.html (accessed 29 August 2011).

15 Produce and Grocery Industry Code Administration Committee, *Submission 57*, p. 1.

16 Queensland Dairyfarmers' Organisation, answer to question on notice, 8 March 2011 (received 27 March 2011), p. 10.

8.17 The South Australian Dairyfarmers' Association stated they were unaware of the Produce and Grocery Industry Code's existence and suggested:

The fact that we were unaware suggests this is not an option that is very relevant to the dairy industry.¹⁷

8.18 Another submitter characterised the Produce and Grocery Ombudsman as 'nearly anonymous'.¹⁸

Comparison with the United Kingdom

8.19 Developments in the United Kingdom may be particularly relevant in considering dispute resolution mechanisms and codes of conduct; especially given the supermarkets' pricing decisions on private label milk appears to have been a strategy borrowed from that country.¹⁹

8.20 In 2000, a voluntary Supermarkets Code of Practice was established. In 2008, the UK Competition Commission published the report of an inquiry undertaken into the grocery sector, which found that that major supermarket chains were passing on excessive risks and unexpected costs to their suppliers. As a result, the report recommended that a mandatory Groceries Supply Code of Practice (GSCOP) be introduced. After consultation, the GSCOP came into force in February 2010 and covers all large retailers with a turnover of more than £1 billion. The GSCOP is intended to address concerns about relationships between retailers and their suppliers regarding a variety of issues. It includes an overarching fair dealing provision, provisions for binding arbitration, and otherwise addresses matters relating to supply disputes, such as unexpected retrospective payments, and a number of other payments.

8.21 It was announced by the UK Government in August 2010 that a Groceries Code Adjudicator will be established to enforce the GSCOP. While not yet enacted, draft legislation has been published and examined by a House of Commons committee.²⁰

Calls for a new code of conduct

8.22 An industry code is defined in legislation as a code which regulates the conduct of participants in an industry towards other participants in the industry or

17 South Australian Dairyfarmers' Association, answer to question on notice, 8 March 2011 (received 25 March 2011), p. 3.

18 The Hon. Robert Brokenshire MLC, *Submission 67A*, p. 3.

19 Milk discounting in the United Kingdom was discussed in the committee's *Second Interim Report*. See Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry: Second Interim Report*, May 2011, pp. 23–27.

20 See House of Commons Business, Innovation and Skills Committee (UK), *Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code*, 19 July 2011.

towards consumers in the industry.²¹ A number of submitters called for a new industry code to be developed; either to cover the drinking milk sector, or grocery suppliers more generally.²²

8.23 CHOICE and the Australian Food and Grocery Council (AFGC) suggested that the Produce and Grocery Code could be amended to require that:

- All retailers' contracts with their suppliers include a fair dealing clause.
- Retailers are prohibited from making retrospective adjustments to terms and conditions of supply (unless where this has been provided for).
- Retailers are required to enter into binding arbitration to resolve any dispute with a supplier.
- Retailers are required to keep written records of all agreements with suppliers on terms and conditions of supply.
- The Ombudsman [a new office also proposed by CHOICE and the AFGC] publishes guidelines on specific provisions of the Code of Conduct when necessary and advises the relevant Minister on the operation of the Code of Conduct.²³

8.24 Some submissions pointed to the United Kingdom's GSCOP as something that should be examined, with a view to introducing a similar mandatory code in Australia.²⁴ A code that applies a 'sustainability test' to contracts was also suggested.²⁵

8.25 A code that applies to the all sectors that supply the major supermarkets may be difficult to develop, and may attempt to address problems that do not exist in some sectors. The experience of the dairy industry may not be shared by others. In 2008, after conducting a lengthy inquiry into the entire grocery sector, the ACCC stated it:

... is not persuaded that there is a significant buyer power problem in the retail chain that requires broad regulatory action to resolve. The sheer size of the MSCs [major supermarket chains] and their share of sales in some categories obviously deliver to them a significant amount of bargaining power in many transactions and there are suppliers who are disappointed with the returns they receive when dealing with the MSCs. However, there are also suppliers who are content with the terms they are able to obtain

21 *Competition and Consumer Act 2010*, s. 51ACA.

22 See for example: Australian Dairy Farmers, *Submission 150B*; Associate Professor Frank Zumbo, *Submission 99*; Queensland Dairyfarmers' Organisation, *Submission 94B*; NSW Dairy Industry Conference, *Submission 92A*.

23 CHOICE and the Australian Food and Grocery Council, *Submission 152*, p. 5 (footnotes omitted).

24 Australian Dairy Farmers, *Submission 150B*, p. 7.

25 Australian Dairy Farmers, *Submission 150A*, p. 4.

from the MSCs ... from the point of view of suppliers, no single picture emerges regarding the buyer power of the MSCs.²⁶

8.26 These concerns are true even within the dairy industry—suppliers of drinking milk in the southern manufacturing dairy regions do not appear to have been significantly impacted by the January 2011 price cuts.

Framework for industry codes

8.27 There are two broad categories of industry codes. A mandatory code is one which is binding on all participants in the relevant industry. A voluntary code is binding only on those who have agreed to be bound.

8.28 Under Part IVB of the CCA, mandatory or voluntary codes may be prescribed in regulations. Under section 51AD of the CCA, a corporation must not contravene the provisions of a mandatory code (or a voluntary code they have agreed to that has been prescribed).

8.29 The Government has published guidance on proposals for industry codes of conduct, and when they may be considered. The document notes:

... codes of conduct which can be effectively developed, implemented and enforced by the participants in an industry are generally to be preferred over the prescription of industry codes in law. An industry will generally only be subject to government intervention where there is a demonstrable problem affecting other participants or consumers which the market cannot or will not overcome.²⁷

8.30 The policy requires a compelling case for regulatory intervention be made, and outlines the following criteria that are applicable to a decision to prescribe an industry code:

- identification of a problem, and existing regulation that applies, within an industry (i.e. whether additional regulation is need);
- effectiveness of any industry self-regulatory measures;
- other regulatory options (such as reliance on the CCA);
- goals of a prescribed industry code; and
- benefit-cost analysis.²⁸

26 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 385.

27 Department of the Treasury, *Policy guidelines on prescribing industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, p. 2.

28 Department of the Treasury, *Policy guidelines on prescribing industry codes under Part IVB of the Competition and Consumer Act 2010*, May 2011, pp. 5–6.

Calls for an ombudsman

8.31 Issues remaining in the grocery sector have prompted calls from a number of sources for either a dairy industry-focused or a broader supermarket ombudsman²⁹ to be established.

8.32 The consumer organisation CHOICE 'strongly supports' the establishment of a supermarket ombudsman.³⁰ The major representative organisation for food and drink manufacturers, the AFGC, also considers:

... there may be a role for a Food and Grocery Ombudsman to investigate issues of food and grocery retail pricing behaviour. The role of the Ombudsman would be to independently adjudicate concerns relating to predatory pricing and anti competitive behaviour, including those related to significant and dramatic price discounting.³¹

8.33 Associate Professor Frank Zumbo recommended a broader office be created to include all small businesses—an Australian Small Business and Farming Commissioner. He described what role this could play:

In effect the Australian Small Business and Farming Commissioner would be a "trouble shooter" who would systematically investigate new and emerging areas of disputation in such areas as the Australian dairy industry with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.³²

8.34 CHOICE and the AFGC later jointly submitted:

Rather than suggesting functions based entirely on existing models, the most useful approach is likely to be one that identifies what is 'missing' from supermarket competition issues in Australia and works backwards. For example, key issues identified through the recent milk discounting debate include the need for a more proactive focus and follow-through on competition concerns, greater transparency around pricing and the capacity to address retailer market power where it results in anti-competitive behaviour.³³

8.35 The calls for an ombudsman were also closely linked to the calls for a mandatory code of conduct:

29 The committee notes the concerns raised by the Australian and New Zealand Ombudsmen Association (ANZOA) regarding the use of the word ombudsman in this context. ANZOA considers that the functions being suggested for such a body are not consistent with the role of an ombudsman. See Australian and New Zealand Ombudsmen Association, *Submission 153*.

30 CHOICE, *Submission 51*, p. 8.

31 Australian Food and Grocery Council, *Submission 100*, p. 9.

32 Associate Professor Frank Zumbo, *Submission 99*, p. 11.

33 CHOICE and the Australian Food and Grocery Council, *Submission 152*, p. 2.

It is important to note that there is a need for any new code of conduct to have a referee to enforce and police the rules.³⁴

8.36 There has been some activity regarding business dispute resolution generally and other matters directly related to the food sector. In May 2011, the Minister for Small Business, Senator the Hon. Nick Sherry, released for consultation an options paper on a national dispute resolution service for small business (for business-to-business disputes). Additionally, in 2010 the Government established a National Food Policy Working Group, and more recently, a Food Processing Industry Strategy Group.

8.37 While these developments may have merit, they may not address the issues regarding bargaining power in the dairy supply chain. A general small business dispute resolution service, for instance, may not be appropriate for addressing issues faced by farmers. Accordingly, there may be a gap within the current framework of various government departments and agencies and voluntary industry codes where the concerns of dairy farmers about their direct and indirect relationships with other participants in the dairy supply chain can be addressed. These issues are also likely to be shared by other grocery suppliers more generally.

8.38 As the ACCC has a specific role—to administer the provisions of the CCA—it is not well-placed to address broader industry concerns. It is apparent that this is not always understood; accordingly the ACCC often is criticised regarding issues about which it has no power to act upon. A separate statutory office that provides a point of focus for issues relating to grocery supply chains could have some advantages with respect to whole-of-government coordination as well as facilitating the building of expertise within government on supermarket-specific issues. If such an arrangement were to proceed, it would be expected that the new office and the ACCC would form a close working relationship to ensure the appropriate referral of matters and timely dealing of complaints when matters related to the CCA are involved.

8.39 On the other hand, if the new office did not have clear functions to perform such as a code to enforce, it could create an expectation gap between what industry participants believe an ombudsman can achieve, and what powers have been granted to it.

Committee view

8.40 Based on the evidence received during this inquiry, the committee considers that the effectiveness of the Produce and Grocery Industry Code of Conduct needs to be reviewed and made more relevant for the dairy industry. The committee also considers there is a likely case for the Code to be strengthened, particularly to capture entire supply chain relationships. If not otherwise acted on by the processors, the committee is also interested as to whether its recommendations in chapter 5 regarding the nature of contracts could be incorporated into a strengthened Code.

34 Australian Dairy Farmers, *Submission 150B*, p. 5.

8.41 The committee notes the arguments for a statutory office to be created (generally referred to by submitters as a Supermarket Ombudsman) to enforce a strengthened Produce and Grocery Code and/or otherwise help deal with perceived supply chain issues in the grocery sector. The committee is of the view that such an office could prove beneficial for more vulnerable participants in grocery supply chains provided it has clear functions to perform.

8.42 However, in forming its views on the Produce and Grocery Code and the need for a statutory office to deal with grocery supply issues, the committee is aware that it has been asked to focus on one sector that supplies the major supermarkets—namely the dairy industry. Certain issues which are relevant to dairy farmers may not be relevant to other producers. Other industries would need to have input into these proposals. In any event, these proposals would require a number of detailed matters to be assessed. Accordingly, the committee believes these proposals require dedicated consideration and requests that the Government develop an issues paper and facilitate a public consultation process on this matter as soon as possible.

Recommendation 7

8.43 The committee recommends that the Government initiate the following:

- **A review of the effectiveness of Produce and Grocery Industry Code of Conduct and mediation process undertaken through the Produce and Grocery Code Ombudsman. The review should include a consultation process regarding options to strengthen the Code, including that it captures entire supply chain relationships, and whether a revised Code should be made a prescribed mandatory industry code under the *Competition and Consumer Act 2010*.**
- **A consultation process on the need for a new statutory office to address issues regarding supply relationships in the grocery sector, and the role, powers, coverage and governance regarding such an office.**

**Senator David Bushby
Chair**