

The Senate

Economics

References Committee

The impacts of supermarket price decisions
on the dairy industry

Final report

November 2011

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Glossary and abbreviations

ABARES/ABARE	Australian Bureau of Agricultural and Resource Economics and Sciences (previously the Australian Bureau of Agricultural and Resource Economics)
ACCC	Australian Competition and Consumer Commission
ACCC Grocery Inquiry	public inquiry conducted by the ACCC in 2008 into the competitiveness of retail prices for standard groceries. The inquiry was instigated by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs under Part VIIA of the TPA
ADIC	Australian Dairy Industry Council
AFGC	Australian Food and Grocery Council
bargaining group	a group of farmers who bargain collectively rather than individually with a processor
branded milk	milk sold under the processor's brand name
CBC	Competition Bureau (Canada)
CCA	<i>Competition and Consumer Act 2010</i> ; legislation governing competition in Australia
collective bargaining	when two or more businesses negotiate a deal for the sale or purchase of products or services with a common customer or supplier
co-operative	processor jointly owned by a group of farmers
cpl	cents per litre
DAFF	Department of Agriculture, Fisheries and Forestry
Dairy Adjustment Levy	an 11 cent levy imposed on milk sales in place from 2000 to February 2009 to fund a deregulation restructure package
Dawson Report	<i>Review of the Competition Provisions of the Trade Practices Act</i> ; 2003 report of the Trade Practices Act Review Committee, chaired by Sir Daryl Dawson
DFMC	Dairy Farmers Milk Co-operative

drinking milk	milk sold for drinking as opposed to having been used to make products such as butter, cheese and milk powder
elastic	more responsive to price changes
farm gate price	price paid by processors to farmers
<i>First Interim Report</i>	an interim report of this inquiry released on 20 April 2011
FSANZ	Food Standards Australia New Zealand
generic milk	another term for private label milk
GSCOP	Groceries Supply Code of Practice; a code of conduct that deals with contracts between supermarkets and suppliers in the United Kingdom
Hilmer Report	<i>National Competition Policy</i> ; 1993 report of the Independent Committee of Inquiry into Competition Policy in Australia 1993, chaired by Professor Frederick Hilmer
home brand	another term for private label milk
inelastic	less responsive to price changes
Lion Dairy & Drinks	major drinking milk processor; formerly known as National Foods
<i>Milking it for all it's worth</i>	the May 2010 report of the Senate Economics References Committee's inquiry into competition and pricing in the Australian dairy industry
NARGA	National Association of Retail Grocers of Australia; industry body representing independent grocery retailers
PGICAC	Produce and Grocery Industry Code Administration Committee; administers the Produce and Grocery Industry Code of Conduct and consists of key representatives in the produce and grocery industries with an independent chair
predatory pricing	economic concept of when a company sets its prices at a sufficiently low level with the purpose of damaging or forcing a competitor to withdraw from the market. This leaves the company with less competition so it can disregard market forces, raise prices and exploit consumers. In a legal context, predatory pricing is addressed by various provisions within section 46 of the CCA
price discrimination	when a firm charges a different price to different persons or groups of persons for identical goods or services for reasons

	not related to costs
private label milk	milk sold in supermarkets under the supermarket's brand name
processors	manufacturers who make dairy products from raw milk
RPA	Robinson–Patman Act of 1936, 15 U.S.C. § 13(a); United States law which deals with anti-competitive price discrimination
<i>Second Interim Report</i>	an interim report of this inquiry released on 9 May 2011
supermarket channel	the supermarket or grocery channel are terms used to describe the sale of drinking milk to grocery retailers (a sector dominated by the two main supermarket chains—Coles and Woolworths)
TPA	<i>Trade Practices Act 1974</i> ; legislation governing competition in Australia which was renamed the <i>Competition and Consumer Act 2010</i> on 1 January 2011. See CCA
UHT	ultra high temperature treated milk
UK OFT	Office of Fair Trading (UK)
WCB	Warrnambool Cheese and Butter Factory Company

Summary and recommendations

Australia has a large and efficient dairy industry which acts as a major regional employer. While the bulk of milk production occurs in the south-east regions of Australia, dairying continues to be a geographically widespread economic activity with dairy farms operating in each state.

The industry has experienced much consolidation, rationalisation and adjustment, particularly since deregulation in 2000. At times, dairying can be an uncertain and challenging occupation. As with other agricultural industries, phenomena such as drought and flooding can make the occupation difficult, and for some farmers, no longer viable. International prices have a significant influence on farm gate prices (although the extent of this influence varies between dairy regions depending on the volume of exports). Negative external shocks to these international prices, such as those following the global financial crisis, can significantly reduce the value of the supply chain, sometimes leading to tense contract renegotiations and eventually impacting farmers' incomes. The structure of the supply chain and domestic market trends, issues which are directly relevant for this report, can also have various short and longer-term implications.

This committee was tasked by the Senate with examining the impacts of the decision in January 2011 by the major supermarket chain Coles (followed by its competitors including Woolworths, ALDI and Franklins) to heavily discount the price of its 'private label' or 'home brand' milk and other dairy products. In particular, the price cuts mean that milk can now be purchased by consumers for \$1 a litre—a price many argue does not reflect the significant effort put into producing and distributing milk, as it is lower than the price of many other food and drink products which are not perishable and are less costly to produce.

The circumstances which gave rise to this inquiry appear unusual in many respects. In recent years, public debate about the competitiveness of the supermarket sector has been focused on concerns about food price inflation and grocery prices being too high. In conducting this inquiry, the committee has been troubled that the benefits gained by consumers have not received sufficient attention in the debate about milk prices. In general, price discounting is likely to be pro-competitive and of benefit to consumers. Provided it does not constitute predatory pricing, a retail price cut should not be discouraged. The January 2011 price cuts in a staple product is undoubtedly good news for consumers in the short-term. Attempting to predict with any certainty any longer-term impact on overall consumer welfare is difficult, if not impossible.

Along with the impact on consumers, the committee focused on any impacts, or likely impacts, on the other end of the supply chain. When the inquiry commenced, the committee had strong concerns about the effect the price cuts could have on dairy farmers' incomes. The committee is grateful to the large number of individuals and organisations involved in the dairy supply chain who were willing to provide detailed

evidence and material for this inquiry. Much of this information, however, concentrated on concerns about shifts in sales away from the processors' branded milk products to the discounted supermarket private label milk. As a matter of overall principle, these types of free market outcomes should not be a matter for government. Many private label grocery products have grown in share in recent years, fulfilling the demand of those consumers who are happy to purchase them—particularly when there are little distinguishable characteristics between the branded products and their lower priced private label equivalents.

Milk is one such product; it is apparent that there are very little quality and specification differences between many of the processors' branded milks and the private label alternatives. It should not be a matter for public policy to protect brands that consumers no longer value. It also does appear that the steadily increasing sales of private label milk—which have more than doubled their share of sales in supermarkets over the past decade—is a trend that is unlikely to be reversed.

Impact on dairy farmers

It is apparent that when looking at the dairy industry at a national level, most dairy farmers will not be significantly worse off because of the price cuts. This is because the vast majority of milk production occurs in states such as Victoria where a number of processors operate and drinking milk represents a relatively small share of production, compared to the production of manufactured dairy goods. Due to significant export opportunities, international prices are a key determinant of the income farmers in those areas receive.

However, it is clear that in states which do not have these characteristics, such as Queensland and Western Australia, the impact is potentially greater. In these states, there are few processors operating and milk production is primarily for drinking milk. The emphasis on drinking milk means any pressure on retail prices could potentially be pushed back down the chain, although at this stage there is no evidence the major supermarkets have done this. Additionally, in some areas it is also difficult to distinguish between the consequences of natural disasters, such as the Queensland floods, and the impacts of the discounting.

One key area of concern for the committee, however, was the speed and ease with which a certain group of farmers in Queensland contracted to Parmalat were affected by the cuts in the retail price of private label milk led by Coles. Under these arrangements, it appears the risk of any retail price movements or other shocks that affect the sales of branded products are in large part being passed immediately onto the farmers. It is not clear why this should be the case when the processor has chosen to supply both products to the supermarket. Whether a consumer chooses to buy a bottle of processor-brand milk or the supermarkets' private label should not (again, as a matter of principle) be a concern for farmers. Although processors are undoubtedly in a challenging position, the management of their branded products and the terms on which they supply private label milk to the supermarkets is a matter for them.

Recommendation 1

5.43 The committee urges processors to make their pricing structures for sourcing drinking milk:

- **reflect the volume they estimate they require to meet their total commitments;**
- **offer more stability in prices rather than changing frequently; and**
- **not be dependent on the final retail sales of branded versus private label milk.**

Recommendation 2

5.45 The committee recommends that contracts with dairy farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The committee received evidence about the current deficit in drinking milk production in Queensland and, given present market signals, the likely ability of the dairy industry in the drinking milk-focused states to meet future demand.

If it is the case that it is more economically viable for processors to transport milk from other states where it is cheaper to produce, this is also not necessarily a matter for public policy. Such a result can be argued to be an outcome dictated by realities in the market, as well as similar to the interstate trade which occurs for other agricultural produce. However, the committee believes these issues need further examination to allow an informed discussion about the future of the industry in those states.

Recommendation 3

5.47 The committee recommends that the Government commission a study of the dairy industries in Queensland, New South Wales and Western Australia. The study should focus on the future sustainability of the dairy industry in each of these states and their capacity to meet future local consumer demand. The report of the study should also examine possible policy options and be tabled in the Senate.

Competition law

A number of organisations that participated in this inquiry called for an investigation of Coles' conduct by the Australian Competition and Consumer Commission (ACCC) and for aspects of Australia's competition laws to be amended.

The ACCC undertook an examination of Coles' conduct against the current competition law, and concluded that there was no evidence that Coles was engaging in predatory pricing in contravention of the *Competition and Consumer Act 2010*. The committee discussed the details of this investigation extensively with the ACCC, and also passed on other issues to the ACCC regarding the milk discounts, such as certain statements made in Coles' initial advertisements relating to its 'Down Down' campaign.

The committee is not of the view that the specific price discounts by Coles which were the subject of this inquiry warrant legislative amendments. Care needs to be taken when suggesting amendments to the Competition and Consumer Act based on the experience of one industry (or part of one industry, as is the case with the milk discounts) as they would apply to the entire economy. Even if amendments to Australia's competition law were needed, it is not clear that the amendments proposed during the inquiry would actually provide a 'remedy' to the milk pricing issue.

The committee, however, notes the recent comments by the new chairman of the ACCC that some aspects of section 46 of the Competition and Consumer Act, which deals with misuses of market power, are 'worth debating'.¹ The effectiveness of Australia's competition laws has been raised in the context of various sectors and has been considered by this committee on numerous occasions. It has also been some time since the Dawson Review in 2003, which was the last independent review of the Act undertaken. The inquiry before that was the Hilmer Review, which was finalised in 1993.

Since the report of the Dawson Review, a number of amendments have been made to section 46 of the Competition and Consumer Act. The committee urges the ACCC to identify and litigate appropriate matters that will enable these recent amendments to be tested in the courts. However, questions remain about the operation of certain provisions. Additionally, in recent years a number of other competition issues including price signalling, creeping acquisitions and geographic price discrimination have been raised. It appears appropriate that, rather than recommending piecemeal amendments, an independent inquiry be formed to fully address any perceived gaps in, or issues with, Australia's competition law.

Recommendation 5

7.100 The committee recommends that the Government initiate an independent review of the competition provisions of the *Competition and Consumer Act 2010*.

It is clear that Coles and Woolworths have a very strong position in Australia's grocery market. While the recent signs of Coles and Woolworths more fervently seeking to attract consumers to their respective stores are encouraging for competition, the effects need to be closely monitored. Other possible developments, such as implications for the major supermarkets' dealings with their suppliers due to the growth in private label products generally, need to be monitored for any signs of anti-competitive conduct. The committee expects the Government and the ACCC to keep a watching brief on these issues and the grocery sector in general.

Transparency of ACCC investigations

An issue which the committee considered was the transparency of the investigations the ACCC undertakes. Whether or not the ACCC was undertaking an active

¹ Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 41.

investigation into Coles' milk price cuts was a question that frequently arose during the early stages of this inquiry. More broadly, there can be significant concern within certain sectors and the wider community regarding the effectiveness of the ACCC in enforcing the legislation for which it is responsible.

In most cases there will be little public information available as to whether or not the ACCC is investigating or has investigated a particular matter; however, substantial public interest appears to pressure the ACCC to provide some insight into its investigative activities. The committee is pleased that the ACCC was, on this occasion, willing to publish a statement that provided a high-level summary of the findings of its investigation. Such public statements on key matters help inform the broader public debate.

It is important to keep in mind that the ACCC is a law enforcement agency, and accordingly there are certain principles and practices it should be expected to adhere to. While increased transparency of what the ACCC is investigating at any point in time may be desirable in terms of ensuring public confidence in the ACCC, there are important consequences to consider. Overall, while the majority of investigations would still require confidentiality, there may be some scope for increased transparency or improved communication of the ACCC's enforcement activities.

Recommendation 4

6.58 The committee recommends that the Australian Competition and Consumer Commission (ACCC) review its approach to publicly releasing information about its investigations, with a view to providing greater general information about its current enforcement activities and relevant issues of particular public concern.

6.59 This recommendation is subject to the proviso that such action would not deny procedural fairness to the parties involved or threaten the integrity of the ACCC's investigations.

Imbalances of bargaining power and use of collective bargaining

More so than raising questions about the effectiveness of Australia's competition laws, the milk pricing issue is fundamentally a matter that reflects imbalances of bargaining power at various points in the dairy industry supply chain. These imbalances can be more pronounced in some regions than others.

The dairy industry makes use of allowances contained in legislation for some collective bargaining arrangements. However, the ability for processors to 'walk away' from negotiations with collective bargaining groups (as highlighted during the committee's 2010 inquiry), market realities such as the number of drinking milk processors in some areas and the fact that the processors must deal with the two major supermarket chains that dominate the grocery sector, can mitigate the benefits of collective bargaining arrangements.

Evidence was given, however, that although the dairy industry is utilising collective bargaining arrangements to some extent, they could be used more in situations where

there is a choice of processor. While imbalances of bargaining power issues are difficult to resolve and are always going to be present in some form, the committee considers this is an area that warrants attention.

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.

Industry codes of conduct

The terms of reference for this inquiry required the examination of the suitability of the framework contained in the Horticulture Code of Conduct for the Australian dairy industry. 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 did not appear relevant.

The Produce and Grocery Industry Code of Conduct was also examined by the committee. It is a voluntary code created after the report of a joint parliamentary committee in August 1999. A government-funded ombudsman is in place to assist in dispute resolution.

This Code was put forward as a mechanism that is already in place for resolving disputes between suppliers and the major supermarkets. However, it is apparent that there are a low number of enquiries received by the Produce and Grocery Industry Ombudsman, and many representative organisations for dairy farmers were either unaware of the Code, or did not consider it relevant. Based on the evidence received during this inquiry, the committee considers that the effectiveness of the Produce and Grocery Industry Code should be reviewed.

A number of submitters also called for a mandatory code of conduct and an ombudsman or commissioner to be created, either for the drinking milk industry or covering the grocery sector more broadly. There may be merit in some form of office to act as a point of focus for grocery sector issues, particularly for responding to matters which are outside of the remit of the ACCC. However, 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. Others would need to have input into any grocery sector-wide proposals. This consultation and debate could take place as part of the review of the Produce and Grocery Industry Code, which the committee also recommends.

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.**

Chapter 1

Introduction

The supermarkets' price decisions

1.1 On 26 January 2011, Coles announced as part of its 'Down Down' price promotion campaign that the price of Coles brand regular and low fat milk will be cut by as much as 33 per cent, to \$2 for a two litre bottle. The price cut in low fat milk to \$2 for a two litre bottle eliminated the premium that was previously charged.¹

1.2 In its media release announcing the price changes, Coles stated:

Because we all buy milk, this price cut will offer significant savings for customers proving that quality food really does cost less at Coles. We are lowering the price of the family shopping basket because we know that is what our customers want the most.

1.3 Coles also stated:

Coles is not reducing the price it pays to its milk processors ... so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased. Coles is fully absorbing the price cut, bringing great value to customers whilst supporting Australian dairy farmers.²

1.4 Woolworths followed Coles' price cuts straight away, with other supermarkets such as ALDI, Franklins, some IGA stores and other retailers following soon after.³ Coles' assessment of the impact of its decision on the dairy industry supply chain was not shared by other participants. Woolworths immediately questioned the sustainability of the move,⁴ later informing the committee:

... this price move has effectively re-based the price of white of milk across Australia overnight, and for an unknown period into the future, which also

1 The prices of Coles brand 3 litre bottles of milk were also reduced to \$3. Additionally, Coles consolidated the two generic brands of milk products it previously sold into one brand.

2 Coles, 'Because we all buy milk: Coles cuts the price to help shoppers save', *Media release*, 26 January 2011.

3 On 3 February 2011, Coles also announced reductions in the prices of other dairy products, namely Coles brand butter and cream. Coles, 'Coles cuts more prices across the store to help customers save – Butter, cream and olive oil "Down Down" and staying down!', *Media release*, 3 February 2011.

4 On 27 January 2011, Woolworths' spokesperson Claire Buchanan was reported to state 'this is certainly not a sustainable price level for milk and it will inevitably lead to pressure at the farm gate'. Paddy Hintz, 'Supermarket war between Coles and Woolworths cuts milk price', *Courier Mail*, 27 January 2011, www.couriermail.com.au/lifestyle/supermarket-war-cuts-milk-price/story-e6frer4f-1225995314655 (accessed 22 February 2011).

potentially devalues the whole milk category in the eyes of the consumer. In effect, the consumer baseline for price is now at 1990s levels, but with 2011 input costs for all parts of the supply chain.⁵

1.5 The Australian Dairy Industry Council (ADIC) questioned whether the supermarkets would absorb the price cuts, submitting that the milk price cuts led by Coles and followed by other supermarkets will remove over \$70 million from supermarket margins each year, with Coles experiencing less than half of this decrease.⁶ The ADIC suggested that, for the entire supply chain, the impact on revenue and margins could 'easily extend to hundreds of millions of dollars per annum', and that pressure will build 'on the more vulnerable members of that chain to accept lower prices'.⁷

Referral and conduct of this inquiry

1.6 Various issues facing the dairy industry have received detailed consideration from Senate committees in recent years. Commencing in September 2009, this committee conducted an inquiry into issues facing the dairy industry. Its report, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, was tabled in May 2010. The third interim report of the former Senate Select Committee on Agricultural and Related Industries' inquiry into food production, tabled in November 2009, also focused on the dairy industry.

1.7 However, following industry concern about the supermarket price cuts, on 10 February 2011 the Senate resolved to refer the issue to the Economics References Committee for inquiry and report. The terms of reference are as follows:

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;

5 Woolworths, *Submission 98*, p. 2.

6 Australian Dairy Industry Council, *Submission 96*, p. 10.

7 Australian Dairy Industry Council, *Submission 96*, pp. 11, 15.

- f) the need for any legislative amendments; and
- g) any other related matters.

Submissions and public hearings

1.8 The inquiry received a significant amount of interest from stakeholders, the media and the general public.

1.9 The committee advertised the inquiry in *The Australian* and on its website. It also wrote to relevant companies, organisations, academics and individuals to inform them of the inquiry. The committee also invited and received a number of supplementary submissions.

1.10 In total, the committee received 160 submissions and a further 22 supplementary submissions. Details about this material can be found in Appendix 1.

1.11 The committee held public hearings in Melbourne (8 March 2011 and 6 October 2011), Sydney (9 March 2011) and Canberra (10 and 29 March 2011). It heard from individual dairy farmers, national and state dairy farmer organisations, members of federal and state parliament, consumer advocates, academics, smaller supermarket chains and independent retailer groups, major milk processing companies, milk vendors, senior representatives of relevant government departments and agencies, and the two major supermarket chains—Coles and Woolworths. The witnesses who appeared at these hearings are listed in Appendix 2. The committee thanks those who participated in this inquiry.

Reports

1.12 The committee was asked to report by 15 April 2011. Initially, the committee requested a short extension to 20 April 2011, which the Senate approved on 21 March 2011.

1.13 However, to enable the significant amount of information received to be thoroughly considered, the committee tabled its *First Interim Report* on 20 April 2011, seeking a further extension in its reporting date to 1 October 2011. On 9 May 2011, the committee tabled its *Second Interim Report*. To enable a further public hearing to be conducted to examine developments in the dairy industry since the *Second Interim Report* was tabled, the committee requested a further extension of the final reporting date to 1 November 2011.

1.14 Various governments have undertaken to the Senate that they will table a formal response to reports of the Senate's standing or select committees which recommend action by the government within three months. As the committee was concerned that the Government had not tabled a formal response to its 2010 report *Milking it for all it's worth*, and as many of the issues addressed remained relevant, the *First Interim Report* called on the Government to do so. To date, the Government has not responded to *Milking it for all it's worth*, but it did respond to the *First Interim*

Report and outlined the reasons for its approach. A copy of that response can be found at Appendix 3.

1.15 The May 2011 *Second Interim Report* provided an overview of much of the evidence and proposals put to the committee. The report also provided a statement of the committee's intent regarding the direction of the remaining months of the inquiry and its final report:

The committee is of the opinion that no final conclusions can be made or recommendations given until it knows:

- (a) the duration of the 'Down Down' campaign and if it becomes permanent; and
- (b) the outcome of renegotiated contracts with the processors and impact on farm gate prices.

It will only be when the answers to these questions are known that the committee will be in a position to draw definitive conclusions about the impact of Coles' campaign and broader supermarket price decisions on the dairy industry.⁸

1.16 On the first issue—the duration of the 'Down Down' campaign—Coles advised the committee in March:

It is intended that our milk prices will stay down for at least six months, subject to cost increases by suppliers and, in the case of dairy products, commodity price increases impacting on farm gate prices.

We note that, if Coles did not honour its price representations made in respect of milk as part of our "Down Down" campaign, it may give rise to misleading and deceptive conduct under provisions in the Australian Consumer law intended to ensure representations are fully honoured.⁹

1.17 The final duration of the 'Down Down' campaign is ultimately a decision for Coles. At present, the price of the major supermarkets' private label milk remains at the post-26 January 2011 level of \$1 a litre for most products. The price cuts have therefore been in place for over eight months. On 25 July 2011, Coles announced that it would maintain its private label milk pricing 'for the foreseeable future'.¹⁰

1.18 Given Coles has maintained its pricing decisions in the short-term, and it looks likely they will be maintained at least in the medium-term, from this point forward the report will focus on the remaining key issue stated by the committee in May—namely the outcome of renegotiated contracts and impacts on farm gate prices—as the broader terms of reference for the inquiry noted earlier are also addressed.

8 Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry: Second Interim Report*, May 2011, p. 64.

9 Coles, *Submission 131*, p. 16.

10 Coles, 'Coles brand milk prices to stay Down Down', *Media release*, 25 July 2011.

Outline of the report

1.19 This report consists of eight chapters which are briefly described below:

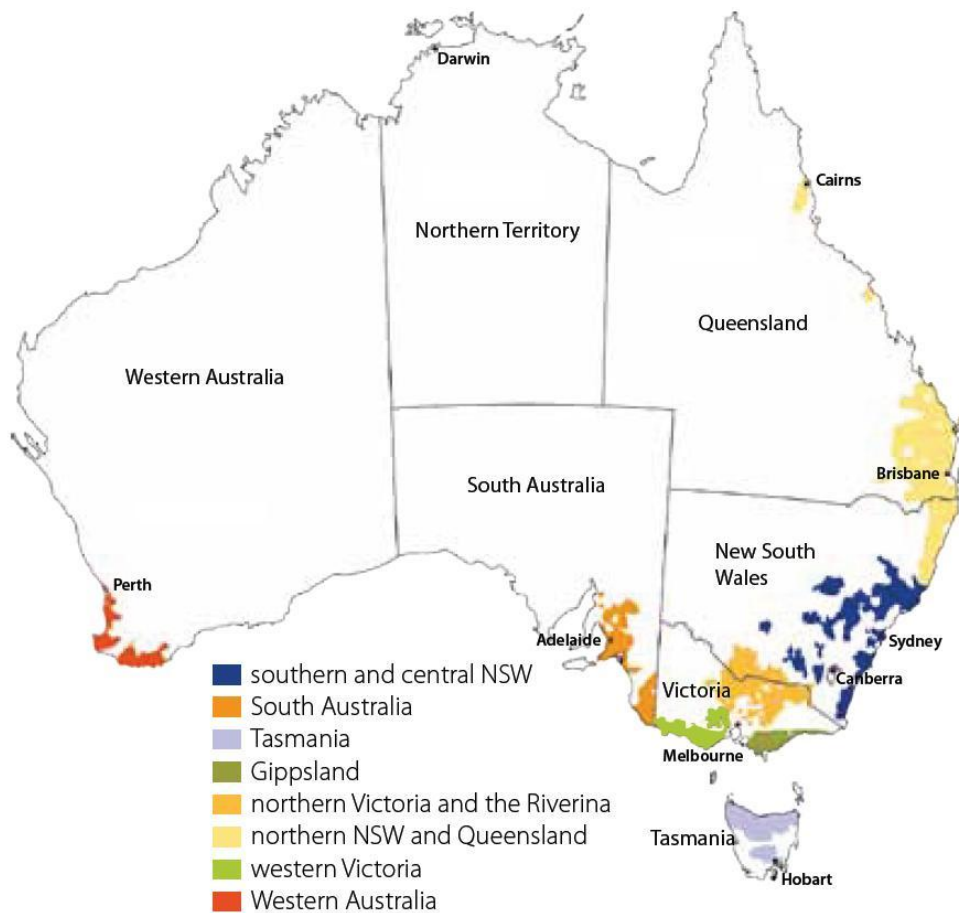
- Chapter 2 provides an overview of Australia's dairy industry including a discussion of the differing exposure to retail price movements.
- Chapter 3 discusses private label milk in Australia, including the growth in private label milk post-deregulation, current contract arrangements between the supermarkets and the processors, and product quality and specifications. The chapter also discusses in general the influence of the major supermarkets on the dairy industry.
- The impacts of the supermarkets' pricing decisions are examined in chapter 4, with a particular focus on changes in the volume and value of sales of both branded and private label milk since the price cuts commenced in late January 2011.
- Chapter 5 continues the examination of the effects of the pricing decisions by assessing the impact of the price cuts on farm gate prices.
- A number of issues relevant to the supermarkets' decisions possibly raised concerns under Australia's competition laws. Chapter 6 outlines the investigation undertaken by the Australian Competition and Consumer Commission into these matters, and related issues.
- Many aspects of Australia's competition law framework were also raised during this inquiry. These issues are discussed in chapter 7.
- Chapter 8 outlines some issues related to imbalances of bargaining power in the supply chain, and related matters such as calls for a strengthened code of conduct and a supermarket ombudsman.

Chapter 2

Overview of Australia's dairy industry

2.1 Based on a farm gate value of production of \$3.4 billion in 2009–10, the dairy industry ranks as Australia's third largest agricultural industry.¹ Milk production is concentrated in the south-east region of the country. Victoria is the largest producer, accounting for 64 per cent of milk output.

Figure 2.1: Australia's dairy farming regions



Source: Surya Dharma, *Australian dairy: Financial performance of dairy producing farms, 2008–09 to 2010–11*, ABARES report prepared for Dairy Australia, June 2011, p. 1.

2.2 Of the 9.0–9.1 billion litres of milk expected to have been produced in 2010–11, 55 per cent was utilised domestically and 45 per cent was exported.² Drinking milk accounted for 2.29 billion litres—about 25 per cent of total production.³

1 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 9.

2 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 8.

2.3 While drinking milk represents the smaller share of total production compared to manufactured products produced for domestic consumption and export (such as cheeses, butter and whole milk powder), as this chapter will discuss, the relative importance of drinking milk to dairy producers in different regions varies significantly. Unsurprisingly, it has been the producers in the regions where drinking milk is overwhelmingly the main product produced that have been most vocal in arguing that the retail price cuts for milk threatens the sustainability of their segment of the industry.

Recent history

Farm gate prices

2.4 The past five years have seen highs and lows for the Australian dairy industry. In 2007, the overall position of the dairy industry appeared relatively strong. Despite the negative impact of the drought, international conditions were favourable. Dairy Australia believed the industry was enjoying 'the best world market conditions in decades' as a result of international dairy commodity prices reaching record levels in 2007.⁴

2.5 While farm gate prices had generally been increasing in all states since 2004–05, the strong position in 2007 led to a significant jump in farm gate prices. As shown by Table 2.1, the average Australian price rose from 33.2 cents per litre (cpl) to 49.6 cpl between 2006–07 and 2007–08.

2.6 As also demonstrated by Table 2.1, however, following the global financial crisis farm gate prices declined significantly.

3 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 30.

4 Dairy Australia, *Australian Dairy Industry in Focus 2008*, p. 3.

Table 2.1: Trends in typical factory paid prices

		2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 (p)	2010-11 (z)	2011-12 (z)
NSW	cpl	32.9	34.3	35.7	48.6	52.4	48.7	45-53	45-51*
	\$/kg MS	4.62	4.8	5.02	6.73	7.29	6.72	n/a	n/a
VIC	cpl	31.5	32.9	32	50	39.1	33.9	40-41	40-41
	\$/kg MS	4.23	4.44	4.32	6.68	5.14	4.49	5.40-5.50	5.40-5.50
QLD	cpl	35	36.6	38.8	51.8	57.2	55.8	52-60	#
	\$/kg MS	4.84	4.99	5.38	7.14	7.89	7.57	n/a	n/a
SA	cpl	30.1	32	32.6	48.6	44.6	34.6	40-41	40-41
	\$/kg MS	4.19	4.49	4.57	6.75	6.19	4.73	5.40-5.50	5.40-5.50
WA	cpl	27.3	29.1	32.4	41.4	49	42.4	38-42	35-41
	\$/kg MS	3.91	4.12	4.55	5.8	6.77	5.96	n/a	n/a
TAS	cpl	30.9	33.6	36.5	50.2	41.3	34.6	40-41	40-41
	\$/kg MS	4.05	4.39	4.79	6.63	5.4	4.46	5.40-5.50	5.40-5.50
Australia	cpl	31.5	33.1	33.2	49.6	42.4	37.3	n/a	n/a
	\$/kg MS	4.28	4.5	4.51	6.68	5.66	4.98	n/a	n/a

Notes:

p: Preliminary; z: Provisional estimate; n/a: not available. The 2010–11 and 2011–12 estimates for Queensland include data for the region classified as North NSW.

MS: refers to milk solids.

* Dairy Australia notes this estimate may be subject to variation due to different exposure to changes in liquid milk market access (affecting the percentage of milk at Tier 2 prices).

Dairy Australia predicts that there will be a reduction on 2010–11 prices for suppliers exposed to the changing processor liquid milk market.

Source: Dairy Australia, www.dairyaustralia.com.au/Our-Dairy-Industry/Industry-Statistics/Milk/Farmgate-Prices.aspx (accessed 8 August 2011—originally sourced from dairy manufacturers); Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 45.

2.7 Farm gate prices in some regions, however, have improved recently. For example, Murray Goulburn has stated that the final 2010–11 price final 'represented the second highest ever paid by the company'.⁵ The current outlook for overall farm

5 Murray Goulburn, 'Murray Goulburn Co-Operative (MG) announces final step-up in farmgate milk price for 2010/11 season', *Media release*, 6 July 2011.

gate prices is also positive. In May this year, Dairy Australia considered that the opening prices for 2011–12 should be stronger than the opening prices for the previous season;⁶ recent announcements and reports have largely supported this assessment for the larger dairy producing regions.⁷

2.8 For reasons that will be explored elsewhere in this report, farm gate prices in some regions such as Queensland, New South Wales and Western Australia may not be in as strong a position compared to the other states.

Production

2.9 Overall milk production has generally declined since 2002. Two competing forces involved in this long-term trend are the declining number of dairy producers but increasing average herd size.

2.10 The number of dairy farms in Australia has decreased by two-thirds over the last three decades from around 22 000 in 1980 to 7500 in mid-2010. Average herd size increased from 85 cows in 1980 to an estimated 220 in 2010.⁸ Over the past few decades, this increase in per farm productivity led to milk output generally increasing up to 2001–02, despite decreasing farm numbers. The number of farms and total milk production, however, has declined since that time.

2.11 Dairy Australia considers that falling farm numbers reflect 'a long-term trend observed in agriculture around the world, as reduced price support and changing business practices have encouraged a shift to larger, more efficient operating systems'.⁹ The recent report of a UK parliamentary committee supports this claim; although producer numbers have declined by a half over the last decade in the UK, milk production has only fallen by nine per cent because of larger herd sizes and more productive processes being used.¹⁰

2.12 Over the last decade, Australian milk production has also been affected by prolonged seasonal issues such as drought, which resulted in high production costs and low water allocations.¹¹ Other factors attributed to the decline in total production over the past decade include the flow on effects from deregulation in certain regions, the impact of the global financial crisis on farm gate returns in 2008–09 (and an associated rise in farm indebtedness), increased competition for land use in different

6 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 3.

7 For example, Murray Goulburn's opening price equates to a weighted average of \$4.90 per kilogram of milk solids, compared to the opening price of \$4.75 for 2010–11.

8 Dairy Australia, *Australian Dairy Industry in Focus 2010*, pp. 11–12.

9 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 12.

10 House of Commons Environment, Food and Rural Affairs Committee (UK), *EU proposals for the dairy sector and the future of the dairy industry*, eighth report of session 2010–12, 13 July 2011, vol. I, p. 6.

11 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 17.

regions and rising uncertainty over future access to key resources due to regulatory and policy changes.¹²

2.13 Dairy Australia estimates final 2010–11 milk production will be close to 9.1 billion litres. A gradual increase to between 9.2 and 9.5 billion litres is projected to occur by 2013–14.¹³

Table 2.2: Milk production by state (million litres)

	NSW	VIC	QLD	SA	WA	TAS	Australia
1999–00	1,395	6,870	848	713	412	609	10,847
2000–01	1,326	6,784	760	699	388	590	10,546
2001–02	1,343	7,405	744	715	393	671	11,271
2002–03	1,302	6,584	720	733	404	585	10,328
2003–04	1,271	6,434	674	703	404	590	10,076
2004–05	1,218	6,613	619	679	398	600	10,127
2005–06*	1,197	6,651	597	646	377	622	10,089
2006–07*	1,105	6,297	534	655	350	642	9,583
2007–08*	1,049	6,102	485	606	319	662	9,223
2008–09*	1,065	6,135	512	628	340	708	9,388
2009–10* (p)	1,074	5,790	531	605	350	673	9,023

* From July 2005, data collection based on farm location.

Source: Dairy Australia, 'Milk' www.dairyaustralia.com.au/Our-Dairy-Industry/Industry-Statistics/Milk.aspx (accessed 8 August 2011), originally sourced from dairy manufacturers.

Regional issues

2.14 Further to these industry-wide trends, many of the individual regions which make up the Australian dairy industry have faced significant localised challenges in recent years.

2.15 In 2009, controversial contract re-negotiations took place between National Foods (now Lion Dairy & Drinks) and Tasmanian dairy farmers. National Foods offered farm gate prices that were significantly below the cost of production and then announced they would bargain only with individual farmers, resulting in significant

12 Australian Dairy Farmers, answer to question on notice, 8 March 2011 (received 28 March 2011), pp. 2–3.

13 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 5.

adverse publicity for National Foods before negotiations were re-entered into and finalised. These issues were considered in the committee's May 2010 report.¹⁴

2.16 Extreme weather events during the past 12 months have also impacted dairy farmers in many regions—with 12 per cent of farms affected and some facing difficult conditions as a result. The floods in Queensland, Cyclone Yasi and other weather events led to production being lost on 48 per cent of Queensland farms.¹⁵

2.17 The effects of the Queensland floods were outlined to the committee:

Mr Tessmann—... The flood issue ... in central and southern Queensland, has had quite a serious impact on the industry. I would estimate certainly over 90 and probably over 95 per cent of farmers have had some sort of impact from it; some very seriously with inundation, cows swept away and loss of crops—those sorts of issues—and there is loss of infrastructure with washed out laneways and roads. There is a really significant impact on those farms, and they will be left recovering from it for some time.

CHAIR—Is there anything in the contracts that provides for mitigation of milk supplies, or that you do not have to deliver if there is something like a natural disaster of the kind you have had? Are there penalties, for example?

Mr Tessmann—Certainly in some supply systems there are penalties. You have basically a requirement to supply a certain amount of milk and if you do not supply that in the month you have a penalty which is applied to you if you do not keep up that supply. That has been an issue through the floods when a lot of farmers, naturally, have not been able to keep up their supply. There has been a certain amount of understanding, though, from the processors to that issue.¹⁶

... In terms of the impact on-farm from an economic point of view, milk production was lost and milk was dumped because a lot of farms were isolated by floodwaters and tankers could not pick up milk. We had a lot of lost production because of animal health issues, feed issues et cetera. There were also impacts on infrastructure on-farm. We have forecast for this year that the cost is going to be more than \$100 million on our industry in terms of damage incurred and lost milk production. In terms of the impact on production, it is hard to model the recovery component or the end tail of the

14 National Foods initially offered the Tasmanian Suppliers Collective Bargaining Group a farm gate price of 29 cpl (later increased to 33 cpl); an offer that was a significant decrease on the price of 49 cpl in place for the previous year. See Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 69.

15 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 47.

16 Mr Brian Tessmann, President, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 81.

impact but we are expecting a loss of 50 million to 60 million litres of milk out our industry and possibly in excess of 60 farms.¹⁷

2.18 As Coles' announcement regarding the retail price cuts of its generic milk was made on 26 January 2011, in the aftermath of the Queensland floods, some Queensland farmers were particularly critical of Coles' decision:

The morale of our industry had already taken a massive blow. As I said, 98 per cent of our industry's farms are in disaster declared areas. After that announcement on Australia Day, I can tell you all our people phoned. We had people working around the clock on phones seven days a week. I can tell you it is the worst I have seen the morale since the worst of the drought, and we had a decade of drought. We have young farmers who took over their parents' farm during that drought and they were still positive about the future. They pushed through that and stayed in the industry. Those same young people are now saying, 'If this is what is going to go on in our domestic dairy industry, what is the future for us?'¹⁸

Profitability

2.19 In recent years, the average cash income for an Australian dairy farm has unsurprisingly reflected the overall operating conditions experienced in each season. In 2008–09, the average income received by a farm in a financial year was \$87 960. This declined to an estimated \$77 300 in 2009–10 before increasing to an estimated \$100 000 in 2011–11. Average profits shifted from \$6700 in 2008–09, to estimates of -\$1400 in 2009–10 and \$5000 for 2010–11. Further detail about these figures is provided in Table 2.3.

17 Mr Adrian Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 85.

18 Mr Adrian Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, pp. 85–6.

**Table 2.3: Financial estimates—Australian dairy farms, by region
(average per farm)**

	Farm cash income			Farm business profit		
	2009–10 ^p (\$)	RSE	2010–11 ^z (\$)	2009–10 ^p (\$)	RSE	2010–11 ^z (\$)
Queensland and North Coast NSW	105 320	15	59 800	24 250	73	-38 400
Northern Victoria and the Riverina	40 770	89	75 500	- 23 060	143	-7 300
Tasmania	37 550	93	105 000	-51 870	86	6 800
Western Australia	170 280	15	145 900	79 280	29	31 600
South Australia	149 900	18	184 500	31 130	81	67 200
Gippsland	74 550	21	126 600	-2 850	659	39 000
Western Victoria	38 990	84	76 400	-40 890	61	-21 800
Southern and central NSW	228 610	10	154 500	138 120	20	34 500
Australia	77 300	n/a	100 000	6 700	n/a	5 000

Notes:

(1) p: Preliminary; z: Provisional estimate; n/a: not available.

(2) RSE refers to relative standard errors—the extent to which a survey estimate is likely to deviate from the true population expressed as a percentage of the estimate. The ABS considers that estimates with an RSE of 25% or greater are subject to high sampling error and should be used with caution. As the information in the table is based on preliminary data and projections, as well as a sample of farms, it is not surprising that the RSEs are relatively high.

Sources: Surya Dharma, *Australian dairy: Financial performance of dairy producing farms, 2008–09 to 2010–11*, ABARES report prepared for Dairy Australia, June 2011, p. 4; ABARES, *Australian farm survey results 2008–09 to 2010–11*, April 2011, p. 14.

2.20 The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) summarised their expectations for the final 2010–11 figures as follows:

In 2010–11, improved pasture growth and increased availability of irrigation water are expected to favourably affect dairy farm incomes in southern Australia. The financial performance of dairy farms is projected to improve in the southern dairying region of New South Wales and in Victoria, Tasmania and South Australia as a result of higher prices paid for milk used for manufactured dairy products, combined with a reduction in total cash costs as improved seasonal conditions reduce expenditure on purchased fodder and irrigation water purchases.¹⁹

¹⁹ Australian Bureau of Agricultural and Resource Economics and Sciences, *Australian farm survey results: 2008–09 to 2010–11*, April 2011, p. 16.

The structure of the industry and varying levels of exposure to retail prices

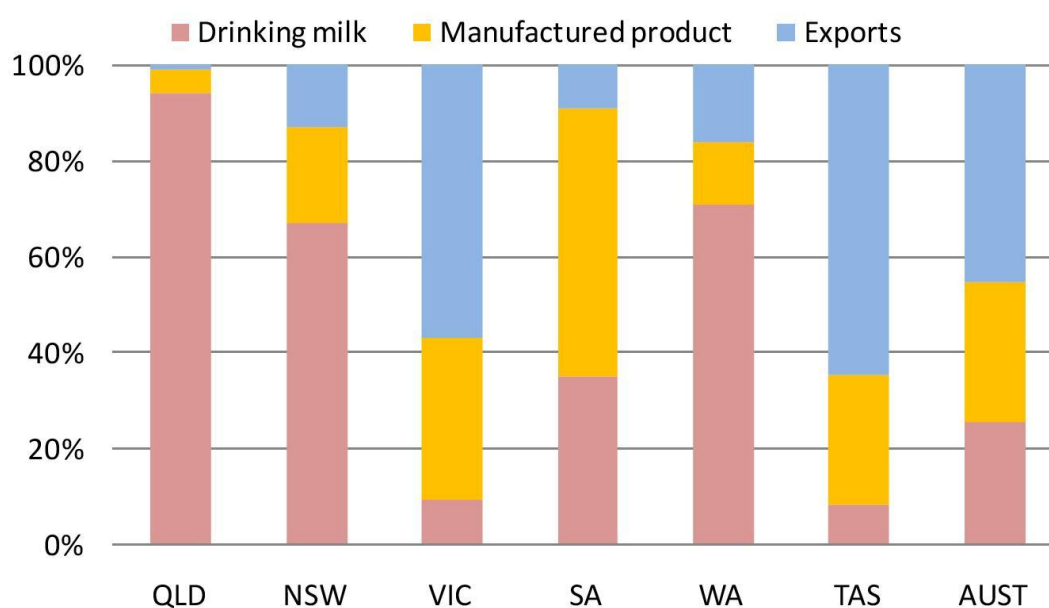
2.21 For drinking milk, there are four main elements in the dairy industry supply chain: production, processing, distribution and retail. This supply chain is shaped by some issues that are not faced by producers and processors of other food products because of the perishable nature of milk:

Compared to milk other beverages such as water, soft drink and beer do not require the same amount of supply chain investment as they are not perishable in the short term and do not require refrigerated storage. In addition, the production of milk is generated from a live farming system and simply cannot be turned 'on or off' or held in storage, as other manufactured drink products can be, including manufactured milk substitutes such as soy beverage.²⁰

Producers

2.22 As discussed in the committee's *Second Interim Report*, and as shown by Figure 2.2, there are two distinct dairy industries in Australia at the producer level.

Figure 2.2: Utilisation of milk by state (2009–10)



Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 41.

2.23 In Tasmania, Victoria and South Australia, milk produced is primarily destined for the manufacturing milk market. Additionally, these states are highly export-focused. Producers in the states of Western Australia, Queensland and New South Wales largely supply drinking milk for domestic consumption in their respective regions.

²⁰ Australian Dairy Farmers, *Submission 150*, p. 4.

2.24 The Australian Competition and Consumer Commission's (ACCC) 2008 inquiry into the competitiveness of retail prices for standard groceries observed that the key determinants of farm gate prices for raw milk are world dairy prices, domestic supply conditions and dairy farmer production costs.²¹ Accordingly, producers are exposed to volatility in the international price of milk and exchange rate movements.

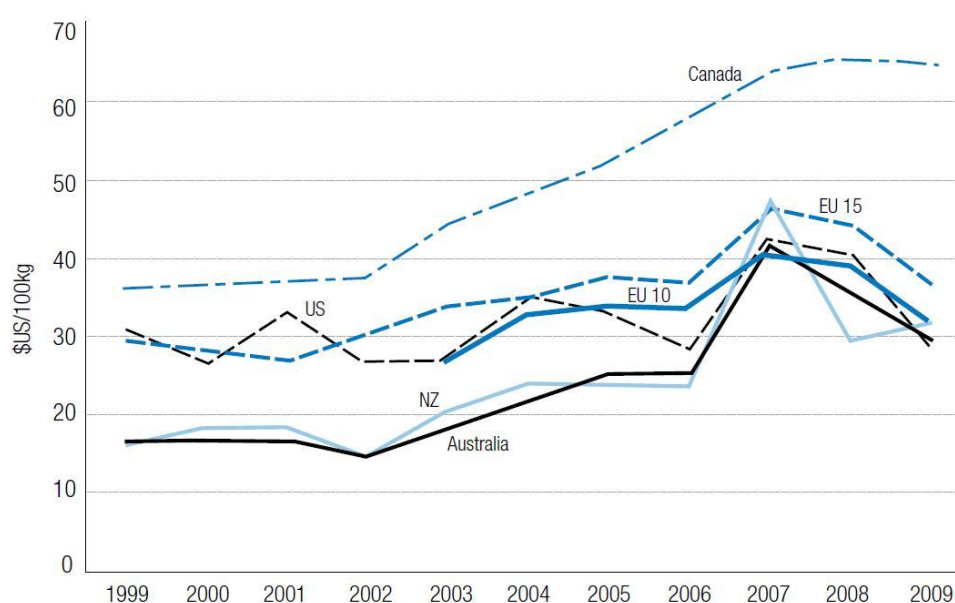
2.25 The entire effect of international prices on Australian farm gate prices, however, is more difficult to encapsulate. Both this inquiry and the committee's previous dairy inquiry heard evidence that the Australian farm gate prices are based on an international commodity price and are not significantly affected by domestic conditions. However, these arguments were rejected by other witnesses. The committee's 2010 report noted such claims were 'hard to reconcile with the differences in farm gate prices across the country'.²²

2.26 Divergences in international prices were also noted, with the committee's 2010 report suggesting that 'it may be more useful to think of the global price (after allowing for transport costs) as setting both bounds on the price that farmers will accept in the medium term for their milk and that processors will pay' although 'in practice, it is unlikely to be economic for processors to import raw milk'.²³

21 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 230.

22 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, pp. 33–4.

23 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 35. However, during this inquiry the committee heard evidence that some fresh milk is imported from New Zealand which is used in some specialised milks: Mr Christopher Phillips, General Manager, Trade and Strategy, Dairy Australia, *Committee Hansard*, 8 March 2011, p. 14.

Figure 2.3: International farm gate milk prices (US\$/100kg)

Source: Dairy Australia, *Dairy 2010 Situation and Outlook*, May 2010, p. 10.

2.27 Although the price paid in the manufacturing states in south-east Australia still acts as a benchmark, producers in the drinking milk states of Western Australia, Queensland and New South Wales are less directly impacted by international factors. Instead:

... farm gate prices are more influenced by contract negotiations between processors and retailers, regional milk production levels, location of regional milk production pools and processing plants, the distance milk can be viably transported both in terms of cost, maintenance of quality and the location of markets.²⁴

2.28 Therefore, a premium price is paid to these producers to secure supply and to avoid high transport costs.²⁵ The cost associated with freighting milk long distances is significant—evidence provided to the committee estimated the cost of transporting milk from Victoria to Queensland at being between 12 and 14 cents a litre.²⁶ However, the required year round milk supply generally imposes higher production costs as supplementary inputs need to be sourced during the winter months.²⁷ Supply and demand also has to be closely matched in these areas because of the absence of manufacturing operations:

24 Queensland Dairyfarmers' Organisation, *Submission 94*, p. 13.

25 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 230.

26 Mr Christopher Phillips, General Manager, Trade and Strategy, Dairy Australia, *Committee Hansard*, 8 March 2011, p. 11.

27 Freshlogic, *Northern dairy industry regional industry outlook update: June 2011*, p. 11.

This is a challenge for both farmers and processors, as either over or under supply represents significant issues for the regional market, producing a flat supply curve is costly for farmers, while coping with seasonal peaks and troughs imposes costs on the processing sector.²⁸

2.29 This distinction is particularly important when considering issues such as the retail price cuts led by Coles. These sorts of domestic market shocks are much more likely to affect farmers in the drinking milk states compared to the manufacturing states. The Australian Dairy Industry Council (ADIC) highlighted this when providing its early assessment of the possible impact of Coles' decision:

Farm suppliers in Victoria and Tasmania appear to be less at risk. They may have to bear some of the impact on returns and margins for their companies who are engaged in production and sale of branded milk for route trade or domestic UHT milk.

Farmers in Queensland, Northern NSW and Western Australia are more at risk. In these states, local milk production is utilised primarily for drinking milk. Therefore, farm gate price drivers in these regions reflect the balance between local demand for drinking milk and security of supply.²⁹

2.30 That the different characteristics of the manufacturing and drinking milk regions is not always recognised was a point of frustration for some submitters:

Despite Coles' claims of recent increases in farm gate prices of 22 percent in Victoria, the reality is that milk prices to farmers have dropped by more than 10 percent in New South Wales and 15 percent in Queensland in the last twelve months in these key drinking milk production states. This includes farmers who supply milk which goes into Coles' private label (home brand) milk. To cite Victoria as an example is disingenuous when its key market is export oriented.³⁰

Processors

2.31 Processors collect raw milk from farms and transform it into dairy products, such as drinking milk, yoghurt, whole milk powder, UHT milk, butter and cheese.

2.32 The following table gives a snapshot of the processing sector as at 2009–10; however, it represents the entire milk market (and so includes milk that is not used as drinking milk and processors that are not involved in drinking milk).

28 Queensland Dairyfarmers' Organisation, *Submission 94*, p. 14.

29 Australian Dairy Industry Council, *Submission 96*, p. 12.

30 Australian Dairy Industry Council, *Submission 96*, p. 4.

Table 2.4: Estimated share of total milk production by processor (2009–10)

Processor	Australia		Vic	SA	Tas	Qld	NSW	WA
	million litres	% of total						
Murray Goulburn	3,200	35.5	3,000	100	0	0	100	0
Fonterra	2,000	22.2	1,310	30	470	0	100	50
National Foods/ Dairy Farmers	1,682	18.6	291	319	150	261	611	51
WCB	800	8.9	700	100	0	0	0	0
Parmalat	480	5.3	215	0	0	215	50	0
Others	861	9.5	275	56	53	54	213	209
Total	9,023	100	5,790	605	673	530	1,074	350

Source: National Foods, *Submission 97*, p. 14. Based on information published by Dairy Australia and National Foods' estimates.

Market concentration

2.33 As Table 2.4 indicates, the milk processing sector is relatively concentrated, with the Murray Goulburn Co-operative the largest processor. Murray Goulburn is also a significant exporter—of its total revenue of \$2.24 billion in 2009–10, \$1.16 billion was from exports.

2.34 The most significant recent consolidation in the sector was the acquisition of Dairy Farmers by National Foods during 2008–09. The ACCC decided not to oppose the acquisition on the condition that certain assets were divested. A proposal for further consolidation—Murray Goulburn's proposed acquisition of Warrnambool Cheese and Butter Factory Company (WCB)—was considered by the ACCC in the first half of 2010, but did not eventuate.³¹ Dairy Australia, however, suggests there is 'ongoing interest' in the ownership of WCB:

... in view of the fact that the 15% limit on individual shareholder ownership will lift in mid-May 2011. WCB now has two large dairy groups with significant shareholdings—Bega Cheese holding 15% and Murray Goulburn 10%.³²

2.35 An interesting outcome of the concentration of the processing sector is the price leadership role effectively held by Murray Goulburn in south-east Australia. As shown by Table 2.4, Murray-Goulburn processes the majority of milk in Victoria

31 On 22 February 2010, the ACCC commenced a review of the proposed acquisition. The ACCC released a Statement of Issues in April which raised certain preliminary competition concerns with the proposed transaction. On 2 June 2010 Murray Goulburn announced that it would not proceed with the acquisition and the ACCC consequently ceased its review.

32 Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 38.

which, in turn, is where the majority of Australian milk production takes place. This issue was examined in more detail in *Milking it for all it's worth*, with the committee noting:

National Foods appeared to set their prices based on those set by Fonterra, who in turn had based their prices on those set by Murray Goulburn.³³

2.36 The ACCC, however, observed that such an outcome:

... is something that you would see across a range of industries given some of the market dynamics. I would not see it as a form of collusion but there is no doubt that it is the result of the market structure...³⁴

2.37 The Sapere Consulting Group similarly commented:

While it appears that MG [Murray Goulburn] occupies a position of price leadership, the available evidence suggests that MG occupies a position of what is known in the economics literature as 'barometric price leadership', where the price leader commands adherence by rivals to the price set because its price reflects market conditions with tolerable promptness. That is, the 'barometer' firm is considered to be reliable and tolerably accurate in its pricing decisions, and therefore others tend to copy it.³⁵

2.38 Another relevant feature is the number of processors in each region. In the larger producing and manufacturing states, such as Victoria, there are more processors operating. The drinking milk processing sector is more concentrated than the overall processing market, with National Foods and Parmalat being the major participants. Smaller processors with regional brands continue to operate in some regions.³⁶ Fonterra, which had about three per cent of the national market share for drinking milk, has now virtually left the market by selling its Brownes milk business in Western Australia to Archer Capital. The sale was completed in March 2011.³⁷

2.39 Also in Western Australia, the Challenge Dairy co-operative went into voluntary administration towards the end of 2010 owing substantial amounts of

33 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 35.

34 Mr Mark Pearson, Executive General Manager, Regulatory Affairs, Australian Competition and Consumer Commission, *Committee Hansard*, Inquiry into competition and pricing in the Australian dairy industry, 18 January 2010, p. 80.

35 Mr Stephen Bartos and Dr Alistair Davey (Sapere Research Group), *An overview of the Australian dairy industry*, March 2011, p. 11; provided by Coles, answer to question on notice, 29 March 2011 (received 19 April 2011).

36 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 26.

37 Fonterra Australia, *Submission 81*, p. 2; Freehills, 'Freehills advises Archer Capital on the acquisition of Brownes dairy and juice business', www.freehills.com.au/7029.aspx (accessed 9 April 2011).

money to farmers.³⁸ Challenge Dairy's assets were purchased by another Western Australian processor, Harvey Fresh.

2.40 As a result, in the drinking milk regions the choice of processors for dairy farmers is more limited. In its most recent application to the ACCC seeking authorisation of collective bargaining arrangements, Australian Dairy Farmers noted:

... in many dairy farming areas of Australia there is often only one dairy company facility, which can leave little or no choice about where individual dairy farmers can market their milk.

This places individual dairy farmer businesses at a significant disadvantage in the market place for milk, leaving them with virtually no bargaining power and making them the ultimate price takers.

Farmers in this position take what the local processor is prepared to offer for the terms and conditions of milk supply. These terms and conditions include price, volume, quality, access to the dairy farm, seasonality of supply and other factors that are incorporated into supply agreements between the individual dairy farmer and the processor.³⁹

Distribution

2.41 Milk is demanded by consumers throughout Australia, not just in the regions where it is produced. Given the limited areas of the country where dairying takes place, this means that many population centres are a significant distance from dairy regions. The fresh and perishable nature of milk as a product also has implications for its handling and transport:

Milk is a 'live biological system' containing an ecosystem of beneficial and nonbeneficial micro organisms that are not eliminated by standard pasteurisation. If milk is allowed to warm to above 5 degrees Celsius, the delicate balance of micro organism can change resulting in flavour taints, physical changes, microbiological spoilage and potential rejection by consumers. The deterioration of unpasteurised fresh milk is sudden and immediate. Pasteurised fresh white milk ordinarily has a shelf life of between 12 to 15 days. A daily consumer would generally begin to consume fresh white milk which is less than 5 days old (from the time of milking).⁴⁰

38 The ABC reported in late December 2010 that 47 dairy farmers in south west WA were owed over \$4 million for unpaid milk: ABC Rural, 'Christmas payments to Challenge dairy farmers', 22 December 2010, www.abc.net.au/rural/wa/content/2010/12/s3099694.htm (accessed 23 February 2011).

39 Australian Dairy Farmers, *Application for revocation of a non-merger authorisation and substitution of a new authorisation*, authorisation A91263. p. 2 www.accc.gov.au/content/trimFile.phtml?trimFileTitle=D11+360556.pdf&trimFileFromVersionId=1001407&trimFileName=D11+360556.pdf (accessed 11 August 2011).

40 National Foods, *Submission 97*, p. 8.

2.42 These factors combine to require a reasonably complicated distribution system called 'a cold chain'. National Foods explained the cold chain process:

A large number of Federal and State laws apply to cold chains, including the Food Standards Code which is administered by State-based regulatory bodies such as the New South Wales Food Authority and Dairy Food Safety Victoria. The laws apply to on-farm handling, transportation to and from processors, onsite storage, distribution centres and retail outlets.

... Cold chain compliance begins at the farm where milk is required to be cooled to 4 degrees Celsius within 3 hours of milking. Typically, milk is collected 3 to 5 times each and every week and delivered to the processor. The trucks collecting the milk are insulated vehicles which require substantial capital investment. Once the milk has been transported to the processor, it is stored in holding storage facilities which can only hold a limited amount of production. The milk is then processed, packaged and dispatched to retailers as fresh white milk within about 24 hours.⁴¹

2.43 National Foods also pointed out:

Dairy processors which do not participate in the drinking milk market do not incur the substantial costs associated with operating a cold chain.⁴²

2.44 Another aspect of the distribution process in the dairy supply chain are the milk vendors who are either contracted or franchised to a processor to distribute milk and other products to a number of retailers or end-users, such as supermarkets (both major and independent), petrol and convenience chains, schools and hospitals. Evidence given to the committee estimated that there are approximately 745 milk distributors in Australia employing around 2200 staff.⁴³

Retail

2.45 About 25 per cent of Australian milk production is used for drinking milk. Drinking milk is sold to customers through two broad 'channels'—the supermarket or grocery channel and the non-grocery channel. The supermarket channel consists of grocery retailers and is dominated by Coles and Woolworths. The non-grocery channel includes of a variety of retailers and users of milk products, such as convenience stores, takeaway food shops, cafés, hospitals and aged care centres.

2.46 Dairy Australia estimates that 13 per cent of national milk production is sold in supermarkets as drinking milk.⁴⁴ Coles has stated that its total milk sales (private and branded milk) make up less than four per cent of national milk production⁴⁵—

41 National Foods, *Submission 97*, p. 8.

42 National Foods, *Submission 97*, p. 14.

43 Amalgamated Milk Vendors Association, *Submission 91*, p. 1.

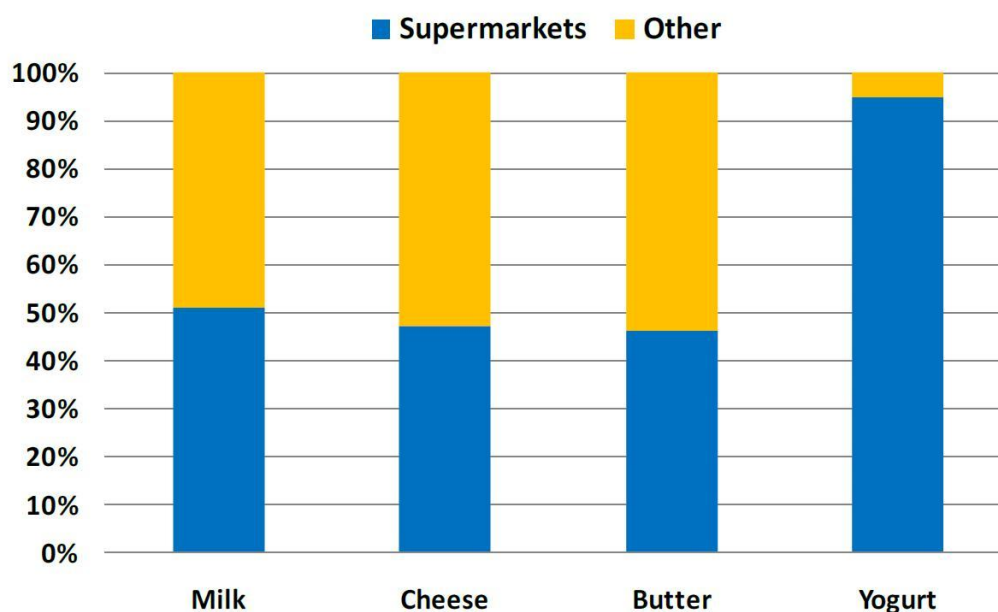
44 Dairy Australia, *Dairy 2011 Situation and Outlook*, February 2011, p. 6.

45 Coles, *Submission 131*, p. 12.

although this would represent a more significant share of the drinking milk market. When asked about their share of that market, Coles advised it was approximately 17 per cent.⁴⁶

2.47 Figure 2.4 provides Dairy Australia's estimates of the breakdown of dairy product sales in each channel. Drinking milk sales via the supermarket channel were estimated to represent 51 per cent of the total in 2009–10.

Figure 2.4: Dairy products sales by channel (2009–10)

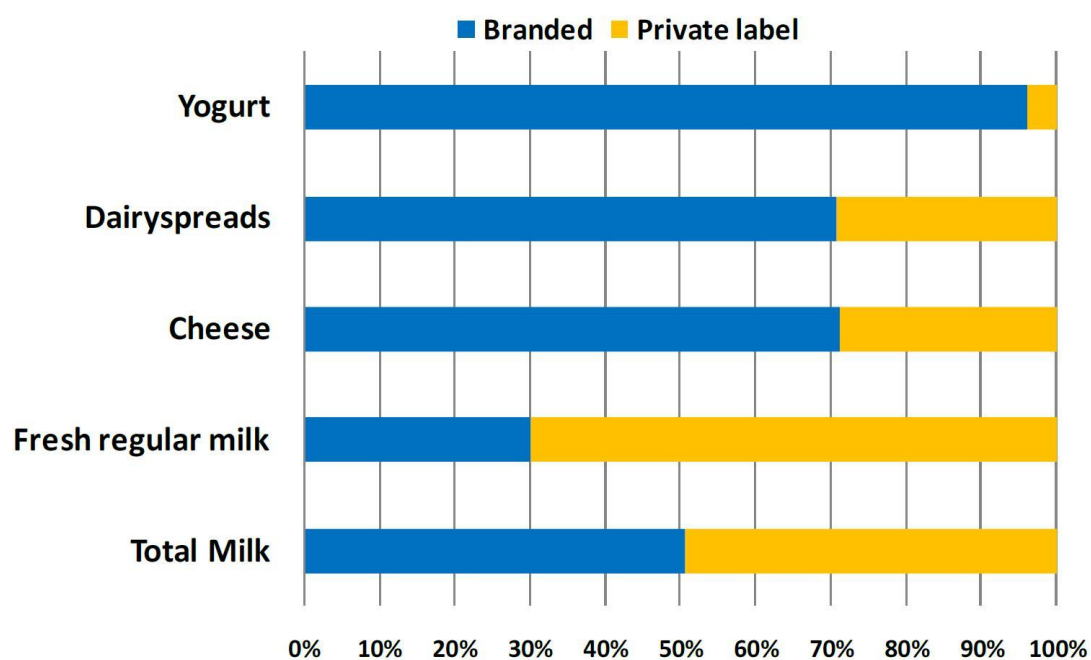


Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 30.

2.48 In recent years, the supermarkets' own-brand or private label products have generally been increasing their share of total sales. While some dairy product categories have resisted the shift to private labels, it is clear that drinking milk, particularly regular full cream milk, has proved susceptible.

⁴⁶ Coles, answer to question on notice, 29 March 2011 (received 19 April 2011), p. 6.

Figure 2.5: Shares within the supermarket channel (December 2010)



Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 31.

Chapter 3

Private label milk in Australia

3.1 The major supermarket chains sell milk in two formats: private label milk (also variously known as 'home brand', 'store brand' or 'generic') which usually carries the name of the supermarket selling it and 'branded' milk which usually carries the name of the processor.¹ The price cuts that are the subject of this inquiry were for private label milk.

3.2 It is estimated that private label products currently account for almost 25 per cent of all grocery sales, including 20 per cent of those through Coles and Woolworths.² A 2010 report released by IBIS World, a market research company, noted that certain categories of products are particularly suitable for successful competition from private label products:

... due to the common perception that branded products are not necessarily of higher quality within specific segments of the supermarket, particularly the dairy aisle. The same applies to other staples such as eggs, flour and sugar, all of which have enjoyed solid private label growth, reaching more than 25% of sales.³

3.3 Dairy Australia notes:

Private labels tend to gain significant share in what are termed 'low involvement' product categories—or those where the product offerings are very similar across the range on the market and the consumer decision-making process is relatively simple and straightforward.⁴

3.4 IBIS World also consider that the 'only way is up' for sales of private label grocery products, noting that they count for about one third of sales in the United States and more than half of those in the United Kingdom.⁵

Growth in private label milk post-deregulation

3.5 The growth in private label milk can be traced back to the deregulation of the Australian dairy industry in 2000, when excess capacity in the industry provided an impetus for growth. The Australian Competition and Consumer Commission's (ACCC) 2008 inquiry into the competitiveness of retail prices for standard groceries received evidence from a major processor on the dynamics of the industry at that time:

1 Examples include Pura, Pauls, Harvey Fresh and Canberra Milk.

2 IBIS World, *Australia's appetite for private labels set to grow*, August 2010, p. 1.

3 IBIS World, *Australia's appetite for private labels set to grow*, August 2010, p. 1.

4 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 31.

5 IBIS World, *Australia's appetite for private labels set to grow*, August 2010, p. 2.

Parmalat contended that this provided a strong competitive tension to the point where the processors were prepared to tender for private label business at very low prices in order to utilise capacity. Parmalat considered that wholesale prices were driven down by this excess capacity, creating a gap between wholesale prices for branded and private label product which then expanded over time.⁶

3.6 The first national contract for supermarket private label milk was given to National Foods by Woolworths in 2002 (Dairy Farmers held a number of contracts at a sub-national level with Coles).⁷ The ACCC, in evidence to the committee, remarked that the change in tendering arrangements by Woolworths had a clear impact on the returns farmers received, although they were not of the view that this experience is applicable to the current pricing decisions:

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

Mr Cassidy—Yes ... I go back to 2000, when Woolworths changed the arrangements for purchasing home brand milk. They moved to a national tender, which drove down the price that they were paying for their home brand milk, and that flowed straight through the chain and ended up with the farmer. That is the sort of history I refer to, but that is not happening at the present time.⁸

3.7 Since 2000, the market share of the supermarkets' private label milk has steadily increased. Sales of private label milk have increased from about 22 per cent in 1999–2000, to approximately 50 per cent in 2009–10. Further, in the plain fresh white milk category, the supermarkets have increased their private label market share from 27 per cent to the current level of approximately 70 per cent.⁹

3.8 In some areas of Australia, however, the supermarkets' private label milk is a relatively new phenomenon. For example, Woolworths only began selling private label milk in their Western Australian stores in 2010.¹⁰

6 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp. 235–6 (footnotes omitted).

7 National Foods, *Submission 97*, p. 16.

8 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 31.

9 Australian Dairy Farmers, answer to question on notice, 8 March 2011 (received 28 March 2011), p. 1.

10 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 24.

3.9 At its appearance before the committee, the Dairy Farmers Milk Co-operative (DFMC) provided some interesting insights into how private label milk came about and grew in market share:

Obviously for many years private label was absolutely loss making. I was on the Dairy Farmers board when it first started to occur. It was not done on the margin line; it was done at the request of retailers wanting some consumer shop choice. We are not against that. The more there the more buy, you might say. The shelf is about choice. Nobody can control the retail price of this product and, as we can see now with Coles, that absolutely happened 10 years ago. It was a pretty keen and loss-making wholesale price. The sales just boomed. Nobody expected the retail price point to be dropped that much compared to brand. I know when Dairy Farmers got the contract we just kept losing and losing money because much more was sold than was ever anticipated in the contract. But you had to meet the contract.¹¹

3.10 The increasing divergence between the retail price of branded milk and the supermarkets' private label milk over the past decade, and its effects on the dairy supply chain, was also discussed:

... if you go back to 2000, the differential between the two pools of milk, proprietary brands versus supermarket brands, was roughly 18c a litre. The differential across all sales through the supermarket was about \$44 million. Ten years later at the end of last financial year, that difference has blown out by about 71c a litre or across the value chain about \$414 million. That is a big chunk of money in terms of the domestic dairy industry value chain. That is money that is not going back into the value chain. This latest discount by Coles has actually pushed that differential out even further. That gives them an absolute price advantage in terms of growing their own brand market share and it puts greater pressure on the proprietary brands and that is going to put greater pressure back through the value chain on, obviously, the farm gate.¹²

3.11 One point that needs to be considered regarding the January 2011 price cuts is that since about December 2009, at least some private label milk products have been available at near \$1 a litre. Prior to the January 2011 price cuts, Coles offered two private label milk brands with different pricing structures (Smart Buy and Coles brand). Coles have now discontinued the Smart Buy brand. The January 2011 price cuts means that while the price of the full cream product Coles retained has been significantly reduced (from \$2.47), the price reduction only amounts to about 4.5 per cent for the now discontinued product (which sold for \$2.09 for two litres). The price cut was more significant for the low fat product, which was reduced from \$2.99 to \$2.

11 Mr Ian Zandstra, Chairman, Dairy Farmers Milk Co-operative, *Committee Hansard*, 8 March 2011, p. 71.

12 Mr Adrian Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 83.

3.12 The committee received evidence from Coles that the majority of private label milk sold prior to the brands being consolidated was the Smart Buy product.¹³ The committee is concerned that, given this evidence, certain advertisements which focused on the larger price drop may have caused the consumers of the full cream Smart Buy product to believe they were receiving a bigger discount than they actually were. These issues were discussed with the ACCC at the last hearing conducted for this inquiry in October 2011, with the ACCC indicating that it will examine them.¹⁴

3.13 Perhaps countering arguments related to the majority of the price cuts being less than five per cent, it could be argued that the January 2011 pricing decisions have continued the trend in declining retail milk prices, and reinforced any negative impacts associated with the earlier price reductions. Coles pointed out that in December 2009 its competitors reduced the retail price for two litres of private label full cream milk by eight cents from \$2.17 to \$2.09.¹⁵ Coupled with the January 2011 price cuts, this represents a total decrease of over eight per cent in just over a year.

Table 3.1: Supermarket private label milk prices (per litre)

	2007–08	2008–09	2009–10	February 2011
Regular whole	\$1.16	\$1.18	\$1.12	\$1.00
Reduced fat	\$1.34	\$1.35	\$1.30	\$1.00

Note: In February 2011 the 11 cent Federal Government milk levy was removed.

Source: Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 44; originally sourced from Synovate Aztec.

Current private label contractual arrangements

3.14 Although Woolworths moved to a national contract in 2002, it has since reverted to state/regional contracts. After the merger of National Foods and Dairy Farmers in 2008, virtually all supermarket private label milk was provided by National Foods.¹⁶ Since then other processors have gained or regained contracts for particular regions.

3.15 The duration of the contracts the processors enter into with the major supermarkets differ; Woolworths advised that their contracts are for either 12 or 24 months, whereas Coles informed the committee that the majority of their contracts end in January 2014.¹⁷

13 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, pp. 51–52.

14 *Committee Hansard*, 6 October 2011, p. 33.

15 Coles, *Submission 131*, p. 16.

16 National Foods, *Submission 97*, p. 16.

17 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 3; Mr John Durkan, Merchandise Director, Coles, *Committee Hansard*, 29 March 2011, p. 43.

3.16 There have been a number of recent changes to private label contract arrangements. From September 2010, Parmalat began supplying Woolworths' stores in north Queensland after being awarded the contract previously held by National Foods. Woolworths' most recent tender process (conducted between December 2010 and June 2011) resulted in:

- National Foods continuing to supply stores in Victoria, South Australia, Western Australia and the Northern Territory;
- Murray Goulburn Co-operative continuing to supply stores in southern New South Wales, the Australian Capital Territory and now also stores in northern Victoria; and
- Parmalat gaining the contract previously held by National Foods to supply stores in New South Wales.

3.17 National Foods holds most of the contracts to supply Coles' private label milk.¹⁸ These contracts were reviewed in January 2011. An additional development this year related to Coles' contracts in Western Australia, where National Foods does not supply Coles. In July it was announced that Harvey Fresh had gained Coles' private label contract for that state from Brownes Dairy.¹⁹

Differences between private label and branded milk

3.18 In its evidence to the committee, Coles responded to claims it had received that it 'has watered down its private label milk to save money', and that there are significant quality differences between its private label milk and other branded products in the same category:

This is simply not true. Coles abides by standard milk formulation practices and, in accordance with federal government requirements, labels the key ingredients in all of its products, including the private label milk.²⁰

3.19 Coles provided a document that compared the levels of energy, protein, fat and other specifications between the major supermarkets' private label milk and selected brands. It indicated that its private label brand has the same levels of energy, protein, fat, saturated fat, carbohydrates, sugars, sodium and calcium as one of the processor branded products, and shared similar specifications to a product offered by another processor.²¹

18 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 32.

19 Coles, 'Harvey Fresh awarded Coles Western Australian milk contract', *Media release*, 28 July 2011.

20 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, p. 37.

21 The comparisons were based on milk sold in Victoria. See Coles, document tabled at 29 March 2011 hearing, appendix VII.

3.20 Coles' position was supported by the Australian Dairy Farmers, which noted the Food Standards Australia New Zealand's (FSANZ) minimum regulatory requirements for drinking milk:

In accordance with *FSANZ Standard 2.5.1 – Milk*, all packaged cows' milk for retail sale in Australia must meet minimum composition requirements for milk fat and protein. The standard also allows for milk composition to be adjusted to comply with the compositional requirements by the addition of and/or withdrawal of milk components, provided the adjustment does not alter the whey protein to casein ratio of the milk being adjusted.²²

3.21 The high degree of similarity between private label and branded products may be a recent occurrence. Previously, when Coles offered two private label brands of milk—'Smart Buy' and 'You'll Love Coles'—there were slight quality differences between the two products.²³ Now that Coles' Smart Buy product has been discontinued, the higher quality private label product—that is, the product whose specifications are further away from the minimum standards set by FSANZ—is being sold. However, prior to the elimination of the lower grade private label brand, a 2009 CHOICE study concluded:

- Almost all milk is highly processed.
- Generic brands are much the same quality as the major branded versions – and a lot cheaper.
- Most people will get no real benefit from the more expensive "milk" products with added extras.
- All milk qualifies for the description "good source of calcium". There's between 115mg and 120mg of calcium per 100mL, regardless of brand.²⁴

3.22 Nevertheless, whether the specifications of this product will significantly change in the future is something that may need to be monitored so consumers stay informed as to what they buying.

Why do processors continue to supply private label milk?

3.23 The profit margin processors currently have on private label milk was raised throughout this inquiry, with a number of assertions made. Coles' submission argues

22 Australian Dairy Farmers, answer to question on notice, 8 March 2011 (received 28 March 2011), p. 16.

23 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, p. 53.

24 CHOICE, *Milk products review*, 10 September 2009, www.choice.com.au/reviews-and-tests/food-and-health/food-and-drink/beverages/milk-products-compared.aspx (accessed 2 March 2011). This study was also noted by the South Australian Dairyfarmers' Association in their response to a written question on notice related to differences in specifications.

that National Foods, Fonterra and Parmalat have each announced profit margins higher than Coles.²⁵ Coles also suggested:

In terms of their overall margins, there is an assumption made that lowering the retail price automatically means that the farm-gate price will be put under pressure. Our view on that is that there are higher levels of profitability within those companies overall and they can look for alternatives to improve their overall efficiency, improve their innovation, improve their product development and look to other ways to make savings should they wish to protect the margin, or invest some of it in the dairy industry here. There are a number of different ways in which they can take action through their broader level of economic strength, rather than just simply taking the easy route of squeezing the dairy farmers.²⁶

3.24 Early in the inquiry, National Foods advised that their margin on Coles' and Woolworths' private label milk was close to zero, with their overall profitability on milk sales (generic milk plus National Foods' branded milk) being approximately two per cent.²⁷ National Foods also advised that they were making a loss on their private label contract with Coles prior to the wholesale price increase paid by Coles in January 2011.²⁸ National Foods (now Lion Dairy & Drinks) has since advised that for the year ending 30 September 2011, its projected full-year white milk earnings before interest and taxes (EBIT) margin 'is now expected to be negative'.²⁹

3.25 Fonterra also objected to statements about the comparative profitability of milk processors:

It has been suggested that the processors who sit between the farmers and retailers are the ones who are making unreasonably high margins and taking value out of the system. Nothing could be further from the truth. Dairy processing is a capital intensive exercise and those in the industry struggle with seasonal conditions, price volatility, higher input and energy costs, higher safety and quality costs, and erosion of margin. Further, developing market leading dairy brands with consumer propositions around health, wellbeing, superior nutrition, taste and convenience, requires significant investment in research and development. Dairy processors in Australia make only a modest return on their invested capital and this may be a

25 Coles, *Submission 131*, p. 11.

26 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, p. 49.

27 National Foods noted that at the time of their hearing it was too early to update these figures to reflect shifts from branded milk to generic as a result of the retail price discounts: Mr Duncan Makeig, Group Sustainability Director and General Counsel, National Foods, *Committee Hansard*, 9 March 2011, p. 63.

28 Mr Duncan Makeig, Group Sustainability Director and General Counsel, National Foods, *Committee Hansard*, 9 March 2011, p. 67.

29 Lion Dairy & Drinks, *Submission 159*, p. 4.

reason why Australian interests have sold dairy assets to foreign entities in recent years.³⁰

3.26 If there is little difference in specification between branded milk and private label milk (and thus processors risk eroding the market share of their branded product by supplying it), and the profits for processors historically associated with private label milk have been low or negative, the question naturally arises: why do processors continue to supply it? When asked at a public hearing why they supply it, National Foods' initial response was 'that is a very good question'. They elaborated:

Since farm gate deregulation in 2000, house brand milk has become more and more of a reality ... [T]he volume of milk is pretty inelastic. Consumers in Australia drink 102 litres per head per year or thereabouts. As more and more milk has transferred to house branded over time, we have large manufacturing facilities which need scale and volume. We also have contractual arrangements ... longer term contractual arrangements with farmers ... it is a volume management issue and it is a cost issue for us as well.³¹

3.27 The ACCC's 2008 report of its grocery inquiry also discussed why processors tender to supply supermarkets' private label brands:

In confidential evidence provided to the ACCC, processors indicated that the main reasons they pursued private label contracts were:

- overhead recovery—generating revenue through private label sales to contribute to fixed costs of running the business
- supply relationships with retailers—supplying private label product provides a stronger relationship and possibly improves processors bargaining position in relation to branded products
- volume—the volume of milk supplied through private label contracts provides some stability to the business.³²

Implications for influence of the major supermarkets on the dairy industry

3.28 A number of arguments were put forward about how the major supermarkets can impact the dairy industry by affecting the overall value of the supply chain, the value of milk as a product and the incomes of farmers. These issues, in the context of the specific price cuts led by Coles, are explored in more detail in chapters 4 and 5.

3.29 There is limited direct evidence available regarding how the major supermarket chains can affect farm gate prices. To complicate matters, a number of

30 Fonterra Australia, *Submission 81*, p. 1.

31 Mr Keith Mentiplay, Director, Technical and Business Development, National Foods, *Committee Hansard*, 9 March 2011, p. 73.

32 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp. 234–5.

seemingly conflicting statements have been made about how the major supermarket chains can directly and indirectly impact farm gate prices.

3.30 Coles has stated on a number of occasions that it is committed to absorbing the costs resulting from its milk price reductions, and that it does not have a 'direct influence over farm gate prices because Coles buys milk from processing companies, not from dairy farmers'.³³ ALDI also submitted that it:

... has not, and is not considering passing on the costs associated with this price reduction onto our suppliers.³⁴

3.31 Coles also noted that because its generic milk accounts for approximately four per cent of total Australian milk production, 'this suggests that Coles, by itself, does not have a material influence over Australian milk prices'.³⁵

3.32 However, Coles' share of the drinking milk market is significantly higher, at about 17 per cent.³⁶ While it may be the case that the influence the major supermarkets have in the manufacturing milk states is restricted by the nature of that market, the major supermarkets appear to have a greater influence on the value of the supply chain in the drinking milk production focused regions of Australia. Also, the observation that Coles' competitors seemingly had no choice but to immediately match Coles' price cuts, while perhaps supporting arguments of robust competition existing in the grocery market, demonstrates Coles' influence on suppliers, such as in the drinking milk market.

3.33 Woolworths made similar statements about its contractual arrangements:

Woolworths has no contractual arrangements with Australian dairy producers. Woolworths does not have any insight into, or control over, the contractual arrangements, such as price, that dairy processors enter into with dairy farmers. That is, Woolworths has little or no ability to directly influence the farm-gate price paid to dairy farmers by processors. To the greatest extent possible, however, Woolworths does look to support farm-gate price through ensuring that it does not enter into a Private Label milk contracts that would, based on Woolworths' estimates, result in a dairy farmers receiving less than an economic return for their milk.³⁷

3.34 Revealingly, however, Woolworths did not share Coles' view on the cost of the retail price cut being absorbed. Woolworths has made a number of public statements, including in its submission to this inquiry, which raised concerns that the

33 See Coles, *Submission 131*, p. 10; Coles, 'Coles Milk Pricing Fact Sheet', www.coles.com.au (accessed 25 February 2011).

34 ALDI Stores, *Submission 61*, p. 2.

35 Coles, *Submission 131*, p. 12.

36 Coles, answer to question on notice, 29 March 2011 (received 19 April 2011), p. 6.

37 Woolworths, *Submission 98*, p. 2.

price cuts are unsustainable for the Australian dairy industry. Woolworths explained in its submission:

... we are specifically referring to the fact that this price move has effectively re-based the price of white of milk across Australia overnight, and for an unknown period into the future, which also potentially devalues the whole milk category in the eyes of the consumer. In effect, the consumer baseline for price is now at 1990s levels, but with 2011 input costs for all parts of the supply chain.³⁸

The tender process for private label contracts

3.35 The supply of private label milk, and the tender process associated with the contracts to supply it, raises questions about the degree of direct and indirect influence the major supermarket chains may have on the prices paid to farmers. Some instances of indirect influence are clear—the shift in demand from branded milk to private label products as a result of the price cuts particularly affects farmers on contracts that are structured to balance these prices. This will be discussed in more detail in chapter 5.

3.36 Woolworths' described its tender process to the committee:

The information that we provide to the processors when we are establishing the tender for milk is the volume of milk that we sell. We provide that information on a national basis, on a state basis and on a regional basis, to all of those suppliers. So we are actually providing the volume of white milk that we sell for a private label product. We are not communicating to the processing partners the price of what we sell product for. It is a volume based tender process.³⁹

3.37 Given the limited number of private label contracts available, and the volumes associated with them, it is clear that there is a strong incentive for processors to win a contract to avoid uncertainty in their business and significant adjustment of their operations. Accordingly, one dairy farmer described the tender process as 'a race to the bottom':

The processors are just putting in a price, as low as they think they possibly can go.⁴⁰

3.38 When it was suggested that the processors are not compelled to supply milk to the major supermarkets at such a low price, the same witness argued:

Who is their other market? We have National Foods with a billion litres, if they do not supply Coles and they do not supply Woolworths, who are they

38 Woolworths, *Submission 98*, p. 2.

39 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 4.

40 Mrs Lynne Strong, Co-owner/operator, Clover Hill Dairies, *Committee Hansard*, 10 March 2011, pp. 66–7.

going to sell that billion litres to? You do not turn round overnight and become an exporter. That takes major capital investment.⁴¹

3.39 Paragraph 3.34 noted Woolworths' view that the recent price cuts put the consumer baseline for retail milk prices at 1990 levels. Perhaps in a further admission of the direct influence on farm gate prices that the supermarkets can have through the tender process, Woolworths' submission also included a warning about future contract negotiations and outcomes:

Ultimately, these prices set a new benchmark, and can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years.⁴²

3.40 The meaning and intent behind this statement was pursued at Woolworths' appearance before the committee:

Senator O'BRIEN—... Is it not fair that I take that to mean that Woolworths—and your competition as well, I expect—will be forced to seek lower prices to retain a reasonable margin on the product that you sell in your supermarket?

Mr McEntee—I think the context in which our submission was written was in relation to the concerns we have with the changing mix of private label milk at retail and the flow-on effects back through the supply chain. Woolworths will always negotiate vigorously on behalf of our customer to offer best value, but our concerns within—

Senator O'BRIEN—Is your submission right or not? Do I understand wrongly? Can you explain it to me in any different way? It seems to be saying very clearly that you are going to have to negotiate a lower price. I just want you to be clear with us. Is that what you are saying or not?

Mr McEntee—What I am saying is that I believe the context in which the submission was written is agreeing with our concerns about the flow-on effect back through the supply chain in milk.

Senator O'BRIEN—The flow-on will go back through the supply chain, so prices will go down in the supply chain.

Mr McEntee—Will flow right through the supply chain.

Senator O'BRIEN—So prices will go down in the supply chain. That is what you are saying, isn't it?

Mr McEntee—Potentially it will.

Senator O'BRIEN—Potentially? So the alternative is that they will stay the same, is it, or will they go up? Is there potential for them to rise?

41 Mrs Lynne Strong, Co-owner/operator, Clover Hill Dairies, *Committee Hansard*, 10 March 2011, p. 68.

42 Woolworths, *Submission 98*, p. 3.

Mr McEntee—As previously discussed, the way in which the processor will submit pricing to Woolworths will be based on their costs and the cost of production back to us.

Senator O'BRIEN—So if the prices to the processors were to go up and the processors' price to you, by that necessity, had to go up, does that mean that the price of milk in the supermarket would have to rise?

Mr McEntee—The price at the supermarket is dictated by the market price. So, clearly, there are two differences here: there is the cost of product and there is the sell price of the product. Sell prices are dictated by the market. We have a central manner in which we check competition prices on a regular basis. Our commitment to our customers is to provide the best value. Therefore, where the market price is on key value items is where the retail sales will be. It is a separate discussion from negotiating the cost price of goods.

Senator O'BRIEN—So you could be selling at a loss?

Mr McEntee—We would not sell at a loss.

Senator O'BRIEN—So if the price goes up, you will have to put your price up at some point? They are contradictory positions that you are putting to us, in a sense, and I am trying to tie you down to a response. Clearly, you have to have flexibility in the market, but if your position is that you have to make a profit on the product and the price has to go up, at some stage the price has to go up, doesn't it?

Mr McEntee—As you would appreciate, I do not think I can predict pricing in a public forum. There are laws that stop me from doing that.⁴³

3.41 On the other hand, there are clear restrictions on any influence the major supermarkets may have. A strong consumer preference for fresh milk will likely mean that the supermarkets will have to continue providing it. An official from Treasury noted:

... it would be an interesting strategy for a supermarket to attempt to steer things in a direction where they are not supplying that milk while others continue to do so. They could be taking themselves out of a market which continues to reflect customer demand.⁴⁴

3.42 Further, given the perishable nature of the product, supermarkets cannot realistically import fresh milk:

... the milk has to come from somewhere. The only place that the milk can come from is from dairy farmers in Australia.⁴⁵

43 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, pp. 11–2.

44 Mr Brad Archer, Department of the Treasury, *Committee Hansard*, 10 March 2011, p. 5.

45 Professor Stephen King, *Committee Hansard*, 10 March 2011, p. 43.

Other factors

3.43 Some of Coles' statements and actions, however, suggest that it can *directly* influence farm gate prices:

In an effort to ensure retail milk price reductions would not adversely impact farmers and to demonstrate our commitment to sustainable dairy farming, we increased the contract price paid to milk processors shortly before the "Down Down" price reductions on Coles brand milk.⁴⁶

3.44 In February 2011, Coles announced that they had increased the price paid to WA milk processor Brownes Dairy (owned by Fonterra) by five cents a litre 'to ensure WA dairy farmers are not impacted by Coles' recent cuts to its retail milk prices'.⁴⁷ Coles explained this action in their submission:

In mid-January 2011, Fonterra offered Coles a lower price as part of the competitive tender in Western Australia. In February 2011, Coles subsequently offered to pay Fonterra an additional five cents per litre if it passed that money direct to their dairy farmer suppliers in WA. Initially, Fonterra decided not to pass on this increase to WA dairy farmers but has now agreed to do so.⁴⁸

3.45 In perhaps another acknowledgement of its ability to directly influence farm gate prices, in a letter to the committee chair the Managing Director of Coles remarked:

In a theoretical worst case scenario, milk processors [sic] margins would be affected by no more than a few cents per litre. Given Coles has just paid them an equivalent price increase there is absolutely no excuse for processors to squeeze farm gate prices. Processors [sic] profit margins are already higher than our own in any event.⁴⁹

46 Coles, *Submission 131*, p. 14.

47 Coles, 'Coles Milk Pricing Fact Sheet', www.coles.com.au (accessed 25 February 2011).

48 Coles, *Submission 131*, p. 10.

49 Mr Ian McLeod, Managing Director, Coles, letter to Senator Alan Eggleston dated 18 February 2011, *Additional information 1* [p. 2].

Chapter 4

Early impacts of the pricing decisions

4.1 This chapter assesses the impacts of the January 2011 supermarket pricing decisions based on the retail sales data that is currently available. The following chapter continues the assessment by discussing any implications of these trends at the farm gate.

Demand for milk

4.2 A key question in considering the short-term and likely longer-term impacts of the supermarkets' pricing decisions is how responsive consumers may be to the price cut in terms of changes to the quantity demanded. This concept, known as price elasticity of demand, is important for understanding any changes to the volume of drinking milk sold, and any changes to the value of the product throughout the supply chain.

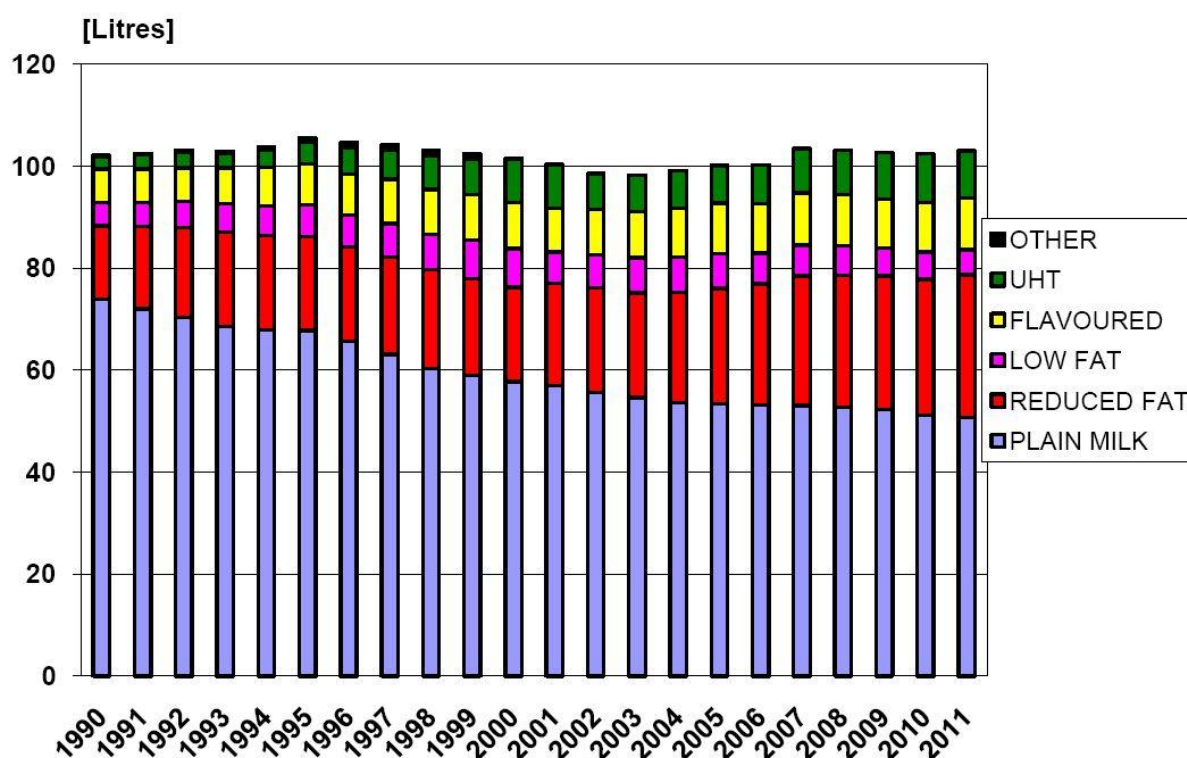
4.3 National Foods considers that consumption of milk is 'pretty inelastic', noting steady levels of domestic consumption over time.¹ Coles disagreed with this view:

We do not fundamentally believe that milk is inelastic. We believe that there will be a higher demand for drinking milk, which we believe carries a higher premium to the farmer. We believe the growth in drinking milk plus the increases we have given to all of our processors should offset any changes that you see in mix.²

4.4 As shown by Figure 4.1 below, per capita milk consumption in Australia has been relatively steady over the past two decades, even with the growth of lower priced private label milk.

1 Mr Keith Mentiplay, Director, Technical and Business Development, National Foods, *Committee Hansard*, 9 March 2011, p. 73.

2 Mr John Durkan, Merchandise Director, Coles, *Committee Hansard*, 29 March 2011, p. 67.

Figure 4.1: Australian per-capita milk consumption

Source: Australian Dairy Farmers, *Submission 150B*, p. 28.

4.5 Professor Stephen King noted that in the short run the demand for milk is 'relatively inelastic', over a six to 12 month period,³ but outlined how he saw the consumption of milk changing as a result of the price cuts:

... Coles is going to need certainly not less fresh milk; almost certainly it is going to need more fresh milk. We would expect milk sales from Coles' supermarkets to go up. Unless milk is an extraordinarily unusual product—in other words, it is a product for which demand has not slowed down—milk sales generally will go up as prices go down. As other sellers of milk products are forced to lower their prices to match Coles to keep their customers, you would expect total milk sales to go up. Sales may not go up by very much, demand may be fairly insensitive in the short term, but you would expect over the longer term there to be some, possibly small, increase in milk sales.⁴

Changes in the volume and value of milk sales since January 2011

4.6 It was anticipated that the price cuts led by Coles—particularly given the heavy publicity they received—would lead to an increase in private label milk sales in the first few weeks, perhaps months, of the promotion. The degree to which the sales of branded products would be affected, whether any shift in sales from branded to

3 Professor Stephen King, *Committee Hansard*, 10 March 2011, p. 44.

4 Professor Stephen King, *Committee Hansard*, 10 March 2011, p. 43.

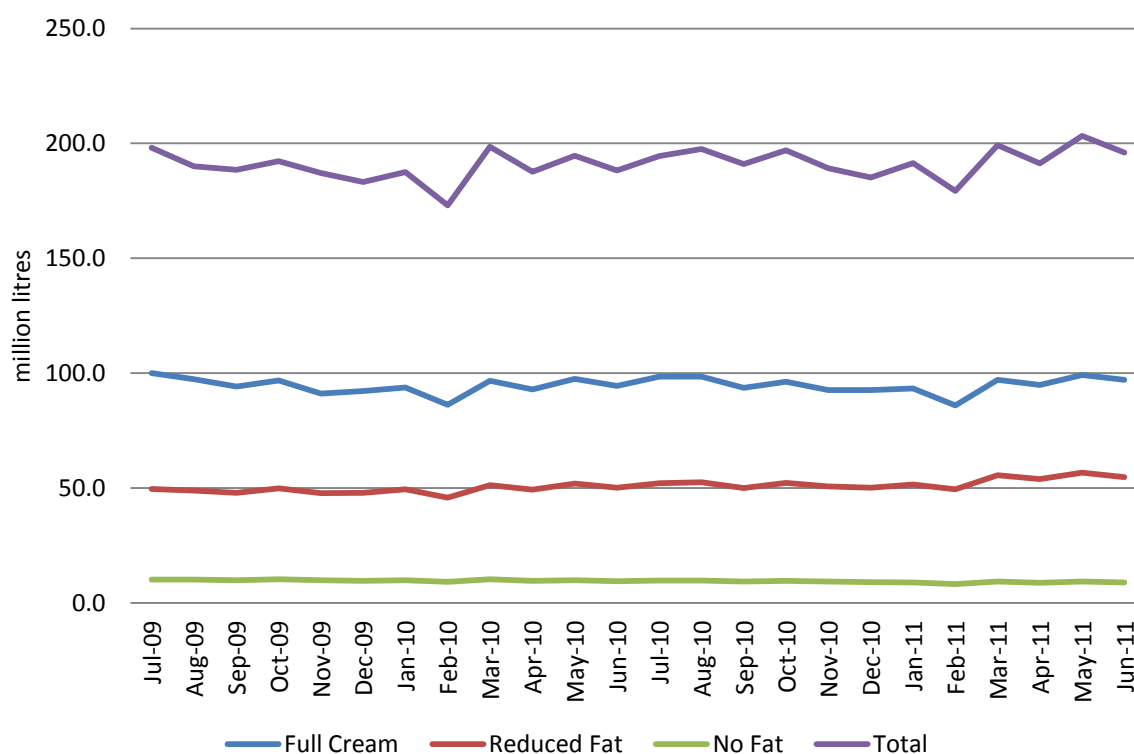
private label milk would be sustained, and the impact on the overall amount of drinking milk sold over a longer period of time was less clear.

4.7 The committee's *Second Interim Report* observed that, based on the information available at that time:

... it is too early to draw meaningful conclusions on any possible sustained increases in drinking milk volume as a result of the supermarket price cuts. Some customers may be slow to respond. Other customers may have over-reacted, deciding to buy a larger sized bottle of milk and then finding it was more than they needed.⁵

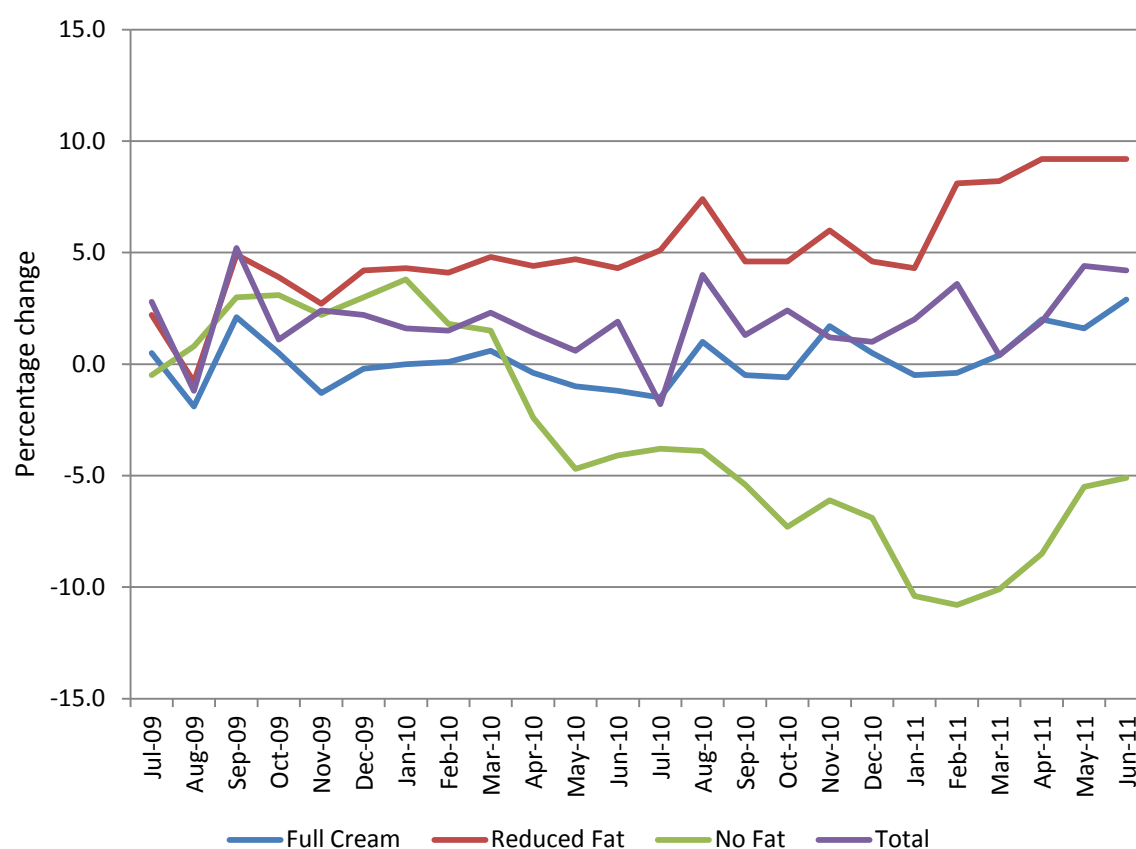
4.8 While the impact on demand is still not clear, some interesting data is at hand. Figure 4.2 shows the sale volume for selected categories of drinking milk for 2009–10 and 2010–11. Figure 4.3 shows the growth in sale volume for each month of 2009–10 and 2010–11 based on changes to sales that occurred in that month during the previous financial year.

Figure 4.2: Packaged milk sales volume by type—July 2009 to June 2011



5 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2011, p. 13.

Figure 4.3: Change in selected packaged milk sales volume by type—July 2009 to June 2011 (percentage change from same month in previous financial year)



Note: Total includes full cream, reduced fat, no fat, flavoured and UHT products.

Source: Compiled using Dairy Australia's 2010–11 national milk sales statistics—Dairy Australia, www.dairyaustralia.com.au/Statistics-and-markets/Production-and-sales/Latest-Statistics.aspx (accessed 17 August 2011).

4.9 As shown by Figure 4.2, packaged milk sales volume for the three fresh drinking milk categories is not subject to dramatic variation. It is also apparent that the total drinking milk volume follows a seasonal pattern. Sales drop significantly from December and throughout January, before returning to higher levels in March. This pattern was also evident for 2008–09 data (not shown in the graph). As the price cuts led by Coles occurred at the end of January 2011, when sales begin to recover from the regular seasonal trough, it is difficult to clearly infer what the immediate effects of the pricing decisions on the total volume sold actually were. As shown by Figure 4.3, however, over the months since the price cuts were introduced, the variation in total milk sales has stayed within the bounds experienced over the past two financial years (approximately -1 and 5 per cent). Accordingly, it is difficult to reliably deduce a significant change in total milk sales when examining the overall milk market.

4.10 One existing development which may have been further supported by the Coles-led price cuts is the growth in sales of reduced fat milk. As shown by both Figures 4.2 and 4.3, the sales volume of reduced fat milk has steadily increased from February 2011 onwards. On 26 January 2011, Coles' private label reduced fat milk

was also reduced to the same price as the full cream variety—\$2 for a two litre bottle and \$3 for three litres. This meant that the extent of the price reduction was actually greater for reduced fat milk as the decision eliminated the slight premium that was previously charged.

4.11 Part of the relatively stronger growth in sales of reduced fat milk, compared to total milk sales and sales of other types of milk products, could be explained by some customers shifting away from other categories of milk. Increased private label reduced fat milk sales at the expense of branded reduced fat or no fat products would likely have some implications for processor revenues and their long-term strategies, as these products have been more the domain of the processor brands rather than the supermarkets' private labels.

4.12 To explore these issues further, the following sections examine the trends in volume and value of sales in each of the two retail channels—the supermarket channel and the non-grocery channel.

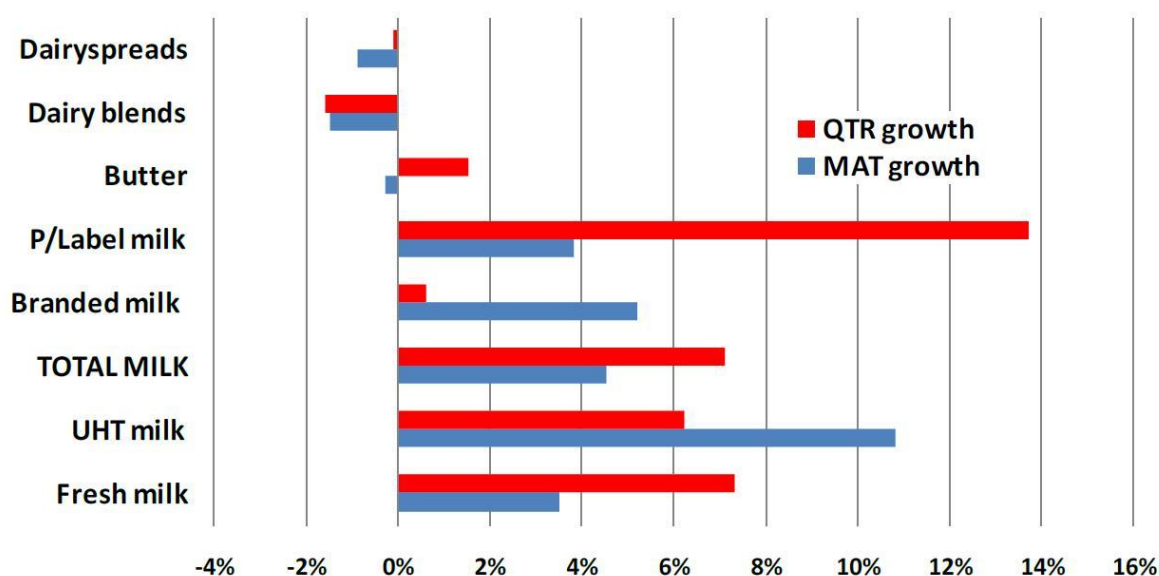
Supermarket channel

4.13 The supermarket or grocery channel consists of grocery retailers and is dominated by the two major supermarket chains—Coles and Woolworths.

Immediate impact on the volume of sales

4.14 The data available for volume growth in private label versus branded products present a clear picture of the impact of the January cuts in the price of private label milk. March 2011 sales figures showed significant volume growth in private label sales, although volume growth for branded milk remained positive.

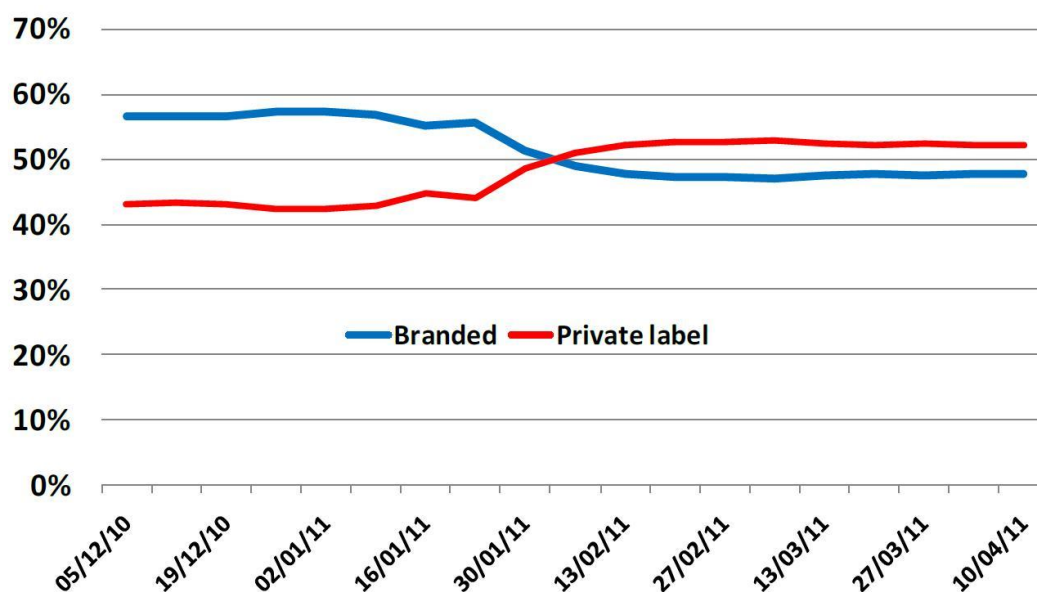
Figure 4.4: Volume growth for Australian sales—year to March 2011



Source: Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 30.

4.15 The effect of the strong growth in private label is shown by Dairy Australia's data on the trend in private label sales, which showed that the breakdown of overall branded milk versus private label milk sales moved from a split of around 50:50 to 45:55.⁶ The shift is particularly noticeable for modified milk products; as shown by Figure 4.5, since the price cuts in January 2011 private label sales have consistently surpassed those of branded products within the supermarket channel.

**Figure 4.5: Share of fresh white modified milk sales within supermarkets
(Dec 2010 to April 2011)**



Source: Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 33.

4.16 Figures 4.6 and 4.7 compare the March 2011 data for private label sales versus branded sales for fresh full cream milk and modified milk against the corresponding data from the previous year and across different states.

6 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 33.

Figure 4.6: March 2011 fresh white milk sales volumes (change from March 2010)

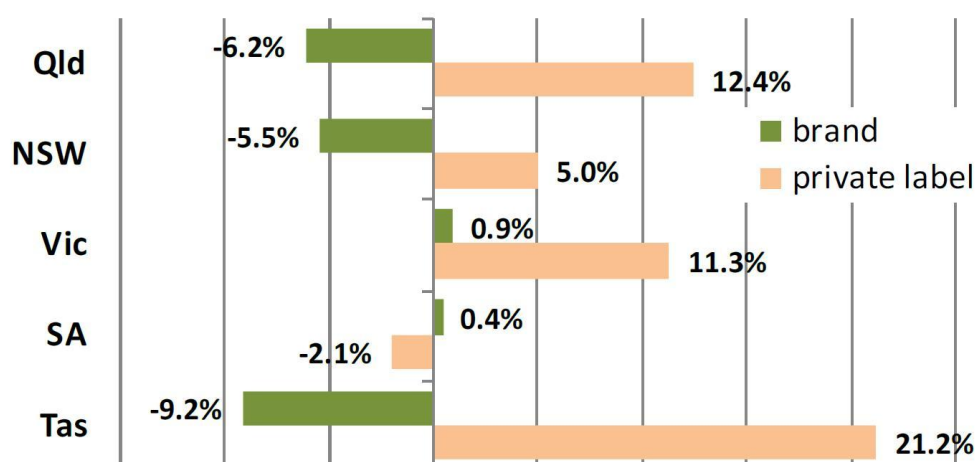
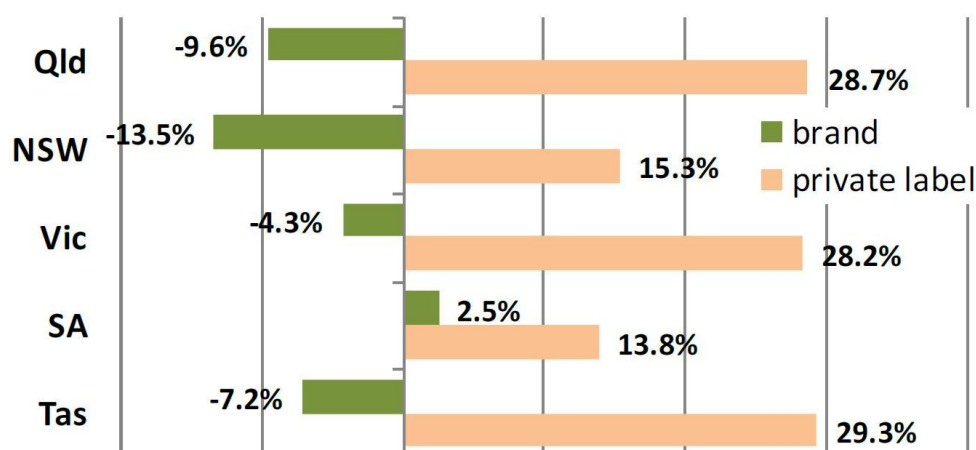


Figure 4.7: March 2011 fresh modified milk sales volumes (change from March 2010)



Source: Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 8.

Impact on volume over several months

4.17 More recently, however, there appears to have been some marginal improvements in the performance of branded products. The Dairy Farmers Milk Co-operative (DFMC) provided the following assessment to its members on the sales figures for June:

June milk sales data from Dairy Australia showed that milk brands regained some ground against private label products in the past months in some states; however, comparisons show that they continued to lose ground to private label products in other states. While branded full cream milk sales had made some progress in all states for May and June, they lost ground in

Victoria. Modified branded products also lost share in Qld, Victoria and to a small extent in South Australia.⁷

4.18 Table 4.1 provides data on supermarket sales trends up to early July.

Table 4.1: Supermarket sales trends (volume)

	<i>5 months to early July 2010 ('000 litres)</i>	<i>5 months to early July 2011 ('000 litres)</i>	<i>% change</i>
Branded fresh full cream white milk	60,868	60,896	+0.05
Private label fresh full cream white milk	147,557	160,152	+8.54
Branded fresh modified white milk	101,919	91,578	-10.15
Private label fresh modified white milk	76,237	99,171	+30.08
Total branded white fresh milk	162,787	152,474	-6.34
Total private label white fresh milk	223,794	259,324	+15.88
Total white fresh milk	386,581	411,798	+6.52
Total milk (includes flavoured and UHT)	484,825	512,384	+5.68

Source: Australian Dairy Farmers, *Submission 150B*, p. 13.

Value of sales

4.19 Although there has been a measurable increase in the volume of sales within the supermarket channel, there is evidence that the increased sales of low priced private label milk at the expense of branded products has affected the overall value of sales through that channel.

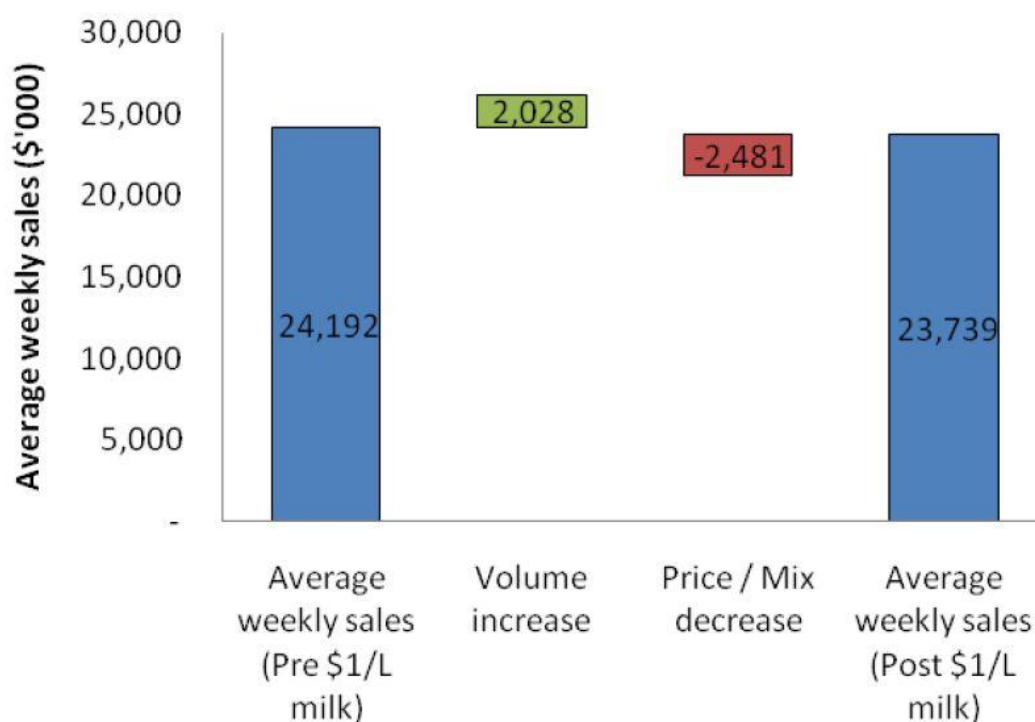
4.20 Lion Dairy & Drinks, formerly National Foods, submitted the following assessment of the changes in volume and value of overall sales in the supermarket channel since the January price cuts:

... Nielsen data shows that total grocery white milk volumes have increased by 8.4% since the end of January 2011. However, average weekly white milk sales value across the grocery channel has decreased by approximately 1.9% (~\$0.5 million) driven by significant shifts in price and mix reflecting volume transfers away from branded into house brand products. Increased house brand market share has resulted in an approximate 14 cents per litre (9.5%) reduction in the average price of fresh white milk across the grocery channel.⁸

7 Dairy Farmers Milk Co-operative, *Dairy Reporter: Weekly Dairy News for Members of DFMC*, 16 August 2011, p. 1, www.dfmc.org.au/docs/dairyreporter16august11.pdf (accessed 18 August 2011).

8 Lion Dairy & Drinks, *Submission 159*, p. 5.

**Figure 4.8: Total grocery average weekly sales—fresh white milk
(late January–early July 2011)**

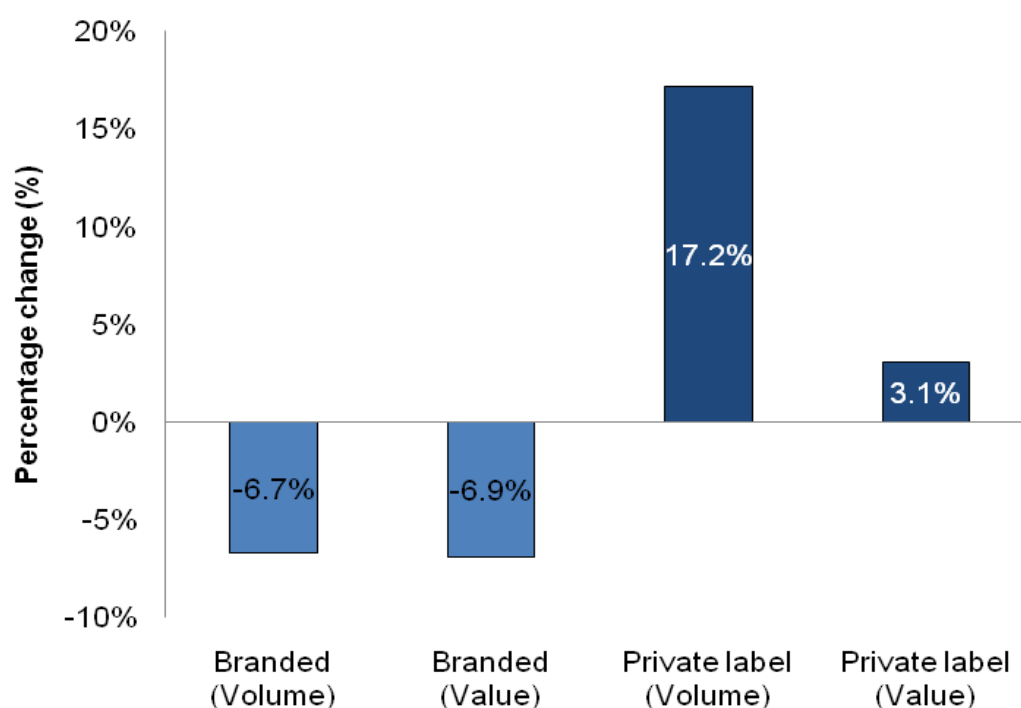


Source: Lion Dairy & Drinks, *Submission 159*, p. 5. Originally sourced from sourced from Nielsen Scan Track and Nielsen C-Track data.

4.21 Lion also noted the effect on the value of sales resulting from the shift from branded products to private label, commenting that although the drop in value from branded product sales largely matched the fall in the volume of those sales, the value of total private label sales increased 'by only 3.1% despite strong volume growth of 17.2%'.⁹ This data is presented in Figure 4.9 below.

9 Lion Dairy & Drinks, *Submission 159*, p. 5.

Figure 4.9: Grocery volume and value change—branded versus private label fresh white milk (late January–early July 2011)



Source: Lion Dairy & Drinks, *Submission 159*, p. 6.

Non-grocery channel

4.22 The non-grocery channel includes a variety of retailers and users of milk products, such as convenience stores, takeaway food shops, cafés, hospitals and aged care centres. Offsetting the overall increase in the volume of sales through the supermarket channel, is evidence of a decline in sales through the non-grocery channel.

4.23 Lion Dairy & Drinks submitted that for petrol and convenience retailers, Nielson data shows that for the 23-week period up to 3 July 2011 (compared to the same period in the previous year) the volume of fresh white milk sold declined by 2.7 per cent, and the value of sales decreased by 2.5 per cent.¹⁰

4.24 Lion also discussed the trends in sales for smaller independent shops (such as milk bars, takeaway food shops, corner stores etc):

White milk volumes in this channel were already in organic decline as a result of an existing trend of white milk volume transfer from unstructured convenience into grocery and national petrol & convenience. However, these volume declines increased significantly post the introduction of \$1 per

¹⁰ Lion Dairy & Drinks, *Submission 159*, p. 7.

litre house brand pricing—from an average -10.3% decline versus previous year to an average -15.1% decline.¹¹

Assessment of early information

Consumer welfare and purchasing decisions

4.25 In examining the impact of the supermarkets' pricing decisions on the supply chain, it is important to remember the benefits gained by consumers. The committee's *Second Interim Report* noted:

It was outlined in evidence to the inquiry that the current retail price competition in milk is saving consumers \$1 million per week. Lower prices are of benefit to consumers as this improves their economic welfare, allowing them to buy more of that product, or to spend their savings elsewhere.

The fact that consumers are saving over \$1 million dollars a week on what is, for many, a basic staple is not a benefit that should be dismissed lightly, or be disregarded by those concerned with impacts upon producers.

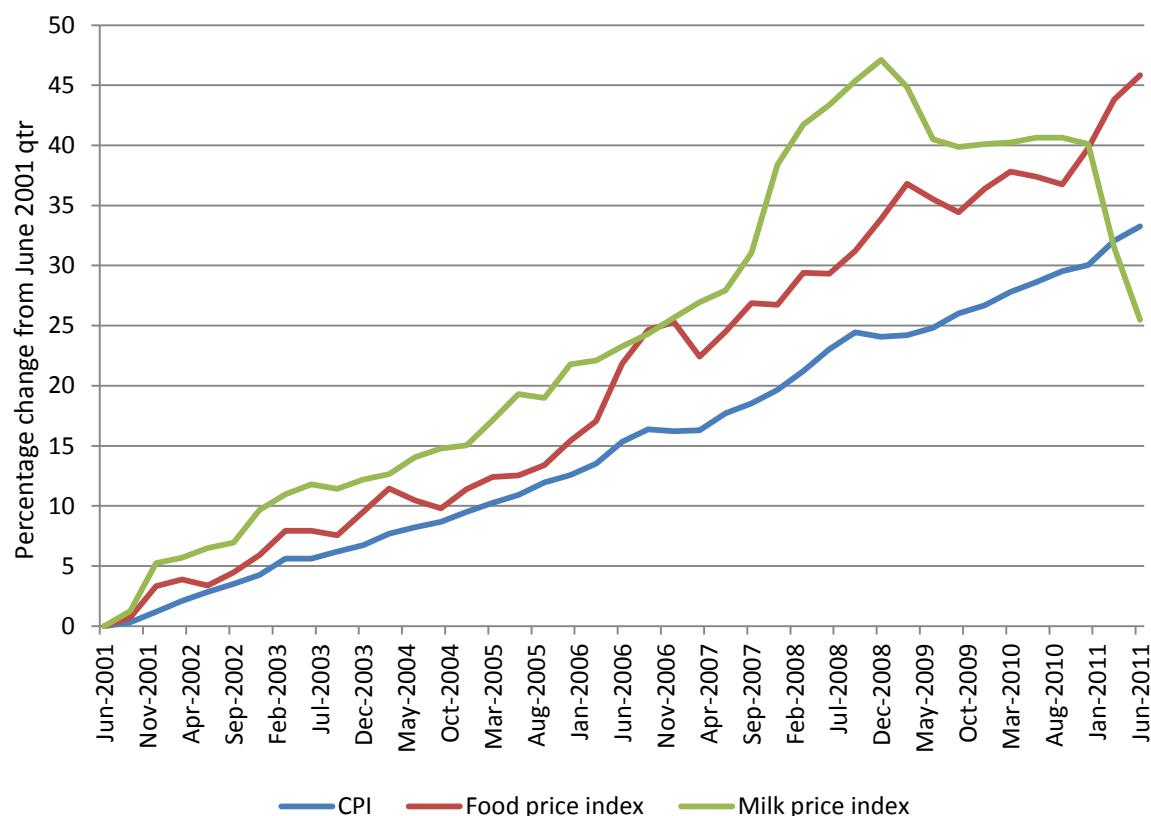
In an era of food price inflation, sadly exacerbated by recent natural tragedies and disasters, this represents a significant saving to individuals and consumers across Australia. This is particularly true for those on lower incomes, who spend a higher proportion of their income on food.¹²

4.26 The Australian Bureau of Statistics' data clearly shows a significant decrease in its milk price index since the January 2011 pricing decisions.

11 Lion Dairy & Drinks, *Submission 159*, p. 8.

12 Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry: Second Interim Report*, May 2011, pp. 13–14.

Figure 4.10: Percentage changes in the consumer price index, food price index and milk price index compared to June 2001 levels (weighted average of capital cities)



Notes:

- (1) This chart plots the percentage changes in the CPI, food price index and milk price index using their June 2011 quarter levels as the base. Changes are measured against the immediately preceding quarter, not the corresponding quarter from the previous year.
- (2) The chart aims to provide a limited graphical representation of the January 2011 price cuts only—there are limitations on long-term comparisons of CPI or other retail data. See www.abs.gov.au.
- (3) The Dairy Adjustment Levy—an 11 cent levy imposed on milk to fund a deregulation restructure package—was in place from 2000 to February 2009.

Source: Australian Bureau of Statistics, *cat. 6401.0 – Consumer Price Index, Australia, June 2011*.

4.27 This provides a simple representation of the immediate gains to consumers in terms of lower prices, and as noted in the *Second Interim Report*, is a benefit that should not be dismissed lightly. At the same time, however, the size of the drop lends support to arguments presented to the committee that the price cuts led by Coles could devalue milk as a product and threaten the sustainability of the industry, meaning that milk could become more expensive in the longer-term.

4.28 Accordingly, the longer-term impacts on consumer welfare need to be considered. Treasury recognised this point when discussing the sustainability of the industry and consumer preferences:

... consumer welfare also goes beyond simply the short-term price that is available to consumers in the market at a given point in time ... If consumer preferences are that there is fresh drinking milk available for them to purchase, then a well-functioning market will deliver that product, hopefully efficiently and at an efficient price.¹³

4.29 Of course, an assessment of changes to overall consumer welfare (limited to supermarket prices) also needs to take into account whether other prices have changed significantly. Associate Professor Frank Zumbo raised this query:

If Coles are reducing the price of home brand milk, what are Coles doing to the prices of other products in the supermarket? We have been told publicly by Coles that they have lowered or are expecting to lower upwards of 5,000 items. However, there are upwards of 20,000 products or more at a Coles supermarket. The real question is: what is happening to the other 15,000 products? Are the prices of those other 15,000 products going up? In other words, if the price cuts to home brand milk are being offset by higher grocery prices elsewhere in the supermarket then consumers will be worse off. We cannot look at the reduction in the home brand milk price in isolation from what Coles may be doing in relation to other products.¹⁴

4.30 In evidence to the committee, Coles estimated that consumers have saved approximately \$175 million as a result of lower milk prices. Coles also provided some detail about price movements on other products they sell:

We can confirm that Coles has reduced prices by more than 10 percent on over 6,000 products over the last 12 months. There have been some price increases on fresh produce as a result of Cyclone Yasi in Queensland and the east coast floods earlier this year and higher input costs for manufacturers of branded grocery products but there has still been net grocery price deflation in our stores over the last 12 months because of Coles' investment in lower prices.¹⁵

Consumer perception regarding the value of milk

4.31 The impact on the value of the dairy supply chain as a result of the price cuts was also considered in terms of the long-term perception of milk as a product. The DFMC explained:

They are buying very strongly, they are selling at cost, they are loss leading in regions, they are damaging milk value on the shelf and to a degree they are damaging the milk value of their partners, the processors who supply

13 Mr Brad Archer, Department of the Treasury, *Committee Hansard*, 10 March 2011, p. 12.

14 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 49.

15 Coles, *Submission 131A*, p. 2.

them and rely on branded milk to extract an average price from the market.¹⁶

4.32 The Australian Food and Grocery Council (AFGC) described the consequences this may have on the price consumers are willing to pay:

Consistent discounting of product eventually results in a "resetting" of the worth of the product in the mind of consumers. Consumers equate the discounted price with the real value of the product and will only buy the product when the price is discounted. If the discounted price is below production price the situation is clearly unsustainable unless significant changes can be made in cost structures within the business.¹⁷

4.33 A number of comparisons were made about the price of other products sold by the major supermarkets, such as bottled water and soft drinks, and the result this could have on the perceived value of drinking milk.

I would just say ... that a dollar does not sound like enough for the amount of the work that goes into producing a litre of milk when you see that a litre of water is \$1.25—or it was yesterday when I looked. It is much easier to produce.¹⁸

Senator XENOPHON—... aren't you actually devaluing the product? As Senator Heffernan says, you are flogging off milk less than bottled water. How is that not devaluing a consumer product?

Mr McEntee—There is no doubt that, when you take the sell price of private label milk from where it was to where it is today, the value at sell point has been devalued. At this point in time, that has not reflected back to the cost price because our cost prices are locked in.

Senator XENOPHON—At this point in time. But inevitably it will, won't it?

Mr McEntee—We agree, and we have been open on our concerns of that.¹⁹

Impact on consumer choice

4.34 As noted in the committee's *Second Interim Report*, some witnesses and submitters suggested the increasing shift in sales from branded products to the supermarkets' private label product is likely to result in negative consequences for consumer choice in the long-term. The AFGC suggested, in a broad sense:

16 Mr Ian Zandstra, Chairman, Dairy Farmers Milk Co-operative, *Committee Hansard*, 8 March 2011, p. 67.

17 Australian Food and Grocery Council, *Submission 100*, p. 7.

18 Mr Francis Davis, Chairman, Warrnambool Cheese and Butter Factory, *Committee Hansard*, 8 March 2011, p. 102.

19 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 19.

... if the Australian food (and grocery) manufacturing base is eroded, so too is the capacity of companies to invest and innovate in such areas as new, healthier and more sustainably-produced goods.²⁰

4.35 For the dairy industry specifically, the future ability for processors to develop modified products was questioned:

For processors it is difficult to differentiate regular white milk in the market place. Processors have moved more to the modified milk products with different fat and taste profiles, added nutrients and levels of functionality for consumers. Processors have been able to capture the benefits of this innovation with more sustainable margins for their branded product, which in turn has supported category development. However, the latest round of retailer price cuts have targeted at this modified milk market segment, and initially reports have presented that processor modified milk brands have lost a significant amount of market share to the heavily discounted supermarket 'store brand' modified milk.²¹

4.36 It may be the case that some modified products which appear more substantially different to the products in the limited private label milk range have increased their sales since the price cuts in the plain products were introduced. For example, it has been reported that sales of a2 Milk, a niche modified milk product, have increased significantly since the price cuts began.²² It has also been reported that sales of Sungold have bucked the trend of branded products decreasing their share of overall sales.²³

4.37 The committee also noted in its *Second Interim Report* the arguments put to it that a possible long-term result if the price discounting is maintained could be a shift towards increased ultra high temperature (UHT) treated milk consumption or UHT milk being the only milk product available in some regions.

4.38 Such an outcome would be of concern, although it is difficult to predict whether it could occur in Australia. It is also difficult to draw meaningful conclusions from international experience. The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) advised the committee that in Europe the percentage consumption of UHT milk compared to fresh milk appears to vary widely—for example, it is estimated that 95 per cent of drinking milk consumed in France is UHT milk compared to less than 10 per cent in the UK. However:

There was a tendency for those markets with a high level of per capita consumption of milk to also have a very low consumption of UHT milk.

20 Australian Food and Grocery Council, *Submission 100*, p. 4.

21 Queensland Dairyfarmers' Organisation, *Submission 94*, p. 5.

22 Jared Lynch, 'Profit in milking health benefits', *The Age*, 17 August 2011; *Weekly Times Now*, 'a2 milk sales rise', 28 April 2011, www.weeklytimesnow.com.au (accessed 22 August 2011).

23 Steve Hynes, 'Rising Sungold: Plant expands to meet demand for WCB's milk', *Warrnambool Standard*, 14 July 2011, p. 1 (On the Land); attachment to Coles, *Submission 131A*.

Countries like Finland, Sweden, Ireland, the Netherlands, Norway and United Kingdom all have relatively high levels of per capita milk consumption and also very low levels—below 20 per cent—consumption of UHT milk.²⁴

4.39 It was also argued that if consumers valued fresh milk they would continue to express this value by paying for it:

There is some degree of consumer sovereignty here and consumers can exercise choice.²⁵

Smaller retailers, convenience stores, petrol retailers and vendors

4.40 One of the key issues in this inquiry was the effect that the price cuts, if sustained, would have on the ability of the smaller competitors of Coles and Woolworths to compete in both the short and long-term. These concerns were shared by a range of businesses, including those that compete directly with the major supermarkets for end consumers—such as independent supermarkets, convenience stores, petrol station organisations—and businesses that work to supply others, such as milk vendors. The committee received a considerable number of submissions raising concerns about the possible effects of \$1 per litre private label milk.

4.41 The impact on milk vendors was an issue raised throughout the inquiry. An operator of an independent supermarket in South Australia informed the committee about the early impact on milk vendors:

I have spoken to our milk vendor. When Woolworths went direct with their milk deliveries, he lost 20 per cent of his volume of milk so he has had to get back on his feet. With this new price war with Coles and Woolworths—mainly Coles—he has lost 15 per cent of his business again in major centres where the snack shops are not buying from him but are going direct to Coles.²⁶

4.42 Early shifts in sales from smaller stores to the major supermarkets were observed by some witnesses:

What we are seeing now, with such a difference in price, is that they are going out of their way to go to a supermarket to pick it up. The volume of smaller shops—newsagents, mum-and-dad corner stores—has been reduced

24 Mr Paul Morris, Deputy Executive Director, Australian Bureau of Agricultural and Resource Economics and Sciences, *Committee Hansard*, 10 March 2011, p. 20. Mr Morris prefaced his remarks by noting that this information was compiled at short notice in response to evidence given during the hearing conducted the previous day, and the reliability of the information may be affected as a result.

25 Mr Brad Archer, Department of the Treasury, *Committee Hansard*, 10 March 2011, p. 17.

26 Mr David Reynolds, Owner-Operator, Yentrac, trading as Goolwa Foodland, *Committee Hansard*, 8 March 2011, p. 47.

by up to 20 or 30 per cent because people are not shopping there; they are shopping at Coles or Woolies.²⁷

In relation to what they call the convenience sector, which is everything below supermarkets—so it is your delis, your snack bars, your convenience outlets—the information I have from our major supplier is that that sector was down 16 per cent in February as a direct result of what is happening with the milk discounting. So the small business area will be suffering due to that.²⁸

4.43 The added impact of the milk price cuts in the context of other pressures and the sustainability of competition in the grocery market was also noted:

... we have been hit on one product after the other. Long term the retailer will decide whether he can better invest his money in the share market or somewhere else rather than get the low return he is getting. Clearly, in the last couple of years the return has diminished.²⁹

4.44 Some convenience store operators noted that, because Coles is also selling low price milk at its Coles Express outlets, other promotions and discounts it offers in these businesses and their effect on competitors in that market need to be considered. APCO Service Stations called attention to the Coles Express discounts on petrol offered on convenience store sales which meant:

... you can walk into any of the 620 Coles Express service stations and pick up an additional 2 cents per litre (over and above the 4 cent supermarket docket by spending \$2 or more in the shop) just by purchasing the Coles generic milk which is already below cost to all small businesses. An additional 2 cents per litre on an average purchase of 35 litres equates to a low of \$1.30 for the 2 litre generic milk bottle. No competitor can survive this predatory behaviour; combining the Coles Supermarket chain with 620 Coles Express service station sites (or satellite Coles Supermarket stores) across Australia.³⁰

4.45 Coles refuted claims that their actions were aimed to drive smaller competitors such as convenience stores out of business, arguing that:

... many customers prefer branded milk and they prefer to pay for the convenience of buying branded milk in corner stores, as they do for tobacco and other convenience based products. I have worked in the supermarket industry for 30 years in the UK and Europe in different countries and I can say that I cannot see a future without corner stores. Supermarkets may be

27 Mr Colin Lawson, Manager, Industry Relations, Amalgamated Milk Vendors Association, *Committee Hansard*, 9 March 2011, p. 79.

28 Mr Russell Markham, Chief Executive Officer, Foodland Supermarkets, *Committee Hansard*, 8 March 2011, p. 51.

29 Mr Russell Markham, Chief Executive Officer, Foodland Supermarkets, *Committee Hansard*, 8 March 2011, p. 50.

30 APCO Service Stations, *Submission 33*, p. 1.

able to compete on price but they cannot compete with the absolute convenience of location. In fact, research shows that the number of convenience stores in Australia has grown by 49 per cent in the last decade.³¹

4.46 Continuing with the example of the United Kingdom, although it has a concentrated supermarket sector, convenience stores can still be successful:

As well as the growth in the supermarket sector, consumers are also using convenience stores on a more regular basis with more than 75% of adults using them at least once a week. Convenience stores are often used for 'top up' shopping for products such as milk and bread.³²

4.47 The degree of the price difference between the supermarkets' private label milk and the price for which branded milk could be sustainably sold at convenience stores, however, is considered to significantly deter convenience store purchases:

People will not pay \$2 more. I think it is also important to remember that by breaking that, by having a scenario where people will not pay the difference, it is not just processors and farmers that suffer. It is all of those milk vendors, corner stores, convenience stores that rely on people saying, 'I'll just pop in and buy the milk', or 'I'll get my petrol and get some milk'. That is a huge part of their business. When there is a big gap, when people say, 'Yes, but it is so much cheaper if I go to the supermarket. I won't buy it anymore', it has a huge potential to flow on through that small business convenience store market.³³

4.48 Lion Dairy & Drinks also warned about the possible impact of continued increases in supermarket sales at the expense of non-grocery retailers on the ability to supply non-grocery stores in the future:

If fresh white milk sales through [the non-grocery] channel continue to decline as a result of sales transfers into the grocery channel, it will become increasingly uneconomic for the cold chain distribution system to service these small regional retail outlets.³⁴

Committee comment

4.49 The committee gives particular weight to the evidence available regarding the gains enjoyed by consumers who purchase milk as a result of the price contests between Coles and its competitors.

31 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, p. 37.

32 Dairy UK, *The White Paper: A report on the UK dairy industry*, June 2010, p. 31.

33 Mrs Kate Carnell, Chief Executive Officer, Australian Food and Grocery Council, *Committee Hansard*, 10 March 2011, pp. 37–38.

34 Lion Dairy & Drinks, *Submission 159*, p. 7.

4.50 While claims about the possible long-term broad impact on consumer welfare that a permanent shift to private label milk will have may have merit, it is difficult to set aside the clear benefits to consumers gained by lower prices.

4.51 Further, as they have increased in quality and reputation over recent years, it is clear that consumption of the supermarkets' private label products in general has been increasing. Given the lack of differentiation between private label and branded milk, it seems milk is a particularly likely target for private label growth. It may be the case that, while the January 2011 price cuts led by Coles have brought forward this event, the shift in consumption towards private label milk is a market adjustment that was inevitable.

4.52 Given the difficulties the independent supermarkets and smaller retailers have in competing with the purchasing power of Coles and Woolworths, as well as other challenges they face, the committee is concerned about the long-term future of these smaller retailers, and the effect that any weakening of this sector of the grocery market will have on competition in the long-run. The committee kept these issues in mind, where they proved relevant, when considering other aspects of this inquiry, as discussed later in this report.

Chapter 5

Impact of the retail price cuts at the farm gate

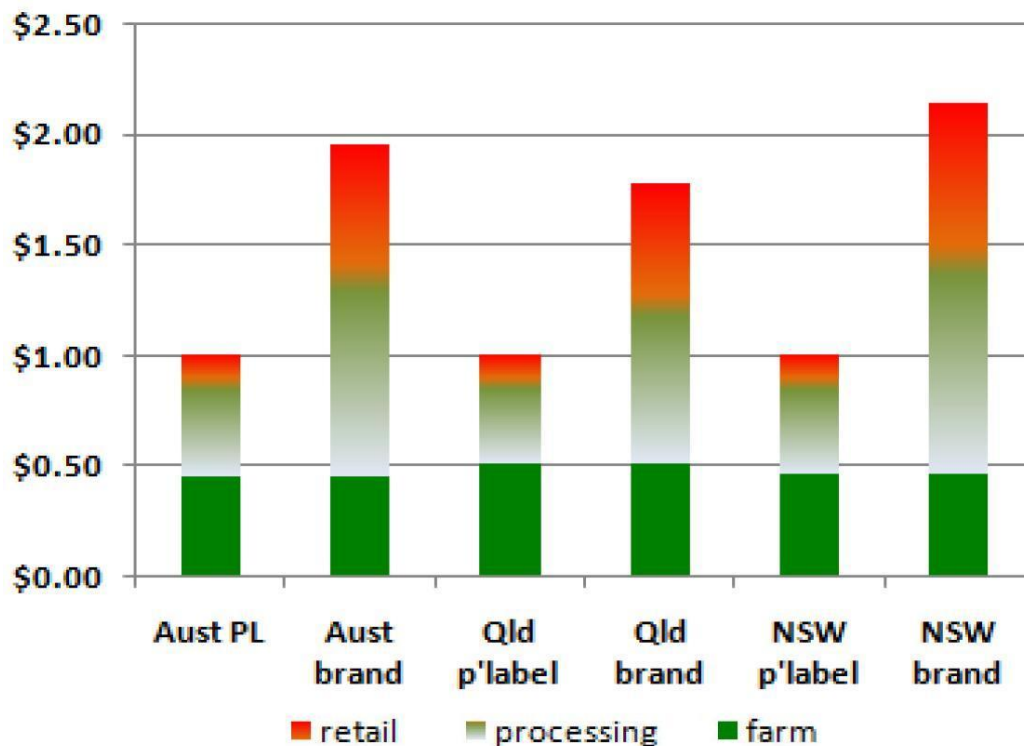
5.1 This chapter addresses the second question posed by the committee in its *Second Interim Report*; namely, the impact of the supermarkets' price decisions on the outcome of renegotiated contracts with the processors and farm gate prices. In so doing, the chapter examines the nature of the processors' pricing structures, the contract negotiation process and the outcomes of renegotiations (or other factors which have affected the incomes dairy farmers receive) since the price cuts were introduced.

Impact on processors and possible flow on effects

5.2 Processors that hold contracts for private label milk balance the low or negative returns they receive from those products with higher returns from their other branded sales. As discussed in chapter 3, this is done for a variety of reasons, including volume management and business stability considerations.

5.3 Figure 5.1 below provides an indicative picture of how the full retail price paid by consumers for private label and branded milk is distributed among the participants in the supply chain.

Figure 5.1: Components of the retail price of milk, brands v private label (March 2011)



Note: As contracts between retailers and processors are generally commercial-in-confidence but farm gate prices are public, the chart reflects some uncertainty about the actual share of revenue received by retailers and processors.

Source: Freshlogic; published in Dairy Australia, *Northern Dairy Industry Regional Industry Outlook—Update: June 2011*, p. 8.

5.4 One aspect that is clear from Figure 5.1 is that an increased shift to private label milk at the expense of the branded milk will have significant implications for the revenue received by processors. As noted in chapter 3, there is very little difference between private plain white milk and branded plain white milk in terms of quality and other specifications. Accordingly, any extra costs involved should be attributable to factors like marketing and the need to distribute the products to a larger number of smaller, dispersed buyers.

5.5 The exact size of these additional costs is unclear. The National Association of Retail Grocers of Australia (NARGA) suggested that for a two litre bottle of milk in Western Australia, the difference in the cost of distributing private label milk to Coles versus branded milk to independent stores is about six cents. NARGA also estimated that the marketing component of branded milk equated to about seven cents for a two litre bottle. This results in a differentiation of 13 cents for the processor to provide branded milk compared to private label, yet the wholesale price paid by a smaller store is significantly higher than that paid by the major supermarkets. NARGA concluded:

It is the same product but there is a \$2 difference in cost to the small retailer versus to Coles, and the only extra cost of that processor selling to the smaller store is the ... distribution and marketing costs. We have been saying for some time that the only way that the processors can continue to supply cheaper house-brand or generic milk to both Coles and Woolworths is to recoup that margin that they lose on the supply of the product by the sale to other customers. It is clearly happening in this case.¹

... We have also been saying for some time that we believe we have been seeing the waterbedding effect in the dairy sector in Australia where you have got high prices for ice-cream and yoghurt. Again, I would assume that the processor is recouping margin out of that.²

5.6 If the new prices for private label milk are maintained and the market share of private label milk continues to grow, the business model of offsetting low, nil or negative returns on private label milk with higher returns on branded milk and other products could result in significant pressure on the processor.

1 Mr John Cummings, Chairman, National Association of Retail Grocers of Australia, *Committee Hansard*, 9 March 2011, p. 2.

2 Mr John Cummings, Chairman, National Association of Retail Grocers of Australia, *Committee Hansard*, 9 March 2011, p. 4.

5.7 As noted in chapter 3, Lion Dairy & Drinks has advised the committee that their return on private label milk is now expected to be negative.³ For the most part, this appears to be an outcome that is a consequence of the processors' business models and their decisions to supply private label milk in the first place. The ACCC warned about arguments focused on the impact of private label milk on branded products, noting that many of them appeared to originate from 'very well-heeled vested interests':

... our main concern is with the farmers on the one hand and with consumers on the other, because they are the smaller parties in all this. But some of the arguments that are being mounted have little to do with the farmers or consumers; they have a lot more to do with the position of the processors.⁴

5.8 Nevertheless, the degree to which any losses suffered by the processors are passed onto farmers remains a key concern.

Contracts between farmers and processors

5.9 Lion Dairy & Drinks (formerly National Foods) advised that, generally, their contracts with farmers are for a minimum of one year, with a number of two and three year contracts also offered.⁵

5.10 These timeframes generally do not necessarily align with the contracts the processors have with the supermarkets. Woolworths advised that their contracts are for either 12 or 24 months, whereas the majority of Coles' are for three years.⁶ The interaction between the contracts the processors have with dairy farmers and those with the major supermarkets was explained by Lion:

For farmers, the pressures arise because they must make investment decisions about the size and composition of their herds and the nature of their plant and equipment. Those decisions necessitate a longer term investment horizon and exposure to ongoing fixed costs. Consequently, farmers look to the processors to provide guaranteed cash flows over the farmers' investment horizons. However, the processors are not able to commit to supply arrangements with farmers until the processors have finalised their contracts for house brand volumes with the supermarkets.⁷

3 Lion Dairy & Drinks, *Submission 159*, p. 4.

4 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 30.

5 Mr Peter Walsh, Manager, Government Relations, National Foods, *Committee Hansard*, 9 March 2011, p. 66.

6 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 3; Mr John Durkan, Merchandise Director, Coles, *Committee Hansard*, 29 March 2011, p. 43.

7 National Foods, *Submission 97*, p. 17.

5.11 Changes to the contract arrangements between the major supermarkets and the processors can cause significant uncertainty and unease. For example, the holder of Woolworths' private label contract for New South Wales recently changed from Lion to Parmalat. This change triggered significant concern from the Dairy Farmers Milk Co-operative (DFMC), suppliers to Lion:

We had been hopeful Parmalat would come to an agreement with Lion to continue to source milk through DFMC. This would have created stability and certainty in the NSW market. However, we have been informed the negotiations between Lion and Parmalat have broken down. We continue to push for these negotiations to recommence but in the meantime we understand Parmalat will now be out in the market trying to convince NSW dairy farmers to supply them directly without the support and assurance of working through a Co-operative. Potentially, Parmalat could also begin drawing on milk supplies in Victoria and bringing it into NSW.⁸

Volume and pricing arrangements

5.12 Lion Dairy & Drinks and Parmalat are the major players in drinking milk processing. At the time of this inquiry, both Lion and Parmalat utilised a multi-tier pricing structure in their contracts, however, the milk that is allocated to each tier, and the variation in the prices between each tier, differ. Clover Hill Dairies described how it supplies National Foods, through the DFMC:

The current practice is for ... [Lion] ... to announce what is known as an Anticipated Full Demand (AFD) to DFMC. For DFMC to meet their obligations under the AFD system our regional dairy farmers are allocated milk allotments akin to quota and sell this milk to DFMC at an announced price. This milk price is known as Tier 1 milk. Farmer suppliers who produce above their allotment or do not hold an allotment receive a lower price which is currently close to 50% of the price of Tier 1 allotment milk. This milk is known as Tier 2 milk ... A secondary processor to processor milk markets occurs for Tier 2 milk. There is no transparency at farmer level as to what Tier 2 milk is being sold to other processors for.⁹

5.13 The Queensland Dairyfarmers' Organisation explained:

Tier 1 milk, under the Lion payment scheme, includes all milk sold by Lion as bottled fresh milk including both processor proprietary branded milk and supermarket store brand milk.¹⁰

5.14 Parmalat appears to pay different prices for drinking milk and manufacturing milk, except for the drinking milk which goes into the supermarkets' private label

8 Dairy Farmers Milk Co-operative, *Letter to suppliers*, 1 August 2011, www.dfmc.org.au/docs/Letter%20to%20Suppliers%20re%20Parmalat%20and%20Woolworths%20Milk%20Offtake.pdf (accessed 23 August 2011).

9 Clover Hill Dairies, *Submission 53*, p. 2.

10 Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 20.

products, which is bought at the lower price. While Parmalat also utilises a two-tier pricing system, unlike the Lion/National Foods model, its tiers are linked to specific end products, and the price of the top tier can vary month-by-month, depending on retail sales:¹¹

There is a group of farmers in Queensland who actually have an arrangement with their company where they get a certain percentage of their cheque from branded sales and then other. With a reduction in branded sales those farmers are expecting to see a cut in part of their margin this year. We do believe that there may be an anomaly in that because of the drop in production in Queensland. So the cents per litre figure might not necessarily change, but the total volume of the branded sales will change. We hope to be able to verify that when we see the milk cheques.¹²

5.15 The operation of Parmalat's Pauls Daily Access Scheme (PDA) was explained in detail in evidence received by the committee:

The PDA scheme only relates to total PAULS branded milk sales and each farmer in the PDA scheme has an allocated daily milk supply volume under the PDA. PDA dairy farmers can trade PDA volume among themselves according to how much milk they calculated they would want to supply in the coming year.

Parmalat pays a higher price for this PDA (or tier 1 milk) but if the farmer failed to supply the PDA amount across the month as specified by the amount of PDA they held, then penalties would apply. All milk supplied over the allocated PDA amount would be collected but paid at a lower manufactured (or tier 2) price. Currently the average base price for PDA milk is approximately 58 cents per litre.

If Parmalat's PAULS branded milk sales do not reach the total PDA level in the state, then farmers are only paid the percentage that sales were of the total state PDA amount. The rest of the farmer's milk supply would attract the lower manufactured (or tier 2) price, which is currently approximately 44 cents per litre.¹³

Relationship between the January 2011 price cuts, farm gate prices and contract arrangements

5.16 What overall impact have the pricing decisions had on farmers' incomes? Conflicting claims were put forward on this issue. The Australian Dairy Farmers provided the results of modelling undertaken based on current trends being extrapolated for the rest of 2011. One scenario suggested the overall supply chain

11 Mr Brian Tessmann, President, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 89.

12 Mr Adrian Drury, Vice President, Australian Dairy Farmers, *Committee Hansard*, 8 March 2011, p. 11.

13 Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 18.

would be devalued by \$28 million, the other as much as \$227 million. The Australian Dairy Farmers commented:

A loss of \$44 million from the value chain due to the shift to private label (home brand) products as outlined in scenario one would lead to a drop of 2 cents per litre in the farmgate price. For the vast majority of northern NSW and Queensland dairy farmers this would result in the loss of any profit margin on their milk.¹⁴

5.17 Coles considers that:

... conditions for the dairy industry as a whole have improved, with steady to rising farm gate prices by all milk processors so far for the FY12 season. Predictions of imminent and severe reductions in farm gate prices as a direct result of the Coles retail milk price reductions in January 2011 have simply not occurred.¹⁵

5.18 The overall picture for farm gate prices since January highlights the split in the Australian dairy industry between the regions which produce largely for manufacturing and export, and those that produce to satisfy domestic demand for drinking milk.

5.19 The state of the manufacturing milk regions, particularly for farmers in Victoria, appears relatively solid compared to recent years. Murray Goulburn, the price leader for the southern manufacturing areas, recently announced an opening price for the 2011–12 season which equated to a weighted average of \$4.90 per kilogram of milk solids. It also forecast a final price of between \$5.30 and \$5.50.¹⁶

5.20 Dairy Australia considers that for the manufacturing regions:

Improved milk prices, combined with low grain prices and generally favourable seasonal conditions have provided southern farmers with the best production conditions for more than a decade. In some regions, the excessively wet conditions have actually curtailed feed production and herd productivity.¹⁷

5.21 Dairy Australia qualifies this assessment by noting:

While cashflows have generally improved, this has merely enabled many producers to restore their financial positions following the shocks of the previous two seasons, and the finance sector is also now generally operating with much tighter controls on debt exposures.¹⁸

14 Australian Dairy Farmers, *Submission 150B*, p. 15.

15 Coles, *Submission 131A*, p. 3.

16 Murray Goulburn, 'Murray Goulburn Co-Operative forecasts solid farmgate returns as it releases opening prices to its dairy farmer supplier-shareholders', *Media release*, 29 June 2011. Opening prices can be increased through 'step-ups' throughout the year.

17 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 3.

18 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 3.

5.22 Other developments, such as Coles' announcement that Bega will now produce its entire private label cheese range (half of which was previously imported from New Zealand), are welcomed by the committee and will be a boost to the southern manufacturing regions. However, it is unlikely to offer any comfort to farmers in the drinking milk production focused areas.¹⁹

5.23 For the drinking milk focused-states, whether the impact of the retail price cuts in private label milk would be felt by farmers immediately, or after some delay when their contracts are renegotiated, appears to depend on whether a farm ultimately supplies Parmalat or Lion (or another processor).

5.24 Lion hinted at what the future may bring:

... the nature of our procurement with our farmer base is through longer term contractual arrangements and the impact of a sustained discounting arrangement that is beneath what last year we were saying was an unsustainable price will only be fully felt by the suppliers that supply milk to us when those contractual arrangements fall due.²⁰

5.25 Any assessment is also complicated by other factors. For instance the uncertainty and disruption caused by changes to the private label contract arrangements in New South Wales noted earlier may also be contributing to pricing outcomes.

5.26 Without dismissing the extent or overlooking difficulties faced by farmers in other areas of the country, developments in three states—Queensland, New South Wales and Western Australia—have been particularly noteworthy.

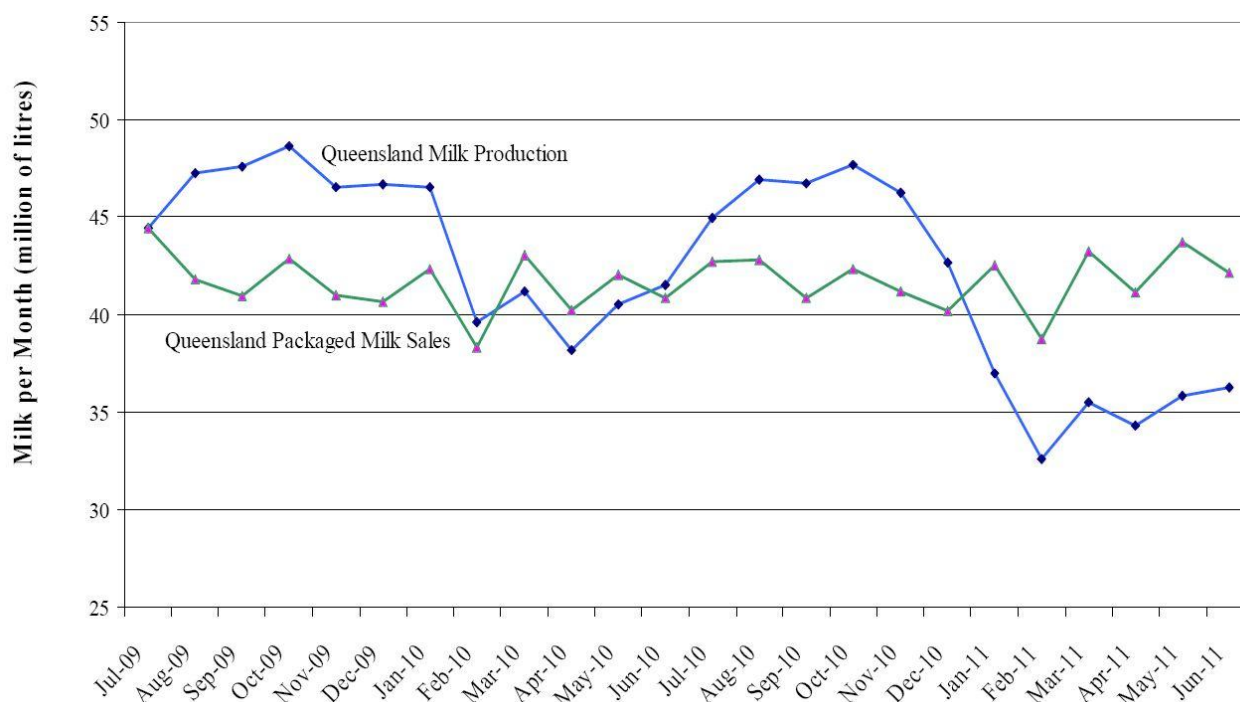
Queensland

5.27 Dairy farmers in Queensland have had a difficult 12 months, with the floods presenting particular challenges for the industry. In the last year, 40 dairy farmers have left the industry in Queensland.²¹ As shown by Figure 5.2, since January 2011 milk production has not met the amount demanded for domestic consumption within the state.

19 Coles, *Submission 131A*, p. 5. Coles submits that Bega will need to source an additional 70 million litres of milk from southern NSW and Victoria to fulfil the deal, and that it will add \$30 million to the industry.

20 Mr Peter Walsh, Manager, Government Relations, National Foods, *Committee Hansard*, 9 March 2011, p. 72.

21 Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 23.

Figure 5.2: Queensland milk production v packaged milk sales

Source: Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 24; from Dairy Australia data.

5.28 Early in the committee's inquiry, it became clear that some of the contractual arrangements in place meant that certain Queensland farmers could be immediately impacted by any changes at the retail end of the supply chain:

... farmers whose milk payments are linked to branded milk sales will see a reduction in their milk cheques. For some this may be as early as mid-March.²²

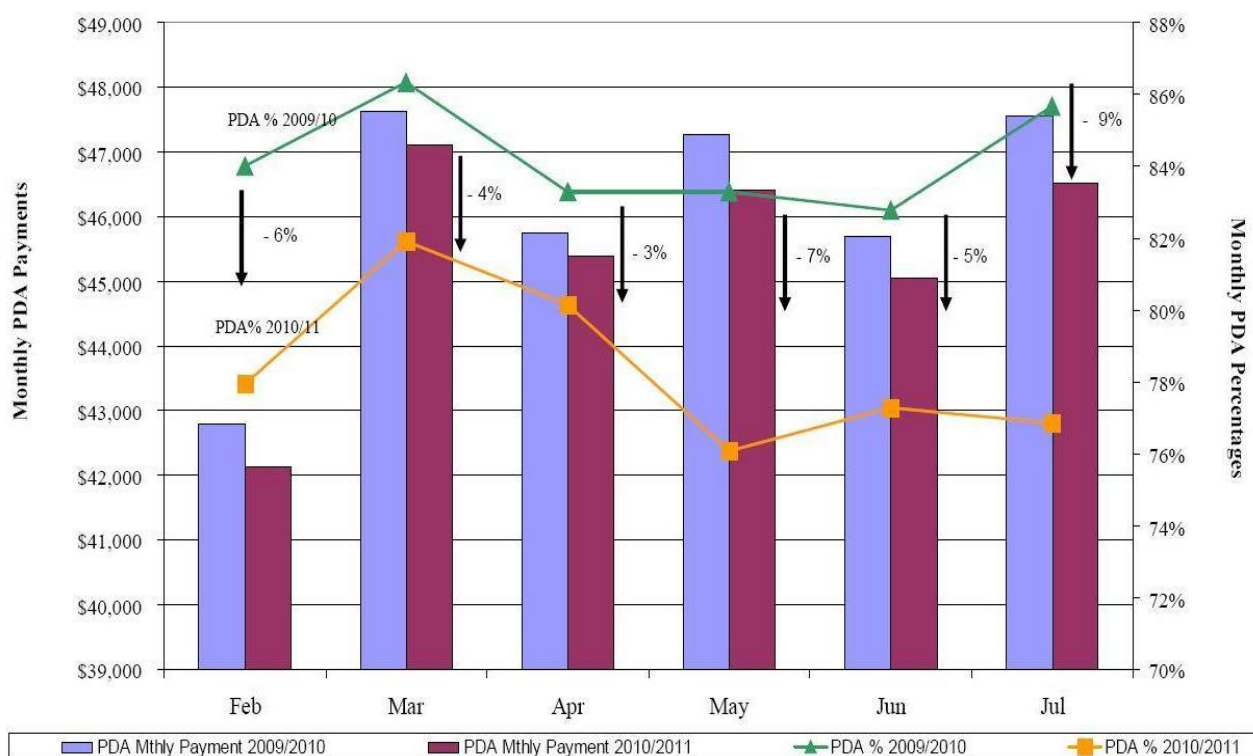
5.29 The implications of the monthly variation built into Parmalat's contract arrangements, and the ease in which shocks would promptly impact farm incomes was explained in detail to the committee:

With the PDA, Pauls Daily Access, system with Parmalat you get paid your tier 1 each month—your higher priced milk—as a percentage of what is basically your PDA quota. There are two figures that are important in calculating the payment: the actual sales figures and then what they have sold outside the area to bolster up another milk pool in Central Queensland. In February last year the initial figure of sales percentage was 84.23 per cent, which was then bolstered up to 88.8 with what they were selling just outside the region. In November it was 84.59. That is the bolstered-up figure; the original figure was 82.85. But when you come to February 2011 the initial figure is 77.9, so the amount that they get paid their better price

22 Mr Christopher Griffin, Vice President, Australian Dairy Farmers, *Committee Hansard*, 8 March 2011, pp. 2–3.

for has come down significantly. The bolstered-up figure is 80.89. That shows already a significant drop off, even since September. Particularly when you compare month on month with a year ago—because months do vary, normally—that is a significant fall, down from the base figure in southeast Queensland of 84.23 to 77.94. To a dairy farmer that is a significant drop in his income for that month.²³

Figure 5.3: Pauls Daily Access one million litre dairy farm monthly returns and percentages, February to July 2009–10 compared to 2010–11



Source: Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 19.

5.30 The Queensland Dairyfarmers' Organisation estimates that one group of 185 producers who supply Parmalat have lost about \$767,000 up to July 2011 as a result of the private label discounting. They further estimate that this would total \$1.5 million for the entire year if the sales trend continues.²⁴

5.31 It appears that farmers who supply Lion Dairy & Drinks in Queensland are also facing lower incomes as the renegotiated contracts for 2011–12 yielded a real decrease in their prices. Table 5.1 shows the prices paid by Lion Dairy & Drinks (formerly National Foods) for the 2010–11 year announced at the end of July, compared to their 2010–11 prices. On these figures, Australian Dairy Farmers

²³ Mr Brian Tessman, President, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 84.

²⁴ Australian Dairy Farmers, *Submission 150B*, p. 8.

commented 'it is worth noting the annual inflation rate in Australia to June 2011 was 3.6 per cent'.²⁵

Table 5.1: Outcome of Lion Dairy & Drinks 2011–12 prices in Queensland

	2011–12	2010–11	% change
<i>Tableland</i>			
Tier 1	\$0.48	\$0.47	+2.13
Tier 2	\$0.33	\$0.33	-
<i>SE Queensland</i>			
Tier 1	\$0.475	\$0.47	+1.06
Tier 2*	\$0.35	\$0.28	+25.00

* Australian Dairy Farmers submitted that Tier 2 milk is used for manufacturing dairy products and has increased in price in Southern Queensland due to higher demand in the market place.

Source: Australian Dairy Farmers, *Submission 150B*, p. 9.

5.32 The Queensland Dairyfarmers' Organisation argued:

... with higher margin processor proprietary branded milk losing market share to supermarket store brand milk with little or no margin, the overall return from the sale of Tier 1 milk by Lion has declined. Consequently Lion's ability to improve farm gate prices has been undermined directly by the current supermarket price war.²⁶

5.33 Although Coles contend:

Coles fully funded lower retail milk prices and substantially increased contract payments to its major milk processors in Queensland in January 2011. The payments to our milk processor suppliers were sufficient to offset any impact on their margins from the expected shift from branded to private label milk. As a result, there should not have been any impact on farm gate returns as a direct result of Coles' pricing initiatives. Coles' position is supported by the fact that farm gate prices offered to dairy farmers in southern Queensland and far north Queensland have been broadly steady or increased for the FY12 season.²⁷

New South Wales

5.34 Dairy farmers in New South Wales have also faced some specific challenges recently as a result of changes to private label contract arrangements. As noted in

25 Australian Dairy Farmers, *Submission 150B*, p. 9.

26 Queensland Dairyfarmers' Organisation, *Submission 94B*, p. 20.

27 Coles, *Submission 131A*, pp. 7–8.

chapter 3 and at paragraph 5.11, Parmalat recently gained the contract previously held by National Foods to supply stores in New South Wales. Given the volume associated with private label contracts, this change caused significant uncertainty for producers in the state. Negotiations over farmers' contracts as Parmalat attempts to source supply to fulfil its new contract have also been difficult. The Australian Dairy Farmers submits:

ADF understands that in New South Wales farmers are being asked, following initial discussions in the week of 22-26 August, to take a drop in farmgate price of 3-4 cents per litre for new contracts with a major processor, Parmalat ... This issue is directly related to the unsustainable pricing of milk at \$1 per litre. At this price there is fundamentally not enough money in the value chain to ensure a sustainable return to dairy farming families. It should also be noted that this follows a drop of more than 10% in milk prices across the board to farmers in New South Wales last year.²⁸

5.35 The NSW Farmers' Association pointed out that, for a farm producing one million litres a year, a two cent decrease in price per litre represents about \$20,000 lost income. It also noted:

Short term changes in contractual supply with processors is putting dairy farmers very business at risk as they cannot turn the milk tap on and off at a whim.²⁹

Western Australia

5.36 The Western Australian dairy industry has faced challenges and uncertainty for some time, with events such as the collapse of Challenge Dairy in late 2010 compounding matters.

5.37 The committee was advised that in Western Australia, the farm gate price announced by Lion for the 2011–12 season was 41 cpl, compared to 42.04 cpl the previous year. The committee was also advised that for Harvey Fresh suppliers, their price increased by approximately 1.3 per cent (less than inflation) to about 39.2 cpl.³⁰

5.38 The operators of a dairy farm located in the south west of Western Australia advised they had been informed they will receive a one cent per litre reduction (on average) in their farm gate milk price as a result of the retail discounts:

A reduction of one cent per litre probably sounds insignificant. In reality it is just the rounding that occurs at the supermarket checkout, which often goes unnoticed by the consumer. However, to a dairy farmer, one cent per litre can be the difference of any particular dairy farmer remaining in the

28 Australian Dairy Farmers, *Submission 150B*, pp. 9–10.

29 NSW Farmers' Association, *Submission 124A*, p. 4.

30 Australian Dairy Farmers, *Submission 150B*, p. 11.

dairy industry. For a farmer producing three million litres of milk annually, this equates to \$30,000!³¹

5.39 It has been estimated that the private label milk price cuts will take between \$22 million and \$28 million out of the Western Australian industry,³² although Coles disputed these findings claiming, among other things, that the analysis did not appear to take into account factors such as the collapse of Challenge Dairy.³³

Committee view

5.40 One key area of concern for the committee was the speed and ease in which a certain group of farmers in Queensland contracted to Parmalat were affected by the cuts in the retail price of private label milk led by Coles.

5.41 These contract arrangements appear to enable that processor to reliably source and manage the supply of milk for their brand. However, the processor also competes for tenders to supply private label product. Under these arrangements, it appears the risk of any retail price movements or other shocks that affect the sales of branded products are in large part being passed immediately onto the farmers. It is not clear why this should be the case; in most other industries, companies performing an intermediate function in a supply chain do not seem to have the ability to change the price of their inputs so readily.

5.42 The monthly variation in prices under some arrangements also leads to some concern, as they likely affect medium-term planning and investment decisions and create further uncertainty for dairy farmers.

Recommendation 1

5.43 The committee urges processors to make their pricing structures for sourcing drinking milk:

- **reflect the volume they estimate they require to meet their total commitments;**
- **offer more stability in prices rather than changing frequently; and**
- **not be dependent on the final retail sales of branded versus private label milk.**

5.44 The committee also reiterates the following recommendation from its 2010 report *Milking it for all it's worth*.

31 Ms Lisa Armstrong, *Submission 154*, pp. 1, 2.

32 Steve Hossen, Steve Hossen Rural Consulting, *Impact of the \$1.00 per litre private label milk pricing on the Western Australian dairy industry value chain* (see Australian Dairy Farmers, *Submission 150B*, Attachment 1).

33 Coles, *Submission 131A*, p. 7.

Recommendation 2

5.45 The committee recommends that contracts with dairy farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

5.46 The committee is particularly concerned about evidence received regarding the deficit in drinking milk production in Queensland, and, given current market signals, the likely ability of the dairy industry in the drinking milk-focused states to meet future demand.

Recommendation 3

5.47 The committee recommends that the Government commission a study of the dairy industries in Queensland, New South Wales and Western Australia. The study should focus on the future sustainability of the dairy industry in each of these states and their capacity to meet future local consumer demand. The report of the study should also examine possible policy options and be tabled in the Senate.

Chapter 6

Predatory pricing and the ACCC's investigation

6.1 This chapter examines:

- the issue of predatory pricing and the current thresholds in statute that need to be met for a predatory pricing case to be successful; and
- the Australian Competition and Consumer Commission's (ACCC) approach to publicly commenting on individual matters.

Predatory pricing

6.2 Two major issues that this inquiry was concerned about was the effect that Coles' January 2011 private label milk price cuts had on the ability of its direct competitors to compete with it, and the impact on other businesses that may not ordinarily be in direct competition with Coles.

6.3 Predatory pricing occurs:

... when a company sets its prices at a sufficiently low level with the purpose of damaging or forcing a competitor to withdraw from the market. This leaves the company with less competition so it can disregard market forces, raise prices and exploit consumers.¹

6.4 Under Australia's competition law, predatory pricing is addressed by section 46 of the *Competition and Consumer Act 2010* (CCA), although the concept is not expressly mentioned in that section.

6.5 Subsection 46(1) of the CCA prohibits the misuse of market power. It has a number of elements that need to be satisfied for it to be relevant. They are:

- that the corporation has a substantial degree of power in a market; and
- that the corporation takes advantage of that power in that or any other market for one of three proscribed purposes:
 - (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
 - (b) preventing the entry of a person into that or any other market; or
 - (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

1 Australian Competition and Consumer Commission, 'Predatory pricing (s46(1) and s46(1AA))', www.accc.gov.au/content/index.phtml/itemId/816375 (accessed 12 August 2011).

6.6 Subsection 46(1AAA), a relatively new provision that was inserted into the CCA in November 2008, provides that if a corporation supplies goods or services for a sustained period at a price that is less than the relevant cost to the corporation of supplying the goods or services, the corporation may contravene subsection 46(1) even if the corporation cannot, and might not ever be able to, recoup losses incurred by supplying the goods or services.

6.7 A number of other provisions in section 46 provide guidance to the court when considering alleged contraventions of the section.²

6.8 Another element of section 46 that is relevant to predatory pricing is subsection 46(1AA), more commonly referred to as the 'Birdsville Amendment'. Subsection 46(1AA) applies to a corporation that has a substantial *share* of a market, as opposed to the prohibition in subsection 46(1) that refers to a substantial *degree of power* in a market. The subsection prohibits these corporations from supplying, or offering to supply, goods or services for a sustained period at a price that is less than their relevant cost. However, it is similar to subsection 46(1) in that it requires that the supply of goods or services is for one of the three proscribed purposes noted earlier. To date, the Birdsville Amendment has not been tested in the courts.

6.9 The ACCC summarised what forms of conduct may, in general, constitute predatory pricing:

Predatory pricing has two key elements to it. Firstly, there has to be a target. There must be an intention to predate someone. That is different to someone suffering loss or harm as a result of the competitive process. What the company with market power does must be targeted at a competitor. It

2 Subsection 46(4A) provides that the court may have regard to the following conduct in order to decide whether a corporation has contravened subsection (1):

- any conduct of the corporation that consisted of supplying goods or services for a sustained period at a price that was less than the relevant cost to the corporation of supplying such goods or services; and
- the reasons for that conduct.

Subsection 46(6A) provides that in determining whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:

- whether the conduct was materially facilitated by the corporation's substantial degree of power in the market;
- whether the corporation engaged in the conduct in reliance on its substantial degree of power in the market;
- whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of power in the market; or
- whether the conduct is otherwise related to the corporation's substantial degree of power in the market.

Subsection 46(7) provides that, for the prohibition under subsection 46(1), purpose may be inferred from the conduct of the corporation or from other relevant circumstances.

could be a particular competitor, it could be more than one competitor but it must be targeted at someone. Secondly, it must have the purpose of damaging whoever it is targeted at. It could be an existing competitor, or it could be a potential new competitor. They are the two key ingredients that we look for and what is in the legislation is really an embellishment of those key ingredients.³

6.10 These considerations are key as price discounting by companies can be pro-competitive. Legitimate price discounting can occur when large companies pass on to consumers the benefits of lower costs or increased efficiencies arising from reduced internal costs or better deals from suppliers.

6.11 The ACCC notes that predatory pricing can be difficult to prove. This is because 'the initial signs of predatory pricing are pro-competitive and there is often no written evidence of anti-competitive purpose with which an allegation could be upheld'.⁴ Section 46 differs from other provisions concerning general anti-competitive conduct in the CCA, as the prohibition only relates to conduct that has the 'purpose', as prescribed by the section, of substantially lessening competition. Other sections in that part of the CCA that do not prohibit conduct outright include an allowance for the 'effect' (or likely effect) of the conduct to be considered.⁵ This difference is explored in more detail in chapter 7.

Initial calls for an ACCC investigation

6.12 The ACCC is an independent statutory authority formed in 1995 by the merger of the Trade Practices Commission and the Prices Surveillance Authority. The ACCC has responsibilities under a number of Commonwealth laws, but most of its work relates to the administration and enforcement of the *Competition and Consumer Act 2010* (CCA).⁶

6.13 A number of submissions and witnesses raised concerns that Coles' conduct constituted predatory pricing (as well as other trade practices issues):

We call on the ACCC to investigate the latest discounting by Coles as a matter of urgency. We feel that there is probably predatory pricing there.

3 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 19.

4 Australian Competition and Consumer Commission, 'Predatory pricing (s46(1) and s46(1AAA))' www.accc.gov.au/content/index.phtml/itemId/816375 (accessed 22 February 2011).

5 For example, paragraph 45(2)(a) of the CCA (which forms part of the provisions relating to contracts, arrangements or understandings that restrict dealings or affect competition) states 'a corporation shall not: (a) make a contract or arrangement, or arrive at an understanding, if: (i) the proposed contract, arrangement or understanding contains an exclusionary provision; or (ii) a provision of the proposed contract, arrangement or understanding has the purpose, or would have or be likely to have the effect, of substantially lessening competition...'

6 Prior to 1 January 2011, the CCA was known as the *Trade Practices Act 1974*.

We feel that the ACCC needs to investigate the pricing practices of Coles, including the guarantee that has been made to dairy farmers that they will not be adversely affected. We do not believe that to be the case.⁷

They are buying very strongly, they are selling at cost, they are loss leading in regions, they are damaging milk value on the shelf and to a degree they are damaging the milk value of their partners, the processors who supply them and rely on branded milk to extract an average price from the market. So I think that is where the issue is. They are abusing their market power. There is predatory pricing, loss leading. They are all terms that came up in the Tasmanian inquiry. We can say we are not sure about those things, but I think the ACCC should look into that.⁸

CHOICE notes recent media reports referencing claims from unnamed industry sources that Coles Supermarkets are incurring losses of \$300,000-\$400,000 per week to sell heavily discounted milk, and that representatives of Woolworths Supermarkets have expressed concerns about the impacts of price reductions on dairy farmers. These claims require further investigation, given it is difficult to see why any retailer would sustain such losses if it were not seeking to eliminate or damage its competitors.⁹

... we believe there is an urgent need for ... [t]he ACCC to investigate the pricing practices of Coles, including its 'guarantee' that dairy farmers returns will not be reduced, to ensure that predatory pricing is not being practiced and that sustainable returns are delivered to Australian farmers and processors.¹⁰

Coles actions are not only hurting farmers. They will also damage Coles' competitors such as small businesses like local corner stores, independent service stations and other small retailers of milk. The industries that service these stores, such as delivery drivers will also be affected. Lower sales for corner stores and independent service stations will lead to a substantial lessening of competition in the market place and leave consumers with less choice.¹¹

7 Mr David Basham, President, South Australian Dairyfarmers' Association, *Committee Hansard*, 8 March 2011, p. 55.

8 Mr Ian Zandstra, Chairman, Dairy Farmers Milk Co-operative, *Committee Hansard*, 8 March 2011, p. 67.

9 CHOICE, *Submission 51*, p. 4 (footnotes omitted).

10 Australian Dairy Industry Council, *Submission 96*, p. 2.

11 Western Australian Farmers Federation, *Submission 88*, p. 2.

6.14 As the inquiry progressed, submissions and supplementary submissions became more direct on this issue, calling for the relevant Federal Minister to issue to a direction to the ACCC to investigate Coles' conduct.¹²

6.15 It is important to keep in mind that the economic concept of predatory pricing is separate to the concept that exists in the language of the CCA. As noted in *Boral Besser Masonry Limited (now Boral Masonry Ltd) v Australian Competition and Consumer Commission*:

There is a danger that a term such as predatory pricing may take on a life of its own, independent of the statute, and distract attention from the language of s 46.¹³

6.16 In the context of predatory pricing, a question arises as to what is meant by 'cost'. The ACCC noted that under the CCA, the focus regarding cost 'is on the corporation that is making the supply', not whether the sale price is below a competitor's cost of supply.¹⁴ The ACCC further defined what they consider cost includes:

Senator WILLIAMS—... if Coles buy two litres of milk and land it in their store for \$1.50, does that cost also include the margin for running their people at the check-outs, their electricity and their rent? In other words, \$1.70 could be their cost...

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

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

Mr Bezzi—The cost of supply, yes.¹⁵

6.17 Woolworths told the committee:

From a cost of product to a sell, at our first margin we are making a profit. When we take into consideration the costs associated with our supply chain

12 Australian Dairy Farmers, *Submission 150*, p. 3; Queensland Dairyfarmers' Organisation, *Submission 94A*, p. 2. It is important to clarify that the Minister, currently the Parliamentary Secretary to the Treasurer, cannot direct the ACCC to investigate matters that may constitute a contravention of the general anti-competitive conduct provisions such as section 46. Subsection 29(1A) of the CCA expressly prohibits the Minister from doing so.

13 *Boral Besser Masonry Limited v Australian Competition and Consumer Commission* (2003) 215 CLR 374, 421 (Gleeson CJ and Callinan J).

14 Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 23. See also p. 21.

15 Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 22.

and distribution, our handling costs and the other costs associated within the store, we are still not selling milk below cost.¹⁶

6.18 Coles stated that it is confident that 'it has not sold milk at prices below the cost it acquired it from milk processors'.¹⁷ Coles was asked about how they define cost:

Senator XENOPHON—... You say in your submission that Coles is not selling milk at prices below the cost it acquired from milk processors. Have you chosen your words carefully by choosing not to focus on just the acquisition cost instead of also including the cost of refrigeration, in-store handling costs and transport?

Mr McLeod—No. We have described it that way because it is the way in which we manage our business. On a product-for-product basis, when we are determining the margin that we make on those products, it is done on the basis of the cost that we buy at and the price that we sell at. In terms of the overall costs within our business, we spread them across the entire company Australia-wide.

Senator XENOPHON—Can you categorically say that, when milk is being sold at \$1 a litre in Darwin or Kununurra, for instance, that that is not below cost?

Mr McLeod—We take the individual prices that we pay for those products on an individual basis by the arrangements that we have with those processors in those individual states and we apply that across that state. You may recall I mentioned earlier on that we have operated since last year with state based pricing, therefore we have uniform pricing across Western Australia, across Victoria, across New South Wales.

Senator XENOPHON—But that means in some parts of Western Australia—and in the Darwin market, for instance—you would be selling milk below cost.

Mr McLeod—I am not saying that at all.¹⁸

The ACCC's investigation

6.19 The public hearings conducted in March 2011 provided an opportunity for the committee to question the ACCC about its approach to investigating predatory pricing matters generally, as well as its specific actions regarding Coles' pricing decision. The implications of the decision by Coles to make its price cuts apply nation-wide were explored:

16 Mr Pat McEntee, General Manager, Fresh Foods, Woolworths, *Committee Hansard*, 29 March 2011, p. 6.

17 Coles, *Submission 131*, p. 16.

18 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, pp. 37–38.

Senator COLBECK—Does targeting it broadly at the market in that context not necessarily constitute that sort of action [intention to predate and a purpose of damaging the target]?

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

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

Mr Cassidy—We would look at it in general terms. We would look at the action taken and whether in all likelihood it is about delivering cheaper prices for consumers or whether the action that was taken and the way it was taken was really more likely to be about damaging a particular competitor where whatever benefits were offered to the consumer were probably a byproduct rather than being the prime objective. Let me give you a hypothetical example. If a firm with market power, with the ability to do it, was selling products at below cost and choosing the particular outlets in which to sell the products and the outlets just happened to be sitting alongside a particular competitor, you might say that is getting lower prices to consumers but if that is the objective why are they just doing it in these particular outlets? You would start to form a suspicion that what the conduct is really about is damaging the competitor rather than providing lower prices to consumers.¹⁹

6.20 The committee was advised of discussions between various organisations and the ACCC regarding the price decisions at an early stage of the inquiry. The ACCC's responses to questions on notice from the March hearings also outlined the meetings it had held with representatives of Coles and Wesfarmers on the issue.²⁰

6.21 The ACCC also made a public request for firm evidence:

If someone has got that evidence—because there are some fairly wild claims being made—then we would certainly like to have it. But on the basis of what we have got, we have no evidence.²¹

6.22 Unsurprisingly, based on the above statement, on 22 July 2011 the ACCC issued a media release stating that 'it considers there is no evidence' that Coles had acted in breach of the CCA. The ACCC Chairman at the time was quoted as stating:

19 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, pp. 19–20.

20 Australian Competition and Consumer Commission, answer to question on notice, 9 March 2011 (received 6 April 2011), pp. 5, 11.

21 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 23.

It is important to note that anti-competitive purpose is the key factor here. Price cutting, or underselling competitors, does not necessarily constitute predatory pricing. Businesses often legitimately reduce their prices, and this is good for consumers and for competition in markets.²²

6.23 The media release further elaborated on the need to prove an anti-competitive purpose:

ACCC enquiries have revealed evidence that Coles' purpose in reducing the price of its house brand milk was to increase its market share by taking sales from its supermarket competitors including Woolworths. This is consistent with what the ACCC would expect to find in a competitive market.

After Coles [sic] price reductions, Woolworths and other supermarket retailers have also reduced prices for house brand milk.

The ACCC's enquiries show that there is a significant variation between respective costs of supply and operating margins among supermarket operators.²³

6.24 The mechanics of the ACCC's investigation was explored at the hearing the committee conducted in October 2011. The ACCC advised that they discussed the issue with 'just about everyone in the supply chain, from the retailers back to the farmer organisations'. The ACCC also noted that they considered a range of confidential material during their inquiries.²⁴

6.25 Additionally, the ACCC explained some of the factors that restricted the scope of its investigation; as the material they had did not indicate that Coles' actions would match one of the anti-competitive purposes outlined in section 46 of the CCA, the ACCC limited some other parts of its assessment because a contravention would not be able to be proved. Although the ACCC advised it did assess whether Coles was selling below relevant cost in capital cities and regional centres (noting that in those areas it was confident that Coles was not), it did not examine more geographically remote areas because:

... 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

22 Australian Competition and Consumer Commission, 'ACCC: Coles discounting of house brand milk is not predatory pricing', *Media release*, NR 129/11, 22 July 2011.

23 Australian Competition and Consumer Commission, 'ACCC: Coles discounting of house brand milk is not predatory pricing', *Media release*, NR 129/11, 22 July 2011.

24 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 34.

put in to establishing one leg in certain geographic areas when we basically knew that we did not have the required other elements.²⁵

Transparency of ACCC investigations

6.26 An issue which the committee has considered as part of this and other inquiries is the transparency of the ACCC's investigations. Whether or not the ACCC was undertaking an active investigation into Coles' milk price cuts was a question that frequently arose during the early stages of this inquiry:

We said to the ACCC that we would welcome an ACCC inquiry, and make a submission to an ACCC inquiry, and felt they should bloody well do one. Clearly, they should. I do not know by what process the ACCC is triggered into action. You politicians have to decide that. But we need an ACCC inquiry here, without any doubt.²⁶

We wonder if the ACCC is providing leadership in the area of supermarkets. They might be doing a lot of things behind the scenes...²⁷

6.27 Some witnesses commented that the ACCC could be more active and upfront about their activities:

From what we have seen, the ACCC likes to watch. They take a long time to investigate. They could not even answer the question on whether they could give an answer about their investigation before the end of the year. If we have to wait beyond the year then there is something seriously wrong with someone's investigative processes.²⁸

6.28 After reflecting on a regular meeting they had with the ACCC during which the milk price issue was discussed, a representative of CHOICE stated:

I suppose I got the impression—and this is a broad impression I got—that the ACCC does not always signal what they are doing in terms of investigation. I do not know if that applies to supermarkets. I think it was argued that perhaps there needed to be more prominent smoke signals, as it were, to the ACCC. Basically, they have been very quiet on this whole issue. I think many people would have looked to them to have real guidance in terms of what was and was not predatory pricing and what was and was not in the consumer interest.²⁹

25 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 36.

26 Mr Ian Zandstra, Chairman, Dairy Farmers Milk Co-operative, *Committee Hansard*, 8 March 2011, p. 72.

27 Mr Christopher Zinn, Director, Campaigns and Communications, CHOICE, *Committee Hansard*, 29 March 2011, p. 87.

28 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 50.

29 Mr Christopher Zinn, Director, Campaigns and Communications, CHOICE, *Committee Hansard*, 29 March 2011, p. 92.

6.29 In their proposal to the committee that a Supermarket Ombudsman be appointed, CHOICE and the Australian Food and Grocery Council argued that one of the benefits of such an office would be that it could shed light on certain issues at an early stage, 'rather than operating under the veil of secrecy associated with the ACCC'.³⁰

The ACCC's policy on commenting on investigations

6.30 The ACCC's website provides the following advice on where information about its enforcement actions can be sourced:

For information on the enforcement activity of the ACCC see:

- News releases
- ACCCount, a quarterly report of Australian Competition and Consumer Commission's activities
- ACCC annual report.

For up to date information on current ACCC litigation in the Federal Court of Australia for alleged breaches of the Trade Practices Act go to the Commonwealth Courts Portal www.comcourts.gov.au. The Commonwealth Courts Portal is a web-based service that provides access to information about cases before the courts.³¹

6.31 The ACCC generally issues a media release and otherwise engages with the media only if an investigation reaches a certain stage, such as when court proceedings are instituted or finalised, or when a matter has been resolved by way of an enforceable undertaking or other arrangement. Prior to one of these stages being reached, however, in most cases there will be little public information available as to whether or not the ACCC is investigating, or has investigated, a particular matter.

6.32 The ACCC states in its *Compliance and Enforcement Policy* that one of the principles it has adopted to achieve compliance with the law is confidentiality:

... in general, investigations are conducted confidentially and the ACCC does not comment on matters it may or may not be investigating.³²

6.33 The effect of this policy is demonstrated by this exchange at Senate Estimates in February 2011 regarding a different matter:

Senator CORMANN—... Are you undertaking any investigations at present of financial institutions in Australia for suspected breaches of

30 CHOICE and the Australian Food and Grocery Council, *Submission 152*, p. 6.

31 Australian Competition and Consumer Commission, 'Enforcement Activities', www.accc.gov.au/content/index.phtml/itemId/585905 (accessed 28 June 2011).

32 Australian Competition and Consumer Commission, *Compliance and Enforcement Policy*, December 2010, p. 1.

part IV of the Trade Practices Act? I am not asking you to name anyone; I am just asking whether you are currently conducting any investigations.

Mr Samuel—Senator, I do not think we can give any details of any matters that we may or may not be investigating in relation to this area. That is not to imply that we are and not to imply that we are not; it is just that it is not appropriate for us to give any details on those issues. You would be aware—and our records would indicate—that one or two matters currently before the courts relate to part IV matters concerning one or other of the major trading banks, but beyond that I really cannot comment any more.³³

6.34 On occasion, however, substantial public interest will pressure the ACCC to provide some insight into its investigative activities. The supermarkets' milk pricing decisions being examined by this inquiry, for instance, is one such matter. At its public hearing on 9 March 2011, and in response to written questions on notice, the ACCC outlined some of the actions it has taken, including meetings with senior Coles and Wesfarmers executives. The then Chairman of the ACCC also gave an example of his engagement with the media on the issue:

In an interview I gave on the Perrett Report on Sky News, which predated the Senate inquiry, I was asked by Janine Perrett what our position was on milk. I said that we were examining all aspects of the milk supply chain from the grower through the processor through the delivery chain through to the wholesalers, the retailers and the like but our primary concerns were—I am almost quoting myself verbatim—at the grower level and at the level of the consumer. There were some strong vested interests that were interposed in between. They were very powerful vested interests. In particular, I referred to both the retailers, the wholesalers and the processors. I thought that gave a fairly open answer to indicate that there was a lot that we are examining.³⁴

6.35 As noted earlier in the chapter, the ACCC then issued a media release summarising the findings of its investigation of whether Coles' actions were likely to constitute predatory pricing. While this was a divergence from the ACCC's usual practice regarding its investigations, it was not unique as similar announcements have

33 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission, *Senate Economics Legislation Committee Hansard*, Additional Estimates 2010–11, 24 February 2011, pp. 94–5.

34 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission, *Senate Economics Legislation Committee Hansard*, Budget Estimates 2011–12, 31 May 2011, p. 97.

been made in the past.³⁵ The different approach was explained by the then ACCC Chairman:

... where a matter, milk for example, is the subject of examination that is of clearly intense public interest, it could be reasonably expected that once that examination is completed, we will make a public statement as to our findings. Those findings will necessarily be largely focussed on whether or not there have been determined to be breaches of the Competition and Consumer Act, though they may well relate to some incidental or other relevant matters.³⁶

6.36 It is not clear whether the ACCC's approach is changing; on 2 September 2011 it also issued a media release stating that it considered allegations that protests against certain businesses with Israeli ownership and which carry on business with the Government of Israel were unlikely to constitute a secondary boycott.³⁷

Issues with increasing transparency

6.37 It is important to keep in mind that the ACCC is a law enforcement agency, and accordingly there are certain principles and practices it should be expected to adhere to. While increased transparency of what the ACCC is investigating at any point of time may be desirable in terms of ensuring public confidence in the ACCC, there are important factors to consider.

6.38 Publicising investigations prior to proceedings being instituted or the matter being resolved in some other way is likely to deny procedural fairness to individuals or corporations that are the target of an ACCC investigation. This is significant because under Australia's competition law framework it is the courts that decide whether a contravention of the CCA has occurred. This principle forms an integral part of the ACCC's policy on engagement with the media:

The ACCC will issue a news release when it decides to institute proceedings in relation to an alleged contravention that accurately describes the allegations and does not imply that the allegations are more than allegations. In practice, the ACCC rarely makes public comments regarding

35 For example, the ACCC issued a media release in April 2008 after investigating allegations that Bakers Delight engaged in misleading and deceptive and unconscionable conduct towards franchisees: Australian Competition and Consumer Commission, 'ACCC does not consider Bakers Delight engaged in unconscionable conduct towards franchisees', *Media release*, MR 104/08, 22 April 2008. Other examples include the media releases issued by the ACCC in 2009 regarding Coles' offer of 40 cents per litre off fuel purchases for customers that spent \$300 at a Coles supermarket.

36 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission, *Senate Economics Legislation Committee Hansard*, Budget Estimates 2011–12, 31 May 2011, p. 97.

37 Australian Competition and Consumer Commission, 'ACCC: Recent anti-Israel protests not a secondary boycott', *Media release*, NR 161/11, 2 September 2011.

an investigation because of the potential detrimental impact on the reputation of the parties.³⁸

6.39 While these concerns may not be relevant now, the ACCC has in the past been criticised for how it engages with the media. A number of concerns were raised in 2002 and 2003 as part of the *Review of the Competition Provisions of the Trade Practices Act* (Dawson Review). Submissions to that review raised instances of the ACCC publicising investigations before they were concluded, before proceedings were instituted and when no decision had been reached by the court. The report of the Dawson Review devoted a chapter to the subject.³⁹

6.40 Regardless of any actions to increase transparency, a further issue is that the nature of many investigations undertaken by the ACCC would still require confidentiality while evidence was being gathered. The public disclosure of the existence of an investigation could damage that process. The ACCC has in the past noted:

... firms with substantial market power appear to be very much aware of the consequences of "smoking gun" documents being found in their internal records such as those relied upon in the QWI, Boral and Rural Press proceedings. Such firms appear to be taking great care to avoid potentially incriminating documents being created or stored. For example, the ACCC is aware from experience of instances where corporations have issued specific instructions in relation to the creation or destruction of internal documents, that display a disregard for compliance with the TPA [Competition and Consumer Act]. Consequently, the forensic task for the ACCC in proving section 46 breaches is getting more difficult.⁴⁰

Comparison with international counterparts

6.41 The ACCC's approach to releasing information about its investigations is not radically different from that used by the consumer protection and competition agencies in other countries, although there are some interesting differences.

United Kingdom

6.42 The Office of Fair Trading (UK OFT) is the agency responsible for consumer protection and competition issues in the UK. Like the ACCC's website, the UK OFT's (www.offt.gov.uk) provides general information to consumers and businesses about the legislation it administers. However, the UK OFT's website also includes information

38 Australian Competition and Consumer Commission, *Submission to the Productivity Commission's inquiry into Australia's consumer policy framework*, June 2007, p. 52.

39 Trade Practices Act Review Committee, *Review of the Competition Provisions of the Trade Practices Act*, January 2003, pp. 181–190.

40 Australian Competition and Consumer Commission, *Submission 21*, Senate Legal and Constitutional References Committee, Inquiry into s. 46 and s. 50 of the *Trade Practices Act 1974*, February 2002, p. 7.

about its enforcement activities by sector (such as consumer credit, retail and transport) and by the category of investigation the conduct falls under (such as consumer protection legislation, consultation or mergers). This includes its completed enforcement matters, as well as a selection of current actions.

6.43 The information the UK OFT's website provides about its current enforcement activities is not a complete list of investigations—the site notes it is limited to 'those investigations in the public domain'⁴¹—however, it does include a discussion of matters before the courts and, in some instances, investigations prior to a decision to institute proceedings being made.⁴²

Canada

6.44 Similar to the ACCC's online record of media releases, the Competition Bureau of Canada's (CBC) website (www.competitionbureau.gc.ca) includes its past announcements. However, the CBC also publishes on its website a 'Litigation Status Report' which provides a consolidated summary of matters before the courts.⁴³

6.45 The website also summarises judgements and orders made by the courts, and provides examples of discontinued investigations:

... where the Commissioner of Competition ended an inquiry initiated under the Competition Act because of insufficient evidence to institute proceedings before the courts or to refer the matter to the Director of Public Prosecutions of Canada.⁴⁴

New Zealand

6.46 The New Zealand Commerce Commission's website provides access to information relating to its enforcement activities through a number of methods.

6.47 An Enforcement Action Register outlines all litigation and settlements since January 2010 and all warnings and cease and desist orders issued since January 2011 under the Commerce Act 1986 and the Fair Trading Act 1986. Investigations which resulted in no further action being taken are not included. For competition matters, certain investigation reports are published, such as the Commission's investigation

41 Office of Fair Trading (UK), 'Consumer enforcement current cases', www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-current/ (accessed 28 June 2011).

42 For example, the UK OFT's website has a discussion of its investigation into retirement homes exit fees and an investigation into a possible anti-competitive conduct in the private motor insurance sector. See www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-current/retirement-homes/; www.offt.gov.uk/about-the-offt/legal-powers/enforcement_regulation/Cartels/motor-insurance/ (accessed 29 June 2011).

43 Competition Bureau (Canada), 'Litigation Status Report' www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02037.html (accessed 29 June 2011).

44 Competition Bureau (Canada), 'Legal Actions and Opinions' www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/h_00020.html (accessed 29 June 2011).

into New Zealand electricity markets. The policy on whether to produce and publish these reports is summed up on the website:

In some cases the Commerce Commission decides to publish investigation reports that are of general interest.⁴⁵

6.48 The website also includes a selection of court judgements.

Summary of the approaches taken by overseas agencies compared to the ACCC

6.49 Unlike the websites of the UK, Canadian and New Zealand competition and consumer protection authorities, for most enforcement matters visitors to the ACCC's website need to search through numerous media releases or the agency's quarterly and annual reports to find details about specific enforcement activities. Even then, those matters which the ACCC has been willing to publicise to some degree either in the media, at Senate Estimates or during a specific parliamentary inquiry—but which it has not issued a formal statement such as a media release—are unlikely to be found on its website.

6.50 The major exception appears to be for franchising matters. For these enforcement outcomes, the ACCC operates a dedicated page on its website which provides some information about the number of complaints received, the investigative process, and summarises the enforcement outcomes since 2004.⁴⁶

6.51 The information provided about matters before the courts also differs. As noted earlier, the ACCC merely provides a link to the Commonwealth Courts Portal website (www.comcourts.gov.au). While the Commonwealth Courts Portal provides some useful material such as hearing dates and copies of orders made, the information provided is limited and does not include a summary of the matter. In many instances it also requires the user to have some knowledge of the details of a particular case, such as the formal name of the applicant or respondent, in order to search for it successfully.

Committee view

6.52 The committee is aware that, at times, there can be significant concern within certain sectors and the wider community regarding the effectiveness of the ACCC in enforcing the CCA. On the other hand, the fact that the ACCC has a clear remit and is bound by the specific text of the CCA needs to be remembered.

6.53 The ACCC is an independent statutory authority. To ensure confidence in the organisation, it is critically important that the ACCC exercises, and is seen to exercise,

45 Commerce Commission (New Zealand), 'Investigation Reports' www.comcom.govt.nz/investigation-reports/ (accessed 30 June 2011).

46 Australian Competition and Consumer Commission, 'Franchising Code complaints, investigations and outcomes', www.accc.gov.au/content/index.phtml/itemId/816437 (accessed 8 September 2011).

its powers independently and based on the evidence it is able to gather. Having said this, the committee had the expectation that the ACCC would review Coles' price decisions against the legislation it is entrusted to enforce. The committee would have had serious concerns if it did not do so.

6.54 The committee is pleased that the ACCC was, on this occasion, willing to publish a statement that provided a high-level summary of the findings of its investigation. The committee believes that such public statements on key matters help inform the broader public debate.

6.55 The committee acknowledges that greater transparency of the ACCC's investigations could help improve public confidence in the regulator and further inform the public debate on certain competition or consumer protection issues. There is a need to consider other factors, however, such as the effect that greater transparency could have on the integrity of the ACCC's investigations and ensuring that, because it is the courts that determine whether the CCA has been contravened rather than the ACCC, the reputations of individuals and businesses are not unfairly damaged due to allegations or the stigma that could be associated with being under an ACCC investigation.

6.56 The committee notes that the ACCC's enforcement outcomes are highlighted within point-in-time documents, such as its annual report, quarterly reports and media releases. While the ACCC's website provides links to these documents, the website itself appears more directed at providing general information to consumers and businesses rather than highlighting specific outcomes. While this approach is understandable, and helps fulfil the ACCC's statutory obligations under section 28 of the CCA, it may be the case that the ACCC's website under-emphasises its enforcement activities compared to the approach taken by its international counterparts.

6.57 Therefore, the committee believes there is some scope, albeit limited, for additional transparency of the ACCC's enforcement activities. Improvements to the way the ACCC releases this information could help ensure that the public is confident that matters are being taken seriously, and increase the accountability of the ACCC.

Recommendation 4

6.58 The committee recommends that the Australian Competition and Consumer Commission (ACCC) review its approach to publicly releasing information about its investigations, with a view to providing greater general information about its current enforcement activities and relevant issues of particular public concern.

6.59 This recommendation is subject to the proviso that such action would not deny procedural fairness to the parties involved or threaten the integrity of the ACCC's investigations.

Chapter 7

Competition law

7.1 This chapter follows on from the previous chapter which outlined the Australian Competition and Consumer Commission's (ACCC) investigation of Coles' pricing decisions under Australia's competition law as it currently stands. Both this inquiry and the committee's 2010 inquiry into competition and pricing in the Australian dairy industry received a significant amount of information regarding the effectiveness and perceived gaps in Australia's competition laws, as well as concerns about the approach taken to their enforcement. This chapter discusses these issues in detail, particularly those relating to price discrimination, misuses of market power and mergers and acquisitions.

Background

7.2 The principal legislation governing competition in Australia is the *Competition and Consumer Act 2010* (CCA), which was previously known as the *Trade Practices Act 1974*. The object of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. Treasury describes the provisions related to general anti-competitive conduct as follows:

The Part IV provisions are principally concerned with protecting the competitive process, not individual competitors. They are not designed to protect competitors from rigorous competitive behaviour, nor to force businesses to compete.¹

7.3 An independent statutory authority, the ACCC, is responsible for administering the CCA. Policy responsibility for most parts of the CCA lies with the Treasury portfolio.

Anti-competitive price discrimination

7.4 Price discrimination occurs when a firm charges a different price to different persons or groups of persons for identical goods or services for reasons not related to costs.² The CCA previously contained a section which explicitly covered anti-competitive price discrimination. Prior to its repeal,³ subsection 49(1) had stated:

1 Department of the Treasury, *Submission 111*, p. 3.

2 Price discrimination was examined in more detail in another inquiry. See Senate Economics Legislation Committee, *Trade Practices Amendment (Guaranteed Lowest Prices—Blacktown Amendment) Bill 2009*, November 2009.

3 Since the repeal of the section 49 which covered anti-competitive price discrimination, an unrelated section 49 regarding dual listed companies was introduced and remains in force.

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

- (a) the prices charged for the goods;
- (b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of goods;
- (c) the provision of services in respect of the goods;
- (d) the making of payments for services provided in respect of the goods if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods.

7.5 Subsection 49(2) listed two defences to 49(1). The first was where the price differences reflected differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the different places to which the goods are supplied to purchasers. The second defence was where the discrimination was constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier.

7.6 In 2002, the ACCC described the operation of section 49 as follows:

Price discrimination was an issue under s. 49 if the discrimination was of such magnitude or was of such a recurring or systematic character that it substantially lessened competition. Section 49 did not apply when the discrimination in price reflected a reasonable allowance for differences in the cost of supply resulting from different delivery destinations or different quantities supplied to purchasers.⁴

Repeal of section 49

7.7 Section 49 was repealed in 1995 after the recommendations of the 1993 report of the independent inquiry into a national competition policy (the Hilmer Report). The view at the time was that price discrimination 'generally enhances economic efficiency', except in instances which may be in breach of either section 45 or 46, in which case those sections would apply.⁵

7.8 In recommending its repeal, the Hilmer Report noted concerns that the provision may discourage pro-competitive conduct.⁶ The Hilmer Report summarised its view on the provision as follows:

4 Australian Competition and Consumer Commission, *Report to the Senate by the Australian Competition and Consumer Commission on prices paid to suppliers by retailers in the Australian grocery industry*, September 2002, p. 8.

5 Independent Committee of Inquiry into Competition Policy in Australia, *National Competition Policy*, August 1993, p. 79.

6 *National Competition Policy*, August 1993, p. 78.

The prohibition against price discrimination prevents the sale of like goods to different persons at different prices, where such discrimination substantially lessens competition. The provision is contrary to the objective of economic efficiency and has not been of assistance to small businesses. The Committee does not believe that it is the role of the competitive conduct rules to protect any particular sector of society, and does not believe that the competition rules should be used to achieve objectives contrary to economic efficiency.⁷

7.9 In its submission to this inquiry, the National Association of Retail Grocers of Australia (NARGA) questioned this finding:

In Hilmer's own words, prevention of a substantial lessening of competition would be "contrary to the objective of economic efficiency". The corollary to Hilmer's logic is that a substantial lessening of competition would promote economic efficiency. And, presumably, that monopoly would be most efficient of all.⁸

7.10 The position of the Hilmer Report was maintained in the 2003 report of the independent review of the competition provisions of the Trade Practices Act (the Dawson Report). Previous inquiries such as the Swanson Committee (1976) and the Blunt Committee (1979) had also recommended the repeal of section 49.⁹

7.11 A 2004 Senate committee inquiry into Parts IV and VII of the Trade Practices Act examined whether section 46 required amendment to deal better with price discrimination (previously addressed by section 49) and concluded that section 46 was adequate.¹⁰

7.12 The ACCC provided a useful summary of the reasoning behind the repeal of section 49, noting that the Hilmer Report:

... observed that anticompetitive price discrimination almost invariably involves a firm with market power. You have to have market power to make it stick. Alternatively, a group of suppliers has to get together and agree on the price discrimination; otherwise, it just does not work. The point the committee made was that if it is a use of market power then that is what section 46 is about. If it is a group of suppliers getting together and deciding on the anticompetitive price discrimination, then that is what section 45 is about. Basically, the Hilmer committee said that they did not

7 *National Competition Policy*, August 1993, p. 74.

8 National Association of Retail Grocers of Australia, *Submission 50*, p. 6.

9 Although, as pointed out in NARGA's submission to this inquiry, it is worth noting that the recommendations of the Swanson and Blunt Committees to repeal section 49 were rejected.

10 Senate Economics References Committee, *Effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 3.

see a role for section 49, because the conduct in question was already covered by sections 45 and 46.¹¹

Calls for the reintroduction of a section 49-type provision

7.13 During this inquiry a number of individuals and organisations called for a specific anti-competitive price discrimination provision to be reinstated:

... we need an effective prohibition against anti-competitive price discrimination. Australia is out of line, out of step, with international practice in this area. Other jurisdictions have express prohibitions against anti-competitive price discrimination. We do not. Any hope that section 46 would deal with that issue, I have to say, with all due respect, is somewhat misplaced if not delusional.¹²

The AFGC is of the view that the switch from the s49 "effects" test to the s46 "purpose" test was a significant weakening of the provision against anti-competitive price discrimination.¹³

The reintroduction of an anti-price discrimination clause into the Act is absolutely warranted and should be a foundation recommendation from the current Senate inquiry.¹⁴

7.14 NARGA considers that the timing of the repeal of the anti-competitive price discrimination is particularly relevant to the dairy industry:

... since the deregulation of the Australian dairy industry in 2000, the supermarket chains' private label milk has consistently been priced substantially and continuously below proprietary branded milk.¹⁵

7.15 Associate Professor Frank Zumbo warned that price discrimination conduct 'adversely impacts' independent retailers, who:

... will go out of business and will not be able to provide any competitive tension to Coles and Woolworths. Coles and Woolworths will just increase their dominance of the market.¹⁶

7.16 It is apparent that the prices and terms of supply in the grocery sector, and the effectiveness of competition laws in this regard, have been raised as issues for some time. In 2003, the Dawson Report noted that during its inquiry, parties involved in the

11 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, pp. 45–6.

12 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 51.

13 Australian Food and Grocery Council, *Submission 100*, p. 11.

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

15 National Association of Retail Grocers of Australia, *Submission 50*, p. 7.

16 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 59.

wholesale and retail grocery industry were the most vocal regarding price discrimination. The Dawson Report summarised their concerns as follows:

Their complaint was that independent wholesalers (who sell wholesale to independent retailers) are not able to obtain goods at prices comparable to those charged by suppliers to the two major chains, notwithstanding that their central distribution warehouses are, in comparison with the facilities of the major chains, of comparable size and capable of like performance. They submitted that this constituted a failure on the part of suppliers to provide 'like terms for like customers' at this level of the grocery distribution chain, namely, the central warehouse level. This meant, they said, that the independent retailers were such that there could be no fair competition between them and the major chains at the retail level, only the latter being able to reflect the benefit of lower wholesale prices in their retail prices.¹⁷

7.17 However, when asked at Senate Estimates whether it is price discrimination when different prices are charged for the same product in different packaging, the Chairman of the ACCC replied that 'it is not', and referred to other issues such as the marketing elements of the branded product.¹⁸ This interpretation was also supported by the chief executive of an independent supermarket chain:

Senator XENOPHON—Is it price discrimination to be selling branded milk and generic milk, or the home brand milk, for different prices when in effect it is the same product?

Mr Markham—I think that is the case for most private labels and branded products anyway. Branded products carry a marketing component, a brand value, which has always put them at a higher price than a private label. So, no, I do not believe so.¹⁹

Effectiveness of section 49 and criticism of its enforcement

7.18 When the price discrimination version of section 49 was in place, it was invoked in legal proceedings in very few instances.

7.19 NARGA was critical of the enforcement by the ACCC and its predecessor (the Trade Practices Commission) of anti-competitive price discrimination provisions—both section 49 and, after it was repealed, section 46. NARGA noted a

17 Trade Practices Act Review Committee, *Report of the Trade Practices Act Review Committee*, January 2003, p. 90.

18 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission, *Senate Economics Legislation Committee Hansard*, Additional Estimates 2010–11, 24 February 2011, p. 86.

19 Mr Russell Markham, Chief Executive Officer, Foodland Supermarkets, *Committee Hansard*, 8 March 2011, pp. 53–4.

private case where conduct was found to be in breach of section 49 to support their argument that it was repealed without cause.²⁰

In 1981, a private case, *JCool&Son v. O'Brien Glass Industries*, was taken to the Federal Court of Australia. Justice Keely found that both s49 and s47 of the Trade Practices Act had been breached.²¹

7.20 Treasury pointed out, however, that it is difficult to state with certainty that section 49 was necessary in the outcome of *J Cool & Son v O'Brien*, noting that if section 49 had not existed at the time, it is not clear if section 46 or another provision may have been pleaded instead.²²

7.21 Treasury also cited two judicial observations made on the case:

There is some overlapping between the different sub-sections of the Trade Practices Act. In particular, in the present case, it is alleged that the same conduct of the respondent constitutes both exclusive dealing contrary to Section 47 of the Act and price discrimination contrary to Section 49 of the Act. In other words, the giving of a substantial discount on certain conditions can be price discrimination and also, constitute exclusive dealing contrary to Section 47. Indeed, in the applicant's submission, it is the combination of the large systematic discounts and the exclusive dealing condition which greatly increases the adverse anti-competitive effects in the present case...²³

It is also to be noted that the purpose of the discrimination in s. 49(1) is irrelevant and this may be compared with the provisions of s. 47(10).²⁴

Limitations of section 49

7.22 Following on from the few instances of section 49 being used in court proceedings, and in addition to questions about the approach taken by enforcement agencies to pursuing section 49 cases, are questions about the possible limitations of the section. The Hilmer Report outlined what, in its view, were practical difficulties with the provision:

It is not clear what degree of similarity is required for goods to be regarded as being "of like grade and quality"; it is not clear what might constitute a "reasonable" allowance for differences in cost; and it is not clear whether,

20 *Re Cool and Sons Pty Ltd Trading As Wagga Windscreen Service v O'Brien Glass Industries Limited* [1981] FCA 95. National Association of Retail Grocers of Australia, *Submission 50*, pp. 8–9.

21 National Association of Retail Grocers of Australia, *Submission 50*, pp. 8–9.

22 Mr Andrew Deitz, Department of the Treasury, *Committee Hansard*, 10 March 2011, p. 13.

23 *Re Cool and Sons Pty Ltd Trading As Wagga Windscreen Service v O'Brien Glass Industries Limited* [1981] FCA 95 (Keely J); cited by Department of the Treasury, *Submission 111*, p. 15.

24 *Re O'Brien Glass Industries Limited v Cool & Sons Pty Limited Trading As Wagga Windscreen Service* (1983) 77 FLR 441 (Fox, Franki and Sheppard JJ); cited by Department of the Treasury, *Submission 111*, p. 15.

when meeting a competitor's price, the goods must bear the same degree of similarity to the competitor's goods as is required by the phrase "of like grade and quality". The cost defence does not necessarily correspond with those factors which firms would monitor or consider significant.²⁵

7.23 The ACCC also explained what it saw as the key limitations of the section:

If you look at section 49, basically it said price discrimination is unlawful if it has the effect of 'substantially lessening competition'. Then there were a couple of exclusions, which included price discrimination because of differing costs and price discrimination in order to match a competitor. When you took all of that into account you had to be able to establish that there was the effect of substantial lessening of competition. Various types of pricing were excluded. So you ended up with a fairly small set of pricing behaviours which potentially would have fallen under that section for consideration.²⁶

7.24 Although only a small set of pricing behaviours were likely to be captured, it is not clear this should be interpreted to be a criticism of the section, as such a provision should only be targeted at very specific behaviours.

Price discrimination laws in other jurisdictions

7.25 It is evident that other key jurisdictions have a specific anti-competitive price discrimination provision in place, although the ACCC disagreed that 'most countries had it', asserting that these types of provisions have been repealed in a number of countries in recent years.²⁷

United Kingdom and Europe

7.26 In the United Kingdom, subsection 18(1) of the Competition Act 1998 provides that, with certain exceptions, 'any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom'. This provision is based on Article 82(c) of the EC Treaty, which covers trade between its member states. The UK legislation extends the prohibition to cover trade within the UK itself.

7.27 Subsection 18(2) provides a non-exhaustive list of conduct which may constitute an abuse of a dominant position, including the 'application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage'. The UK Office of Fair Trading (UK OFT), in its non-binding guidelines on the abuse of a dominant position, states:

25 *National Competition Policy*, August 1993, p. 77.

26 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 27.

27 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 45.

These are no more than examples, and are not exhaustive. The important issue is whether the dominant undertaking is using its dominant position in an abusive way. This may occur if it uses practices that have the effect of restricting the degree of competition which it faces, or of exploiting its market position unjustifiably.²⁸

7.28 The key aspect of this provision is that it requires an abuse of a dominant position—in the absence of this there is no general provision in the UK which prohibits discriminatory pricing.²⁹

7.29 A paper prepared for the American Bar Association examined a number of price discrimination cases taken in the UK. One significant action by the UK OFT against Napp Pharmaceutical Holdings³⁰ was highlighted:

Napp Pharmaceutical Holdings produced sustained release morphine tablets (MST) and distributed its product to both the hospital and community sector of the market. Hospital usage was the 'trigger' for prescription by doctors in the (much larger) community sector. Napp distributed its product to hospitals at a 90% discount from the list price in the wider community. This discount—a form of price discrimination—was held by the OFT to be an abuse of a dominant position as it served to strengthen the dominant position of Napp in such a way that the degree of dominance reached by this undertaking substantially fettered competition in the market for MST.³¹

United States

7.30 Price discrimination in the United States is directly governed by the Robinson-Patman Act of 1936 (RPA), which amended the Clayton Antitrust Act of 1914. The RPA provides that, with some exceptions and defences:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality ... and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce,

28 Office of Fair Trading (UK), *Abuse of a dominant position: understanding competition law*, December 2004, p. 4.

29 Mr Peter Whelan and Dr Philip Marsden, British Institute of International and Comparative Law, *Reflections on the Robinson-Patman Act: A Review of International Perspectives on Price Discrimination*, paper presented to the American Bar Association Antitrust Teleseminar Series, February 2006, www.biicl.org/files/60_reflections_on_the_robinson_-_patman_act_a_review_of_international_perspectives_on_price_discrimination.pdf (accessed 5 April 2011).

30 *Napp Pharmaceutical Holdings Ltd* CA98/2/2001 [2001] UKCLR 597, on appeal *Napp Pharmaceutical Holdings Ltd v The Director General of Fair Trading* [2002] CompAR 13.

31 Mr Peter Whelan and Dr Philip Marsden, British Institute of International and Comparative Law, *Reflections on the Robinson-Patman Act: A Review of International Perspectives on Price Discrimination*, paper presented to the American Bar Association Antitrust Teleseminar Series, February 2006, www.biicl.org/files/60_reflections_on_the_robinson_-_patman_act_a_review_of_international_perspectives_on_price_discrimination.pdf (accessed 5 April 2011).

or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them...³²

7.31 An official of the US Federal Trade Commission described the rationale behind the introduction of the RPA as follows:

In 1936, Congress believed that large firms could dominate markets through predation and other forms of economic warfare directed against smaller firms, and felt that "power buyers" such as large retailers could use their market power to extract price concessions from manufacturers and other sellers that were unavailable to their smaller competitors. As the Commission has stated, [t]he major legislative purpose behind the Robinson-Patman Act was to provide some measure of protection to small independent retailers and their independent suppliers from what was thought to be unfair competition from vertically integrated, multi-location chain stores.³³

7.32 In 2002, the Antitrust Modernization Commission was formed by Act of Congress to examine whether the need exists to modernize the antitrust laws and to identify and study related issues.³⁴ The Commission concluded that the RPA:

... appears antithetical to core antitrust principles. Its repeal or substantial overhaul has been recommended in three prior reports, in 1955, 1969, and 1977. That is because the RPA protects competitors over competition and punishes the very price discounting and innovation in distribution methods that the antitrust laws otherwise encourage. At the same time, it is not clear that the RPA actually effectively protects the small business constituents that it was meant to benefit.³⁵

7.33 These criticisms were also discussed by the Dawson Report when examining Australia's price discrimination laws. The Dawson Report noted:

In recent decades, this legislation has been widely criticised as being too complex, deterring price competition and promoting price uniformity. Although originally directed at large retailers, in practice it has been applied mainly against small sellers who grant discounts in order to compete against large sellers and against businesses engaging in vigorous competition.³⁶

32 Robinson-Patman Act of 1936 (US), 15 U.S.C. § 13(a).

33 Mr Donald Clark, Secretary, Federal Trade Commission, 'The Robinson-Patman Act: General Principles, Commission Proceedings, and Selected Issues', *Address to the Ambit Group Retail Channel Conference for the Computer Industry*, 7 June 1995, www.ftc.gov/speeches/other/patman.shtm (accessed 8 September 2011).

34 Antitrust Modernization Commission Act of 2002 (US), P.L. 107-273, 116 Stat. 1856.

35 Antitrust Modernization Commission (US), *Report and recommendations*, April 2007, p. iii.

36 *Report of the Trade Practices Act Review Committee*, January 2003, p. 90.

7.34 In 2008 the ACCC stated that it understood the approach of the US Federal Trade Commission to enforcing the RPA:

... has been to use the Robinson-Patman Act less and to now take action against price discrimination under the broader competition law framework (e.g. § 2 of the Sherman Act 1890), and only where the practices involved can be considered to be an attempt to monopolise. The ACCC considers that this is similar to the existing situation in Australia.³⁷

Canada

7.35 Under section 50 of the Competition Act,³⁸ price discrimination between competitors who purchase similar volumes of a product was prohibited. Section 50 was repealed in 2009.

7.36 There is a provision currently in effect addressing delivered pricing. Delivered pricing under the Competition Act refers to the practice of refusing delivery of a product to a customer, or a person seeking to become a customer, on the same trade terms at any place where the supplier ordinarily makes deliveries. Under section 81, and subject to certain exceptions, delivered pricing conduct may be ordered to cease in circumstances where a customer, or a person seeking to become a customer, is denied an advantage that would otherwise be available to them in the market.

What would a price discrimination provision in Australia achieve?

7.37 There appears to be two areas where price discrimination issues may be relevant to the dairy industry and the grocery sector generally. The first issue is the wholesale prices within the supply chain, including pricing differences between generic and branded milk and the price of milk offered by processors to different customers. The second is the different retail prices of generic and branded milk, although they are essentially the same product. An anti-competitive outcome may occur as a result of milk processors charging smaller retailers a higher price for their branded milk, to offset the lower wholesale price they receive for selling generic milk to Coles and Woolworths. The Chairman of NARGA expressed his frustration at this:

... I have to admit that it does get up my nose that every day I figure out that I am actually subsidising Fonterra to sell house brand milk to Coles by the price they charge me for their branded milk and other products.³⁹

7.38 These issues were examined by the ACCC during its 2008 inquiry into the competitiveness of retail prices for standard groceries. On the wholesale issue, the ACCC noted that the volume of sales through the major supermarket chains, their

37 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp. 443-444.

38 Competition Act (Canada), R.S.C., 1985, c. C-34.

39 Mr John Cummings, Chairman, National Association of Retail Grocers of Australia, *Committee Hansard*, 9 March 2011, p. 10.

vertical integration, and likely ability to better execute promotions largely explained wholesale price differences.⁴⁰ On these issues in the dairy industry, the ACCC stated:

Generally speaking, larger customers will be supplied on more favourable terms (i.e. more generous rebates and discounts). For example, in its public submission Fonterra stated that it achieves lower unit costs, predominantly linked to volume, when selling to large customers. Fonterra states that additional benefits in dealing with larger customers include consistent purchasing patterns which enable manufacturing efficiencies. Fonterra stated that if a smaller wholesaler or retailer was to purchase the same volume as a larger customer, in general, they may be able to achieve similar discounts from Fonterra to the larger customer.⁴¹

7.39 The different retail pricing structures of goods that were 'essentially the same' were also considered, with the ACCC stating that its view was:

As long as the labelling is not misleading, the ACCC will generally not have a concern with such practices. This is because consumers have different 'willingness to pay' for products, and this form of price discrimination can have potential benefits in allowing end users to obtain goods at more accessible prices.⁴²

7.40 The consequences of reinstating a section 49-type provision on the future of generic products were also discussed. NARGA observed that generic supermarket brand products existed when section 49 was in force. NARGA also noted that in other jurisdictions where an anti-price discrimination law exists, it has not resulted in generic products being unable to compete with branded goods. In fact, NARGA pointed out that some of the most successful supermarket chains which heavily rely on generic products operate in these environments. Tesco in the UK was cited as an example:

If they can do it, there is no reason that Coles or Woolworths or IGA or FoodWorks or Aldi could not do it in Australia. Aldi operate in the UK; Aldi operate through all Europe.⁴³

7.41 This raises the question of what a specific price discrimination provision would achieve for participants in the dairy supply chain, if such a provision is in place in countries such as the UK. As noted in the committee's *Second Interim Report*, conduct within, and the general operation of, both the dairy and grocery sectors in the UK has at times been controversial. Various governments in the UK have reacted by

40 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 441.

41 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 234 (footnotes omitted).

42 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 442.

43 Mr John Cummings, Chairman, National Association of Retail Grocers of Australia, *Committee Hansard*, 9 March 2011, p. 11.

making a mandatory code of conduct for dealings between major supermarkets and grocery suppliers, and by developing an office with responsibility for enforcing that code.

7.42 The possible result of a price discrimination provision adversely affecting consumer welfare was also raised by the ACCC:

Mr Cassidy—... before the Coles action we already had quite a discrepancy in the price of branded versus home-brand milk. Indeed, that was shown in the report of this committee in, I think, table 3.4 [of *Milking it for all it's worth*]. The gap was about 60c or 70c a litre. What Coles has done, followed by others, might have widened that gap by 10c or 12c a litre. You then get the question: if it would have applied to the Coles behaviour, what would then be the case in relation to home-brand milk and branded milk more generally? Would that section result in the cost of home-brand milk increasing by 60c or 70c a litre, back to being equal to branded milk?

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

Mr Cassidy—Yes, if you go back in history, that could be right. But I am just asking you to think a bit about what would be the outcome of that—would it be that home-brand milk would be 60c or 70c a litre dearer than it currently is?⁴⁴

7.43 The Law Council argued:

Such a law will more likely be harmful, since it would raise the cost to retailers of offering a discount on any product, because this would be required to be offered more widely than would otherwise have been the case. Such a law is likely to have the effect of increasing prices for consumer goods and staples generally, in all categories where generics or other forms of product differentiation are used, to the detriment of consumers and the economy.⁴⁵

Misuse of market power and predatory pricing

7.44 It is clear that Coles and Woolworths dominate the Australian grocery retail sector:

Senator HEFFERNAN—What percentage of the market do Coles and Woolies have in the prepackaged market? I say 80 per cent. You said it is less than that.

44 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 28.

45 Law Council of Australia, *Submission 115*, p. 4.

Mr McLeod—I think it is about 60 per cent, between 60 and 70 per cent, depending which market you use.

Senator HEFFERNAN—Just say 70 per cent for a nice easy work. That would be considerable market power, would it not?

Mr McLeod—We are very sensitive to the fact that the market share that we have ... is something that you have to be very responsible with.⁴⁶

7.45 A recent draft report issued by the Productivity Commission estimated Woolworths' market share in 2009–10 to be 38 per cent, followed by Coles at 26 per cent, Metcash at 19 per cent, ALDI with three per cent and Franklins at one per cent.⁴⁷

7.46 Many submissions and witnesses criticised the market share and market power held by Coles and Woolworths. The two major supermarket chains are able to access products on more favourable terms and conditions, including at lower prices, than other businesses such as smaller retailers and milk vendors.

7.47 Treasury commented on what is relevant when considering market power issues, noting other issues which need to be taken into account:

Senator COLBECK—... I am trying to define how we characterise misuse of market power, because that is one of the key things that people are talking about in this instance. You have two supermarkets that effectively control the retail sector. Everyone down the supply chain and some of their competitors, who I accept have vested interests, are complaining about the market power that they have in these sorts of circumstances. How do we characterise that as far as the law is concerned so that we can ensure that the balance is fair?

Mr Archer—Our submission points to a range of factors that are relevant to the consideration of the degree of competition in a particular market. That does include, but not exclusively, the degree of market share that participants have, but it also includes other factors, importantly barriers to entry that might exist in that market. We have seen in the retail sector Aldi introducing competition into the retailing sector and there is the prospect of other companies, such as Costco, coming in—they are in Melbourne.⁴⁸

7.48 As noted in chapter 6, the misuse of market power for an anti-competitive purpose is prohibited by section 46 of the CCA. Specifically, subsection 46(1) prohibits corporations that have a substantial degree of power in a market from taking advantage of that power in that or any other market for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person or deterring or preventing a person from engaging in competitive conduct in that or any other market.

46 Mr Ian McLeod, Managing Director, Coles, *Committee Hansard*, 29 March 2011, p. 57.

47 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, Draft Report, July 2011, p. 35.

48 Mr Brad Archer, Department of the Treasury, *Committee Hansard*, 10 March 2011, p. 6.

7.49 The relevance of section 46 when considering aspects of Coles' pricing decisions is clear. Treasury considers:

Concerns that the current conduct of supermarkets amounts to anti-competitive conduct would, if proven, appear capable of being dealt with under the existing prohibitions of the CCA, particularly section 46, which deals with the misuse of market power.⁴⁹

7.50 One of the forms of anti-competitive conduct that is addressed through section 46 is predatory pricing (see chapter 6 for a discussion of predatory pricing).

7.51 However, as also discussed in chapter 6, after conducting an investigation into Coles' pricing decisions, the ACCC announced in July 2011 that, in their view, the actions did not constitute predatory pricing. This led to renewed calls for amendments to the anti-competitive conduct provisions of the CCA.⁵⁰

Is section 46 adequate?

7.52 Section 46 differs from other provisions concerning general anti-competitive conduct in the CCA, as the prohibition only relates to conduct that has the 'purpose', as prescribed by the section, of substantially lessening competition. Other sections in that part of the CCA that do not prohibit conduct outright include an allowance for the 'effect' (or likely effect) of the conduct to be considered.⁵¹

7.53 The ACCC's recent announcement regarding its investigation of Coles' pricing, discussed in more detail in chapter 6, demonstrates some of the possible consequences of the lack of an effects test in section 46. The statement 'it is important to note that anti-competitive purpose is the key factor here'⁵² is particularly informative.

Recent reviews and reforms to section 46

7.54 Section 46 has been a controversial aspect of Australia's competition law, and accordingly has been subject to a number of inquiries and reviews. The last major independent inquiry, the Dawson Committee, examined the operation of section 46. In

49 Department of the Treasury, *Submission 111*, p. 3.

50 See, for example, Australian Dairy Farmers, *Submission 150B*; NSW Dairy Industry Conference, *Submission 92A*; Queensland Dairyfarmers' Organisation, *Submission 94A*; National Association of Retail Grocers of Australia, *Submission 50B*.

51 For example, paragraph 45(2)(a) of the CCA (which forms part of the provisions relating to contracts, arrangements or understandings that restrict dealings or affect competition) states 'a corporation shall not: (a) make a contract or arrangement, or arrive at an understanding, if: (i) the proposed contract, arrangement or understanding contains an exclusionary provision; or (ii) a provision of the proposed contract, arrangement or understanding has the purpose, or would have or be likely to have the effect, of substantially lessening competition...'

52 Australian Competition and Consumer Commission, 'ACCC: Coles discounting of house brand milk is not predatory pricing', *Media release*, NR 129/11, 22 July 2011.

its submission to the inquiry, the ACCC argued that the object of the general competition provisions of the CCA (then the Trade Practices Act) were to:

... prohibit various types of conduct that are likely to maintain or enhance market power other than by competitive means.⁵³

7.55 However, the ACCC's view at the time was that section 46 was of limited effect:

... if the law does not even prohibit large firms with substantial market power from taking advantage of it with the effect of damaging competition—by virtue of such actions as an anti-competitive refusal to supply, anticompetitive predatory behaviour, anti-competitive leveraging of market power in one market to damage competition in another market—the law is not only deficient as a matter of economic policy, but deficient in relation to the above objectives.⁵⁴

7.56 The ACCC were particularly concerned about the lack of an 'effects' test in section 46:

The reason for the distinction between s. 46 and the other Part IV prohibitions is not obvious. The policy objective of s. 46 is fundamentally the same as the other prohibitions in Part IV—that is, the prohibition of specified conduct that will damage competition. As well, Australia's prohibition on misuse of market power is inconsistent with similar prohibitions in the United Kingdom, Europe and the United States. The Commission believes the distinction between s. 46 and the other Part IV provisions should be removed. However, this does not suggest that the purpose test in s. 46 is inappropriate. As in ss. 45 and 47 a purpose test is an important element of s. 46 where it can be proved.⁵⁵

7.57 However, on the need for an effects test the Dawson Report concluded:

The difficulty in proving purpose may be doubted. Not only may purpose be inferred, but the proof that is required is on the civil standard of the balance of probabilities only, and not on the criminal standard of proof beyond reasonable doubt. The purpose does not have to be the sole or dominant purpose. An admission of purpose is not required, much less an admission in the documentary form of a 'smoking gun'.⁵⁶

53 Australian Competition and Consumer Commission, *Submission to the Trade Practices Act Review Committee*, June 2002, p. 67.

54 Australian Competition and Consumer Commission, *Submission to the Trade Practices Act Review Committee*, June 2002, p. 68.

55 Australian Competition and Consumer Commission, *Submission to the Trade Practices Act Review Committee*, June 2002, p. 78.

56 *Report of the Trade Practices Act Review Committee*, January 2003, p. 77.

7.58 The Dawson Report also provided reasons for section 46 being limited to a purpose test, noting that the other provisions relating to anti-competitive conduct, such as sections 45 and 47, are:

... concerned with conduct involving competitive relationships between two or more corporations, whereas section 46 is concerned with unilateral anti-competitive behaviour on the part of a corporation with a substantial degree of market power. It is the behaviour which gives rise to the prohibition rather than its effect...⁵⁷

7.59 The Dawson Report also considered that an effects test would discourage competition:

Not only would the introduction of an effects test alter the character of section 46, but it would also render purpose ineffective as a means of distinguishing between legitimate (pro-competitive) and illegitimate (anti-competitive) behaviour. The section is aimed against anti-competitive monopolistic practices, not competition, even aggressive competition. The distinction is sometimes a different one, but it is one that section 46 seeks to maintain and in doing so seeks to balance the risk of deterring efficient market conduct against the risk of allowing conduct that would damage competition and reduce efficiency.⁵⁸

7.60 A similar debate was conducted at the time of the Hilmer Report, with the Trade Practices Commission, the forerunner to the ACCC, proposing that unilateral conduct that has the effect of substantially lessening competition should be prohibited.⁵⁹

7.61 The High Court's decision on the predatory pricing case *Boral v ACCC*⁶⁰ was a turning point for section 46. In March 1998 the ACCC commenced proceedings in the Federal Court alleging that Boral Masonry misused its market power by selling concrete masonry products at or below its cost of manufacture to drive out a new competitor. The case went all the way to the High Court which, in February 2003 and by a 6-1 majority, found that Boral did not have substantial market power. The ACCC stated in 2003:

The High Court decision in the Boral case, in our view—and in the view of senior counsel—has given a legal interpretation to the wording of section 46, which indicates that parliament did not achieve its intention. The use of the words 'substantial degree of market power' did not lower the threshold below that of dominance as was previously the case with section 46. This is a legal issue. What we have said is that as the High Court appears to have made it clear that parliament did not achieve its intention

57 *Report of the Trade Practices Act Review Committee*, January 2003, p. 79.

58 *Report of the Trade Practices Act Review Committee*, January 2003, p. 80.

59 *Report of the Trade Practices Act Review Committee*, January 2003, p. 70.

60 *Boral Besser Masonry Limited v Australian Competition and Consumer Commission* [2003] HCA 5.

and, as there is now some uncertainty as to what 'substantial degree of market power' now means, it is appropriate for parliament to revisit the intention it expressed in 1986 to clarify the meaning of section 46 and, in particular, to clarify the threshold for the application of the section in the way that was evidenced by the intention of parliament in 1986.⁶¹

7.62 Amendments were made to the competition provisions of the Trade Practices Act in 2007 and 2008.⁶² These included the clarification of what is meant by substantial degree of market power, factors the court may consider in determining whether a corporation has taken advantage of its market power, and an amendment (subsection 46(1AAA)) to specify that a corporation may breach subsection 46(1) even if it cannot, and might not ever be able to, recoup the losses incurred from below cost supply. In 2007, a provision to address predatory pricing conduct—subsection 46(1AA), or the 'Birdsville Amendment'—was also introduced.

7.63 The Law Council considers that 'these amendments have clarified section 46' and that 'the ACCC is now in a position where it could, in an appropriate case, more confidently prosecute conduct in breach of section 46'.⁶³

7.64 However, issues about the sole reliance on the purpose test in section 46 may still remain. The ACCC's current ability to pursue a case under section 46 was examined by the committee:

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

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

Mr Bezzi—I slightly qualify that by saying that if you are dealing with an organisation that is in the habit of having lots of exchanges by email and you get your hands on emails which really indicate what their true purpose

61 Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission, *Senate Economics References Committee Hansard*, Inquiry into the effectiveness of the *Trade Practices Act 1974* in protecting small business, 31 October 2003, p. 85.

62 *Trade Practices Legislation Amendment Act (No. 1) 2007* and the *Trade Practices Legislation Amendment Act 2008*.

63 Law Council of Australia, *Submission 115*, p. 6.

was, it can sometimes be an easier case than for purpose, in practical terms.⁶⁴

7.65 During this inquiry, the committee received evidence indicating that criticism of the section still exists:

Section 46 has failed in its objective of dealing with abuses of market power. There were High Court decisions that basically undermined the effectiveness of section 46.⁶⁵

The lack of prosecutions under section 46 despite ongoing concerns in industry suggest that it may not contain the powers necessary to overcome problems within industries such as the dairy industry.⁶⁶

7.66 On the other hand, Treasury and the Law Council also point out that the new provisions introduced in 2007 and 2008 are largely untested.⁶⁷ The ACCC also noted that since the Boral case they have succeeded in a predatory pricing case against Cabcharge:

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

Mr Cassidy—That was Cabcharge, and we are awaiting judgment on another case in the courts at the moment.⁶⁸

7.67 Perhaps indicating a change in the ACCC's approach to deciding whether to litigate matters, its new chairman⁶⁹ recently remarked:

The ACCC's success rate in first instance litigation stands at almost 100 per cent. This is frankly too high. It may sound strange to say so, but benchmarking against our international counterparts we are sitting at a

64 Mr Brian Cassidy, Chief Executive Officer; Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 26.

65 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 48.

66 NSW Farmers' Association, *Submission 124*, p. 11.

67 Department of the Treasury, *Submission 111*, p. 12; Law Council of Australia, *Submission 115*, p. 3.

68 Mr Brian Cassidy, Chief Executive Officer; Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, p. 44.

69 On 1 August 2011, Mr Rod Sims took over from Mr Graeme Samuel as Chairman of the ACCC.

much higher level of success. Of course I'm happy with the implication that ACCC staff handle cases well, but the flip side is that we have been too risk averse. We need to take on more cases where we see the wrong but court success is less assured...

... There is a need, I believe, to test some aspects of Section 46 in the courts. Although there is some case law on "taking advantage of market power", the precise boundaries of that concept are not yet clearly defined. There is also a need to test some relatively new laws. For instance, in predatory pricing, we have yet to test our view of what "sustained period" means. It is in the public interest that these issues are tested, and the ACCC will take appropriate legal cases to do so.⁷⁰

7.68 When asked whether section 46 needed adjustment, the new ACCC Chairman repeated his view that more test cases need to be taken, but also that:

... 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.⁷¹

Divestiture and limits on market share

7.69 This inquiry also heard calls for the major supermarkets to be forced to divest their assets and for a general divestiture power to be available to the courts as a remedy for anti-competitive conduct. The issue of divestiture was also considered by this committee in its previous inquiry,⁷² and as part of other inquiries, such as the inquiry into competition in the Australian banking sector.

7.70 A general divestiture power which would enable the ACCC to take court action to break up existing companies is not a feature of Australia's competition laws. At present, the ACCC's divestiture powers are limited to seeking divestiture in merger and acquisition matters if the merger parties proceed with a transaction that is found to have the effect, or be likely to have the effect, of substantially lessening competition in a market. An application to the court for such a divestiture must be made within three years.

7.71 Associate Professor Zumbo explained how a general divestiture power could be framed:

70 Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, 'ACCC: Future Directions', *Address to the Law Council Competition and Consumer Workshop 2011*, 28 August 2011, pp. 5, 6 www.accc.gov.au/content/index.phtml/itemId/1004650/fromItemId/8973 (accessed 8 September 2011).

71 Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 42.

72 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, pp. 54–5.

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

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

Prof. Zumbo—In practice it could be sold off as particular units, and it could be broken up on a geographical basis. It would be up to the discretion of the court in appropriate circumstances. In the case of vertically integrated companies it could be a vertical separation. It would need to depend very much on the particular factual context.⁷³

7.72 The Australian Food and Grocery Council did not express a firm view on the need for a divestiture power, but supported a broader inquiry to consider issues such as divestiture. Their Chief Executive Officer argued that:

I do not think you would jump into something like anti-trust laws or divestiture or whatever until you had really determined what the cost benefit of that was.⁷⁴

7.73 A general divestiture power does exist in the United States and United Kingdom. The use of the power is probably most well known in the context of 'trust-busting', such as the breaking up of Standard Oil ordered by the Supreme Court in 1911.⁷⁵ The Dawson Report, with reference to *United States of America v Microsoft Corporation*, commented that the experience in the United States has been:

... that divestiture is a remedy which is much more suited to dealing with anti-competitive mergers than to dealing with the conduct of unified enterprises, as would be the case if it were applied to a misuse of market power. A corporation that has expanded by acquisition often has pre-existing lines of division along which it may more easily be split than a corporation that has expanded through organic growth. Courts have, in the United States, referred to the logistical difficulty of 'unscrambling' the latter without greatly harming the efficiency of a viable market participant.⁷⁶

73 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 51.

74 Mrs Kate Carnell, Chief Executive Officer, Australian Food and Grocery Council, *Committee Hansard*, 10 March 2011, p. 35.

75 *Standard Oil Co. of New Jersey v United States*, 221 U.S. 1 (1911).

76 *Report of the Trade Practices Act Review Committee*, January 2003, p. 162; *United States of America v Microsoft Corporation*, United States Court of Appeals, No. 00-5212, 28 June 2001.

7.74 In *United States v Microsoft*, the Court of Appeal observed that 'divestiture is a remedy that is imposed only with great caution, in part because its long-term efficacy is rarely certain'.⁷⁷

7.75 The ACCC has in the past noted that in the United States, the divestiture power is a remedy for monopolisation.⁷⁸ Depending on how it is drafted, such a law may not be effective for markets where there is more than one large participant.

7.76 There are also likely constitutional implications. Section 51(xxxi) of the Constitution states that:

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws.

7.77 Depending on the form a divestiture law takes, it may fall under this provision—thus requiring the acquisition to be on 'just terms' and likely involving significant compensation.

Mergers and acquisitions

7.78 The law governing mergers and acquisitions, and the ACCC's approach to assessing these transactions, is a particularly relevant area to consider due to the high degree of market concentration in both the grocery retailing sector and the milk processing industry.

7.79 Section 50 of the CCA prohibits acquisitions that would have the effect, or likely effect, of substantially lessening competition in a substantial market in Australia. Subsection 50(3) provides a non-exhaustive list of factors which must be taken into account when assessing whether a merger would be likely to substantially lessen competition. The ACCC's *Merger Guidelines 2008* also provides guidance on the ACCC's approach when reviewing and analysing acquisitions.

7.80 During its previous inquiry related to the dairy industry, the committee heard a lot of criticism about the ACCC decision not to oppose, on condition that certain divestitures took place, the acquisition of Dairy Farmers by National Foods. The committee noted that the acquisition resulted in a significant reduction in competition,

77 *United States of America v Microsoft Corporation*, United States Court of Appeals, No. 00-5212, 28 June 2001, www.justice.gov/atr/cases/f257900/257941.htm (accessed 6 April 2011).

78 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Senate Economics References Committee Hansard*, Inquiry into competition in the Australian banking sector, 25 January 2011, p. 56.

notably in Tasmania.⁷⁹ On the other hand, the NSW Farmers' Association noted there may have been some benefits from the divestitures the ACCC required:

The resulting divestiture of National Foods assets as a result of their purchase of Dairy Farmers has provided opportunity for Parmalat to enter the NSW industry both as a buyer of NSW milk off farm, as a processor with NSW based infrastructure, and also a brand. This does provide an additional market for farmers however the full extent of this competition is not yet realised.⁸⁰

7.81 The committee is also aware of criticism from a number of areas regarding the continued concentration of the grocery market in general, including through creeping acquisitions.⁸¹ The committee's 2010 report *Milking it for all it's worth* examined market share issues, in both anti-competitive conduct and merger contexts, in other jurisdictions:

It is a matter for judgement what market share might be regarded as raising potential concerns about market power. The European Commission takes the view that a firm would generally have a dominant position once it reaches a market share of 40-45 per cent and may achieve a dominant position in the region of 20-40 per cent.

This is broadly consistent with approaches in some individual European countries. The Austrian Cartel Act places the burden of proof on a company to show it is not dominant where its market share exceeds 30 per cent. In Germany a market share of a third is taken as indicating dominance. The corresponding threshold in Bulgaria is 35 per cent and in Croatia, Estonia, Lithuania, Poland and Serbia 40 per cent. In Malta a company with a 40 per cent market share is deemed dominant unless it provides evidence to the contrary. In Sweden a market share of 40 per cent is regarded as indicative of dominance. Latvia and Slovakia have removed their previous 40 per cent thresholds for defining dominance. A firm would, of course, have some market power well before reaching dominance.

The US Department of Justice's benchmark for challenging mergers is where the sum of the squared percentage market shares of the merging companies exceeds 1800. This would occur if two firms each having a 30 per cent market share wanted to merge; or a firm with a 40 per cent market share wanted to take over a competitor with a 14 per cent market share.⁸²

79 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 62.

80 NSW Farmers' Association, *Submission 124*, pp. 4–5.

81 The committee's sister legislation committee has previously examined the issue of creeping acquisitions. See Senate Economics Legislation Committee, *Competition and Consumer Legislation Amendment Bill 2010 [Provisions]*, 15 June 2010; *Trade Practices (Creeping Acquisitions) Amendment Bill 2007 [2008]*, 26 August 2008.

82 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 60 (footnotes omitted).

7.82 The United States model is supported by some smaller retailers in competition with Coles and Woolworths:

CHAIR—It is really all about market share, isn't it? In the United States they do limit market share. Do you think that would be something that we should consider in Australia to facilitate competition?

Mr Reynolds—I would love to see that. There has to be a balance of green sites going to the independents and also distance between stores. The Woolworths store got the green site that we were chasing and had spent several years trying to achieve. We got into a bidding war and, of course, we could not afford it. We had done our sums and told the landlord what we could afford, what we wanted to do, and Woolworths just outbid us. In the end we are situated in the same footprint that we had when we started the business 25 years ago.⁸³

7.83 The committee notes that the Competition and Consumer Legislation Amendment Bill 2011, aspects of which relate to the consideration of acquisitions in local markets (including creeping acquisitions), is currently before the Senate.

Ex-post analysis of merger decisions

7.84 The lack of any analysis of the actual effects of the ACCC's merger decisions after they have been made was discussed in the committee's 2010 report, *Milking it for all it's worth*. The committee observed:

There is inadequate assessment of whether markets have become excessively concentrated because the agency assessing this (the ACCC) is the same agency that approved the mergers leading to the high degree of concentration.⁸⁴

7.85 This issue was also raised in the committee's recent inquiry into competition within the Australian banking sector. Competition academic and former ACCC Commissioner (during which time he chaired the ACCC's Mergers Review Committee), Professor Stephen King, was asked about the merits of reviewing past merger decisions during the banking competition inquiry. He appeared generally in favour of the idea:

One of the things that we have not had in Australia which has occurred within the competition agencies in the US, for example, is an ex post evaluation of mergers—a looking back after five or six years out to see whether the decision that was made was the right decision. We need to find out whether a decision that was good at the time make a difference, whether that decision was to allow a merger to go ahead or to oppose a merger. That

83 Mr David Reynolds, Yentrac, trading as Goolwa Foodland, *Committee Hansard*, 8 March 2011, p. 47.

84 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 65.

sort of exercise would allow us to, in a sense, check that our laws are appropriate.⁸⁵

7.86 Reflecting later, Professor King observed:

This type of retrospective study represents best regulatory practice. The U.S. antitrust authorities have carried out this type of study. One recently published example is in the Review of Industrial Organization (subscriber only). However, such a study is a major piece of work as the econometricians have to try and tease out the relevant effects.

The benefits of such a study are clear. It allows feedback to both the regulators and the legislature about our competition laws and their implementation. If the federal government made the resources available to do this exercise (and required relevant businesses to provide relevant data, such as retail scan data) then this would be a good outcome.⁸⁶

Is there a need to review the Competition and Consumer Act?

7.87 In its previous inquiry, the committee concluded:

A combination of narrow interpretations by the courts of expressions in the *Trade Practices Act 1974* and the repeal of section 49 mean that the Act fails to provide adequate protection against excessive market concentration and abuse of market power.⁸⁷

7.88 The committee subsequently recommended that a review of section 46 and a Productivity Commission review of the effectiveness of the National Competition Policy be undertaken.

7.89 Some time has passed since the last major independent review of Australia's competition framework. It is also apparent that some of the findings of these reports take time to enact. Most of the amendments made as a result of the Dawson Report came into effect at the start of 2007. While the report furthered the push to introduce criminal sanctions for cartel conduct, such laws were only passed by the Parliament in 2009.

7.90 Since the Dawson Report was published, however, there have been many amendments either made or proposed to the Trade Practices Act/CCA. Australia's competition laws are evidently not complete—the current proposals to address price signalling and the issue of creeping acquisitions are clear examples.

7.91 A review of the CCA had some support:

85 Professor Stephen King, *Committee Hansard*, 21 January 2011, p. 109.

86 Professor Stephen King, 'Retrospective merger analysis', *Core Economics blog*, economics.com.au/?p=6638 (accessed 5 April 2011).

87 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 65.

The AFGC seeks a review of the effectiveness of the *Competition and Consumer Act 2010* ... to establish and respond to anti competitive pricing behaviour.⁸⁸

Consideration and review of the *Competition and Consumer Act 2010* ... to determine if the Act is effective in dealing with actions such as those taken by Coles recently with a view to changing provisions to ensure that such conduct is not repeated.⁸⁹

7.92 The key advantage of a broad inquiry into Australia's competition laws is that it would allow a wide range of views and issues to be considered with an economy-wide focus. It would also allow the ACCC's and Treasury's views and proposals on a number of issues to be examined.

7.93 Other organisations, such as the Law Council, considered the number of recent changes make moves to review or reform the CCA premature:

... it is still too early for the full effect of these changes to be confirmed, and so it is important that the ACCC be given the opportunity to test those new powers before further reform of section 46 is considered...⁹⁰

7.94 It is clear that care needs to be taken in recommending amendments to economy-wide competition laws. Treasury warned:

Where policies are being proposed which contemplate government intervention in markets in response to an identified market failure, consideration must be given to Clause 5 of the Competition Principles Agreement 1995. Relevantly, it provides that, when intervening in markets, competition should not be restricted unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs, and
- the objectives of the legislation can only be achieved by restricting competition.

... If a market failure is identified in a particular industry, industry-specific measures may need to be considered, and it is likely such measures would be preferable to amending the economy-wide competition laws. Any proposals to amend the provisions of the CCA which seek to correct market failures in one sector need to carefully weigh the full range of possible costs and benefits which would accrue across the economy.⁹¹

7.95 General concerns about the form of a government response were also shared by participants in the grocery sector. IGA argued that although 'this price war is not

88 Australian Food and Grocery Council, *Submission 100*, p. 11.

89 Australian Dairy Industry Council, *Submission 96*, p. 3.

90 Law Council of Australia, *Submission 115*, p. 3.

91 Department of the Treasury, *Submission 111*, p. 3.

part of the normal competition in grocery retailing ... government and regulatory intervention may be worse than the problem that they try to solve'.⁹²

Committee view

7.96 During this inquiry, the committee received many submissions and took a significant amount of evidence at public hearings in which the effectiveness of Australia's competition laws was questioned. Among other key issues raised were the repeal of the specific anti-competitive price discrimination law in 1995 and the lack of an 'effects' test in provisions such as section 46 of the CCA, which currently is tasked to deal with price discrimination issues as well as other misuses of market power.

7.97 The committee notes that the object of Australia's competition law is to enhance the welfare of Australians. Competition law is not intended to protect competitors, but instead is intended to promote the competitive process. With respect to this object, the concentration of the grocery market, the market power that Coles and Woolworths may have and the ability of smaller retailers to compete with their purchasing power, are concerning issues for the operation of the grocery sector and for longer-term consumer welfare.

7.98 Concerns with aspects of the competition law and the approach taken to their enforcement have also been raised in the context of other sectors and in several other inquiries previously conducted by the pair of Senate economics committees. However, the committee is firmly aware that this inquiry has been primarily focused on the dairy supply chain, with broader elements of the grocery sector necessarily examined as well. Australia's competition law is usually framed to apply to the entire economy. Any amendments to the CCA that are proposed as a result of issues facing the dairy industry and/or grocery sector need to be examined to determine how they will impact other sectors and overall consumer welfare. As this inquiry was directly focused on the dairy industry, other sectors may not have had the opportunity to engage on these issues as part of this process. Accordingly, the committee has not formed a view on the merits or otherwise of the proposals put forward for amendments to the CCA. Such issues could be appropriately dealt with by a specific independent inquiry into the CCA which allows for submissions and evidence to be taken from all areas of the economy.

7.99 The last independent inquiry of the CCA/Trade Practices Act was the Dawson Committee, which commenced in 2002 and reported in early 2003. The inquiry before that was the Hilmer Committee, which was finalised in 1993. Since the Dawson Report, a number of amendments have been made to section 46 of the CCA. The committee urges the ACCC to identify and litigate appropriate matters that will enable these recent amendments to be tested in the courts. However, questions remain about the operation of certain provisions. Additionally, in recent years a number of other competition issues including price signalling, creeping acquisitions, geographic price

92 IGA Retail Network, *Submission 112*.

discrimination and, as noted earlier in the report, the effectiveness of current collective bargaining arrangements have been raised. It appears appropriate that, rather than recommending piecemeal amendments, an independent inquiry be formed to fully address any perceived gaps in Australia's competition law.

Recommendation 5

7.100 The committee recommends that the Government initiate an independent review of the competition provisions of the *Competition and Consumer Act 2010*.

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

Government Senators' Additional Comments

1.1 It is clear that the price reductions in private label milk announced by Coles on 26 January 2011, and followed by other supermarkets, have caused significant concern and anxiety within elements of the dairy industry in Australia—particularly in the regions which are more focused on drinking milk production, such as Queensland, New South Wales and Western Australia.

1.2 Government Senators on the committee broadly support the approach and a number of the recommendations of the majority report. We believe recommendations 1–3 of the report are sensible initiatives for both industry and government to adopt in a complex, deregulated industry. We also support recommendation 4 of the majority report which encourages the Australian Competition and Consumer Commission (ACCC) to publicly release greater information about its investigations and current enforcement activities.

1.3 Government Senators also agree with the majority report's observation that the benefits gained by consumers due to the lower price of a staple good have not received enough attention, particularly as in recent years concern about food prices has been focused on them being too high, rather than too low. As the Parliamentary Secretary to the Treasurer, the Hon. David Bradbury MP, stated in April this year:

In my living memory, the debate around competition in the supermarket sector has always been characterised by concerns about prices being too high. It is, in my view, ironic that we are now having a public debate about prices being too low.

While I understand that people are concerned about significant market concentration in the sector, it should be noted that recent developments in the supermarket sector demonstrate that aggressive competition can occur and is occurring.¹

1.4 In this context, however, Government Senators are concerned with recommendations 5 and 6 of the majority report. In 2008, the ACCC conducted a broad-ranging public inquiry into the competitiveness of retail prices for standard groceries. This included an examination of the drinking milk industry. The report found that the grocery sector was 'workably competitive', although one of the findings was that the level of price competition was restricted by the limited incentives for Coles and Woolworths to compete.² The more frenzied price competition that has been occurring recently between the two major supermarket chains, such as the price

1 The Hon. David Bradbury MP, Parliamentary Secretary to the Treasurer, 'The critical role of competition policy', *Address to Regulatory Reform Conference*, 12 April 2011.

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

discounts for private label milk, appears to be an improvement on the situation in 2008 in this regard, and of clear benefit to consumers.

1.5 With specific reference to the drinking milk industry, ultimately Coles cannot put the sustainability of the supply chain at risk. With strong consumer preferences for fresh drinking milk throughout Australia, Coles has to ensure that it is able to be supplied with that product. In other words, those down the supply chain also have power in the sense that retailers depend on the supply of fresh drinking milk to satisfy consumer demands. As noted by the Chairman of the ACCC:

... [it] 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.³

1.6 Additionally, dairy farmers do not appear worse off from the growth in private label milk that has occurred over time. While there may be some short-term uncertainty due to changes in private label milk contractual arrangements between the major supermarkets and the processors, this appears to be a separate issue. The ACCC's 2008 report concluded that the lower price of private label milk over time has appeared to shift margin away from processors (with benefits for both the major supermarkets and consumers), while not resulting in a reduced farm gate price.⁴

1.7 The processors have provided evidence to the committee about the slim or negative margin they receive on private label milk. In a free market, it is up to the processors—who after all supply both the private label and branded products to the supermarkets—to decide on what terms they are willing to continue to do this. Provided they do not contravene competition laws in doing so, or are not being subjected to clear anti-competitive conduct themselves, it is not apparent why their concerns should be anything else than a matter for them to address in the marketplace.

Competition law

1.8 As noted earlier, Government Senators are particularly concerned about recommendation 5 of the majority report regarding a review the *Competition and Consumer Act 2010* (CCA), formerly the *Trade Practices Act 1974*. The object of Australia's competition law is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.⁵ The ACCC, the independent statutory authority charged with enforcing the CCA, undertook an investigation of Coles' actions and concluded that there 'is no evidence'

3 Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 32.

4 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 384.

5 *Competition and Consumer Act 2010*, s. 2.

that Coles has acted in breach of the CCA.⁶ The ACCC issued a statement outlining its findings:

"It is important to note that anti-competitive purpose is the key factor here. Price cutting, or underselling competitors, does not necessarily constitute predatory pricing. Businesses often legitimately reduce their prices, and this is good for consumers and for competition in markets", Mr Samuel said.

ACCC enquiries have revealed evidence that Coles' purpose in reducing the price of its house brand milk was to increase its market share by taking sales from its supermarket competitors including Woolworths. This is consistent with what the ACCC would expect to find in a competitive market.

After Coles price reductions, Woolworths and other supermarket retailers have also reduced prices for house brand milk.

The ACCC's enquiries show that there is a significant variation between respective costs of supply and operating margins among supermarket operators.

"As to the relationship between dairy farmers and milk processors, it is the case that some processors pay some farmers a lower farm gate price for milk sold as supermarket house brand milk. However on the evidence we've gathered over the last 6 months it seems most milk processors pay the same farm gate price to dairy farmers irrespective of whether it is intended to be sold as branded or house brand milk" ... Mr Samuel said.⁷

1.9 Government Senators are concerned that this proposed review is based on arguments from stakeholders who seem to support undoing certain competition law reforms. Further, undertaking a review of a law which applies economy-wide based on perceived issues in one sector (dairy) is far from an ideal approach. Indeed, an attempt to amend Australia's competition laws based on alleged anti-competitive conduct in one industry could significantly harm the Australian economy.

1.10 It is also not clear how the amendments to the competition law that were suggested during this inquiry could meaningfully assist participants in the dairy industry. Key witnesses put compelling arguments against reinstating an anti-competitive price discrimination provision in the CCA. Other suggestions were also countered. At the 6 October 2011 hearing the ACCC chairman, Mr Rod Sims, remarked with respect to the Coles discounts that, even under a section 46 test which allowed for the anti-competitive 'effects' of an action to be used to prove a misuse of market power (generally considered to be a lower threshold than the current test which

6 Australian Competition and Consumer Commission, 'ACCC: Coles discounting of house brand milk is not predatory pricing', *Media release*, NR 129/11, 22 July 2011.

7 Australian Competition and Consumer Commission, 'ACCC: Coles discounting of house brand milk is not predatory pricing', *Media release*, NR 129/11, 22 July 2011.

requires one of three prescribed anti-competitive *purposes* to be proven), he was still 'not sure it would have got up'.⁸

1.11 As acknowledged by the majority report, in 2007 and 2008 a number of amendments were made to section 46 of the CCA which are yet to be tested in the courts. Mr Sims has indicated that he is 'very keen' to find cases that would test these amendments.⁹ Government Senators are of the view that it would be premature to review the competition provisions of the CCA and consider amendments to them until they are tested, or it is otherwise clear that they are not functioning as intended.

Collective bargaining

1.12 The majority report recommended that the Government review the effectiveness of collective bargaining laws and arrangements for agricultural industries.

1.13 There does not appear to be clear evidence which leads to this recommendation. Government Senators note the evidence from officials of the Department of Agriculture, Fisheries and Forestry and the ACCC on collective bargaining in the dairy industry—while recognising the current provisions have been used, they acknowledged that more use of the provisions could be made.¹⁰

1.14 Government Senators also note the following comments from the ACCC:

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 ... we see that as one of the answers to the situation that dairy farmers perhaps find themselves in dealing with processors, particularly when they have only got one to deal with.¹¹

1.15 Rather than indicating that the collective bargaining laws need review, it may be the case that the dairy industry needs to become more aware on how to utilise the current law to its full potential.

8 Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 35.

9 Mr Rod Sims, Chairman, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 39.

10 Mr Simon Murnane, Department of Agriculture, Fisheries and Forestry, *Committee Hansard*, 10 March 2011, p. 24; Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 9 March 2011, pp. 39–40.

11 Mr Brian Cassidy, Chief Executive Officer, Australian Competition and Consumer Commission, *Committee Hansard*, 6 October 2011, p. 32.

Recommendation 1

1.16 Government Senators recommend that the government takes steps to promote awareness of options for agricultural industries to develop more effective collective bargaining arrangements.

Other issues

1.17 It is apparent that much of the evidence put forward in the inquiry was influenced by so-called 'processor arguments', which contend that because processors offset low returns or losses from private label milk with higher returns from their branded products, shifts in sales from branded to private label would affect the profitability of the processors and, therefore, ultimately the incomes farmers would receive (as well as other outcomes, such as lower levels of product innovation).

1.18 As acknowledged in the majority report, it should not be a matter for public policy to protect brands that consumers no longer value. Processors are the best placed to adapt to changing market circumstances and in any event will still need a supply of milk from farmers. Farmers' incomes are dictated by separate market forces to those that determine retail prices; in most areas (although not all) they are largely influenced by international prices. In the dairying areas where the costs of production are higher, such as in Queensland, a premium is paid above international prices to reflect the cost of freighting milk from other states that would otherwise need to be paid if milk could not be sourced from Queensland.

1.19 While developments in the dairy industry and the grocery sector more generally need to be closely monitored, it is not clear that the market has failed and government action is warranted, particularly when there are such clear benefits to a large number of consumers.

Senator Mark Bishop
Deputy Chair

Senator Doug Cameron
Senator for New South Wales

**Additional Comments by
Independent Senator Nick Xenophon,
Nationals Senator John Williams,
Liberal Senator the Hon. Bill Heffernan,
Democratic Labor Party Senator John Madigan,
and Australian Greens Senator Christine Milne**

**Going 'Down Down': The long-term viability
of Australia's dairy industry**

1.1 Fresh drinking milk is a daily household staple, but the discounting of generic-brand milk to a level that even Woolworths deems 'unsustainable for the Australian dairy industry',¹ has created a situation of looming market failure in the fresh milk market.

1.2 While there may be short-term gain for consumers being able to purchase fresh milk for only \$1 per litre, the move to discount generic milk has serious long-term implications. It will damage the sustainability of dairy farmers, milk vendors, processors and ultimately supply of fresh milk to Australians.

1.3 Evidence from the United Kingdom has shown that this aggressive discounting ultimately leads to less choice for consumers, higher prices on products that are not staples and unsustainable pressure on farmers and others in the supply chain.

1.4 This unsustainable pressure severely impacts the supply chain by causing higher prices several years after the discounting, due to farmers leaving the industry and a loss of production for supply. The discounting cycle ultimately benefits no one except the retailer.

1.5 It should be noted that Coles was given an opportunity to provide additional evidence to the inquiry for its final report, but declined to appear at further hearings.

1.6 Given its pivotal role in commencing the milk price wars, and the consequences it has had on dairy farmers, milk vendors and processors, it seems extraordinary that Coles did not avail itself of this opportunity.

1.7 Since the deregulation of Australia's dairy industry in 1999, the number of dairy farmers has steadily decreased and the volume of milk production has decreased

1 Ms Natalie Samia, Woolworths Limited, *Submission 98*, p. 2.

from 11.3 billion litres in 2001/2002² to just over 9 billion litres in 2009/2010³. The supermarket milk price war will have an even deeper impact.

1.8 In its submission to the inquiry, Woolworths admitted that, while it would absorb the losses in the short term, contracts with dairy farmers and processors would ultimately have to be renegotiated:

These prices set a new benchmark, and can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years.⁴

1.9 Comments by Wesfarmers' CEO Richard Goyder do not appear to support either the claim of 'staying down' or of absorbing the cost:

Obviously if any product range has substantiated and necessary cost increases, we will look to see if we can absorb that and if we can't, we will pass those on. In the long run milk will be no different.⁵

1.10 Irrespective of how Coles' and Woolworths' discount milk campaign is funded, the above statements make it clear that ultimately it will be the farmers, the processors and the consumers who will pay.

1.11 There is no question that the enormous market power of Coles and Woolworths, which, combined, control approximately 80 per cent of Australia's dry packaged grocery market, has allowed them to engage in pricing, procurement and marketing behaviour that significantly disadvantages smaller retailers and, in particular, farmers and processors.

1.12 Such massive market power has been allowed to occur due to a combination of factors, including state planning laws and competition laws that are weak, unclear or where remedies are available, they are not vigorously enforced.

The Role of the ACCC

1.13 The Australian Competition and Consumer Commission's (ACCC) 22 July 2011 response to the milk price war firmly cements this notion. The then-Chairman of the ACCC, Mr Graeme Samuel, indicated that the milk wars were potentially good for consumers and competition within the market:

It is important to note that anti-competitive purpose is the key factor here. Price cutting, or underselling competitors, does not necessarily constitute

2 Australian Bureau of Statistics, *The Australian Dairy Industry, 1301.0 – Year Book Australia*, 2004.

3 Dairy Australia, 'Dairy at a Glance', www.dairyaustralia.com.au/Statistics-and-markets/Farm-facts/Dairy-at-a-glance.aspx, accessed 29 October 2011.

4 Ms Natalie Samia, Woolworths Limited, *Submission* 98, p. 3.

5 *Courier Mail*, Wesfarmers hints at end to discounts, 29 July 2011, p. 38.

predatory pricing. Businesses often legitimately reduce their prices, and this is good for consumers and for competition in markets.⁶

1.14 The ACCC also indicated at the time that it would continue to monitor conduct within the dairy industry and grocery sector for signs of anti-competitive behaviour.⁷ The approach of the-then Chairman appears to have been narrow and blinkered.

1.15 As predicted, this 'wait and see' response has been shown to be inadequate in supplementary evidence provided to the committee.

1.16 Mr Brian Cassidy, Chief Executive Officer of the ACCC, told the committee during the ACCC's first appearance before the committee for this inquiry that the ACCC would wait for the impacts of the heavy price discounting to be fully realised before taking any action.

According to the wording in the act, we have to have a reason to believe not necessarily that there has been a breach but a reason to believe that there may have been a breach of the law or predation. We cannot just do it off the top of our hats; we do need to have some basis to form our suspicion. We have been challenged on this in court on occasions over a period of time. It is a fairly large threshold but we do need to have something.⁸

1.17 He continued:

Our frame of reference, if you like, is to enforce the law. We need to have conduct which, at least on the face of it, may constitute a breach of the act. We cannot look at a situation, and this goes a bit perhaps to some of Senator Heffernan's questions earlier, and say, 'We do not like that, so we're going to do something about it.' It has to be in the context of a potential breach of the law.⁹

1.18 It is concerning that the ACCC does not see that it is within its capacity to investigate potential negative impacts across the supermarket supply chain and to intervene before irreversible damage to the dairy industry is done, particularly given that it has already been indicated to the committee that dairy farmers are being affected financially.

6 Mr Graeme Samuel, ACCC: Coles discounting of house brand milk is not predatory pricing, www.accc.gov.au/content/index.phtml/itemId/998776/fromItemId/142, accessed 29 October 2011.

7 Mr Graeme Samuel, ACCC: Coles discounting of house brand milk is not predatory pricing, www.accc.gov.au/content/index.phtml/itemId/998776/fromItemId/142, accessed 29 October 2011.

8 Mr Brian Cassidy, ACCC, *Committee Hansard*, 9 March 2011, p. 22.

9 Mr Brian Cassidy, ACCC, *Committee Hansard*, 9 March 2011, p. 45.

1.19 Indeed, at the committee hearing on 6 October 2011, Mr Terry Toohey, Director of the Australian Dairy Farmers, indicated that the impacts of the milk wars were taking effect:

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.¹⁰

1.20 Mr Chris Griffin, President of the Australian Dairy Farmers, suggested that the Association's primary concerns with the milk price war still remained the same, despite the conclusion of investigations by the ACCC:

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 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.¹¹

1.21 Mr Griffin further indicated that based on economic modelling, the consumer shift to generic milk as a result of the price wars could cost the value chain \$44 million annually.¹²

1.22 However, Mr Griffin has also indicated that, should the current year-to-date shift to generic milk be annualised, and as a result branded products discounted to remain competitive, an annual loss of \$227 million could be likely.¹³

1.23 Milk processor Parmalat Australia Ltd also indicated to the committee that milk price discounting is 'placing enormous pressure on processor margins through loss of branded sales', and has the 'potential to destroy the Queensland and Northern NSW dairy industries'.¹⁴

1.24 Further, a number of submitters suggested that uncertainty in the industry is undermining investment confidence. The Australian Dairy Farmers suggested that the milk price war and the long-term industry outlook are key reasons for producers limiting their investment or leaving the dairy industry altogether.

10 Australian Dairy Farmers, *Committee Hansard*, 6 October 2011, p. 3.

11 Australian Dairy Farmers, *Committee Hansard*, 6 October 2011, p. 1.

12 Australian Dairy Farmers, *Committee Hansard*, 6 October 2011, p. 2.

13 Australian Dairy Farmers, *Committee Hansard*, 6 October 2011, p. 2.

14 Parmalat Australia Ltd, *Submission 117*, p. 2.

1.25 It is clear from the evidence that the heavy discounting of generic milk products is having a dramatic financial impact on dairy farmers and processors.

1.26 Furthermore, if experiences in the United Kingdom are anything to go by, independent retailers will also suffer a considerable loss of sales as consumers opt for discounted milk.

1.27 In its submission to the committee, National Foods (now Lion Dairy & Drinks) elaborated on the experience in the UK:

While the price reduction did not increase the demand for grocery fresh white milk, the big 4 retailers were able to increase their share of grocery fresh white milk (from 55% to 59%) in just 3 months...

Further, after the big 4 retailers in the United Kingdom reduced the price of house brand milk, herds declined and more milk imports increased to the United Kingdom.

While industry level data is not yet available, National Foods anticipates that this price reduction will also result in a further shift in milk sales from independent grocery stores (e.g. IGA, Ritchies, Foodland, Franklins) and the non-grocery channel.¹⁵

1.28 The Lion Dairy & Drinks (formerly National Foods) supplementary submission also indicated that following the \$1 per litre generic milk pricing, sales at petrol stations and convenience stores declined by 2.7 per cent while grocery volumes gained 8.4 per cent over the same period.¹⁶ Meanwhile, milk sales in the 'unstructured convenience channel', which includes takeaway food shops, corner stores, coffee shops and newsagents, have decreased by 15.1 per cent on the previous year.¹⁷

1.29 The above impact is substantial and will only get worse. It shows that part of Coles' strategy is to take market share from the non-grocery channel, which means there will be fewer corner stores and independent petrol stations to compete with.

1.30 Given this impact, the ACCC's statements that it believes Coles' competitors consist of solely other supermarket retailers, are surprising.¹⁸

1.31 It is worth noting that the unparalleled market power of Coles and Woolworths in Australia is not replicated anywhere else in the world.

1.32 However, Lion Dairy & Drinks (formerly National Foods) actually suggests that the impacts could be much more severe in Australia, given our high concentration of grocery retailers.

15 National Foods, *Submission 97*, pp. 18-19.

16 Lion Dairy & Drinks, *Submission 159*, p. 7.

17 Lion Dairy & Drinks, *Submission 159*, p. 8.

18 ACCC, answers to questions on notice, 20 October 2011.

1.33 Mr Duncan Makeig of Lion Dairy & Drinks suggested in his appearance before the committee that in the long-term, providing fresh milk to non-grocery outlets may not be viable:

...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 customers 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.¹⁹

1.34 He continued:

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.²⁰

1.35 It should be noted that National Foods has expressed concerns that it is looking at a negative return on their investments, a process which is clearly not sustainable either.

1.36 Therefore, the ACCC's assertion that the major impact of the reduction in milk prices has been on the supermarkets is simply not justified by the evidence received by the committee.

1.37 It is also surprising that the ACCC feels able to make such a statement given the limited nature of their inquiries. When questioned about Coles absorbing the cost of the discounting they admitted that there had been no monitoring of the 12,000–18,000 other items in the average Coles stores.²¹

1.38 Throughout this inquiry, it has become apparent that the ACCC feels it is difficult to prove instances of predatory pricing and anti-competitive behaviour. This is due to a lack of transparency regarding the pricing behaviour of the major supermarket chains, as well as between producers and processors.

1.39 Furthermore, from a consumer perspective, the dominance of the major supermarkets means that while they may be able to selectively reduce prices, smaller milk vendors are not able to and therefore there is a lack of effective competition in the dairy sector. This lack of effective competition disadvantages consumers and can lead to higher retail prices over time.

19 Mr Duncan Makeig, Lion Dairy & Drinks, *Committee Hansard*, 6 October 2011, p. 13.

20 Mr Duncan Makeig, Lion Dairy & Drinks, *Committee Hansard*, 6 October 2011, p. 17.

21 ACCC, *Committee Hansard*, 6 October 2011, p. 37.

1.40 It is clear that the relevant legislation must be amended as a matter of priority to ensure that anti-competitive effects are monitored and dealt with comprehensively and effectively.

1.41 The fact that Woolworths and Coles (through its parent company Wesfarmers) hold the lion's share of the supermarket industry, and are increasing their share of the home improvement, liquor and petrol industries, should surely be of considerable concern to our consumer and competition watchdog.

1.42 Unlike the United Kingdom and the United States, Australia does not have an express legislative prohibition against anti-competitive price discrimination. Similarly, Australia does not have a general divestiture power. Such a power also exists in the United Kingdom and the United States.

1.43 Divestiture powers effectively deal with market power by forcing businesses to 'break up' their companies once they become so large they become anti-competitive. This in turn helps maintain a level playing field and fosters more effective competition.

1.44 Associate Professor Frank Zumbo, School of Business Law and Taxation at the University of New South Wales, suggests that Australia is 'out of step' with international practice when it comes to competition legislation:

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

The other one that I do not mention here but is one of my old favourites is that we need a general divestiture power, as per the United Kingdom and the United States. Once again, Australia is out of step with international best practice in not having a general divestiture power. To the extent that those two provisions are not in our competition laws we are out of step with international best practice and those two areas need to be remedied.²²

Recommendation 1

1.45 Amend section 46 of the *Competition and Consumer Act 2010* to effectively prohibit anti-competitive price discrimination. Consideration should be given to relevant legislation in place in the United States and United Kingdom, and the reintroduction of an 'effects test' as per section 49 of the *Trade Practices Act 1974*.

22 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 51.

Recommendation 2

1.46 Amend the *Competition and Consumer Act 2010* to provide for a general divestiture power whereby the ACCC could, in appropriate cases, apply to the Courts for the breakup of monopolies or dominant companies that engage in conduct that undermines competition.

1.47 Another key issue raised with the ACCC during the inquiry was whether it has investigated if Coles has cross-subsidised the lower prices on home brand milk with higher prices on other goods. The question remains as to whether prices and profit margins on other products are increased to make up the loss of profit on product lines that have been reduced.

1.48 The answers provided by the ACCC to a series of Questions on Notice related to this issue are concerning:

Question:

Would it be misleading if a supermarket advertised heavily that it had reduced the price of 6,000 products, but in reality it had also increased the price on the other 15,000 products or more in the supermarket?

Answer:

In addition to considering the accuracy of the representations the Courts will also consider the overall impression of the representations. The ACCC when assessing such matters needs to consider all the relevant circumstances as to whether the representations are misleading and deceptive.

Question:

Does the ACCC agree that misleading conduct under the Australian Consumer Law can occur through silence or half truths, so isn't it potentially misleading if Coles is heavily advertising the discounting of 6,000 products, but Coles is silent on increases on the other 15,000 products or more?

Answer:

The Courts have found that conduct by silence can be misleading and deceptive. Whether silence is misleading or deceptive is dependent upon all the relevant circumstances being taken into account including any specific representations made.²³

1.49 The above answers suggest that the ACCC has not appropriately and thoroughly investigated this issue.

1.50 The question of whether Coles' 'staying down' signage was misleading was also asked of the ACCC:

23 Australian Competition and Consumer Commission, answers to questions on notice, received 20 October 2011.

Question:

Isn't the "staying down" slogan, especially when the signage is seen across the supermarket, creating the impression of a discount across the supermarket product range?

Answer:

It is not possible for the ACCC to form a view that the use of this slogan in itself is likely to mislead and deceive. Consistent with previous answers we are required to consider all the circumstances including the context in which the slogan is made.

1.51 The ACCC's answer to this question was less than satisfactory. The inference can be drawn from these answers that the ACCC has yet to undertake a full and wide-ranging investigation into this issue.

1.52 It is also questionable whether Coles' public claims in its milk discount promotion campaign that its discounting would not affect processors or dairy farmers are now misleading given the evidence presented to the inquiry that the discounting is harming processors and dairy farmers.

Recommendation 3

1.53 That the ACCC undertake a full investigation into whether Coles has engaged in misleading or deceptive conduct as a result of an advertising campaign that may have created the impression that prices are coming down across the supermarket when only a percentage of products have in fact been reduced.

Recommendation 4

1.54 That the Federal Government give a direction to the ACCC under the *Competition and Consumer Act 2010* to formally monitor pricing behaviour by the supermarket chains and along the supermarket supply chain.

Supply Chain Issues

1.55 Another issue raised throughout the inquiry was the lack of transparency in contract negotiations throughout the supply chain. This lack of transparency extends to pricing behaviour by the major supermarket chains and along the supermarket supply chain.

1.56 For consumers, this means a lack of full transparency in relation to the prices of products sold in a particular supermarket. Apart from the prices in relation to weekly specials, consumers are generally not given online access to all the in-store prices of products sold in a supermarket.

1.57 In its submission to the inquiry, Queensland Dairy Farmers argued that there was a need for 'greater transparency'²⁴ when it comes to the contracts offered to farmers by processors.

1.58 As discussed in the Second Interim Report, the discrepancy between the prices paid to the processor and the producer as compared to the retailers and processors was a key concern of the Australian Dairy Farmers:

Senator COLBECK—...I wanted to make sure it was on the record that some of the arguments that are being used by Coles in this whole debate are pretty spurious. In their letter they talk about transparency in pricing. You gave some evidence that farm gate prices are on your website, so it is pretty easy to get information on farm gate prices. The real place where prices are hidden is, in fact, between the wholesaler and the retailer. That is where we have trouble getting a real understanding of what the numbers are. So where costs are really hidden is not at the farm gate; they are, in fact, hidden because of commercial-in-confidence reasons between the wholesaler and the retailer. Would that be correct?

Mr Drury—Yes.

Senator COLBECK—You do not have any sense of any of those numbers?

Mr Griffin—No, I am not aware of any. I have asked the question: is it commercial in confidence? That is the answer we get.

Senator COLBECK—So for Coles to claim that the lack of transparency is, in fact, at the farm gate is not necessarily the case.

Mr Griffin—That is right.²⁵

1.59 Indeed, the lack of communication within the supply chain; that is, farmers are unable to talk to retailers and vice versa, means that, in many ways, the 'middle men', the processors, act as a Chinese Wall.

1.60 Mr John Cummings, Chairman, National Association of Retail Grocers of Australia (NARGA) supported the calls for greater transparency in the pricing mechanism:

There is a total lack of transparency. Again, we go back to the grocery inquiry. We asked for transparency, and I think farmers have every right to expect to see transparency. If I am going to go broke, at least tell me why I am going broke.²⁶

1.61 One method of addressing this lack of transparency is by establishing a Small Business and Farming Commissioner or a Supermarket Ombudsman, to assist dairy

24 Queensland Dairy Farmers, *Submission 94*, p. 27.

25 Australian Dairy Farmers, *Committee Hansard*, 8 March 2011, p. 18.

26 NARGA, *Committee Hansard*, 9 March 2011, p. 14.

farmers in their dealings with milk processors, and milk processors in their dealings with retailers.

1.62 Such a proposal is supported by consumer group CHOICE, who have called for the establishment of a Supermarket Ombudsman to help foster a level playing field in what is becoming an increasingly highly-concentrated retail and supermarket industry.

1.63 In his appearance before the committee, CHOICE's Mr Christopher Zinn further elaborated on how the organisation envisaged an ombudsman could operate:

The ombudsman would ensure that there is a constant focus on reform and competition in the supermarket sector. The ombudsman could drive greater transparency along the supply chain, helping provide consumers with the confidence that they are paying fair prices. The ombudsman would also be able to direct inquiries and make recommendations for change where regulations or legislation is not working as it should.²⁷

1.64 Mr Zinn continued:

... If there is a reasonable belief that down the track the supply of milk, the quality of milk, the types of milk or the brands of milk that are being available or other people who retail it could suffer as a result, then the setting up of an ombudsman is warranted.²⁸

1.65 This proposal is also supported by Associate Professor Frank Zumbo, who suggested that the role of an Ombudsman or Commissioner could assist producers in negotiating their contracts with processors:

The role of a commissioner is to assist, in this particular situation, dairy farmers in their dealings with milk processors. In this context the dairy farmers themselves could approach the commissioner and an industry association on behalf of the dairy farmers could approach the commissioner, so the commissioner is a vehicle.²⁹

1.66 While Associate Professor Zumbo has suggested that a dispute resolution mechanism could be one of the Commissioner's roles, it could also address issues relating to a lack of transparency in negotiations and assist in developing industry codes.

1.67 There is considerable concern that the tactic of using milk as a cut-price marketing agent will devalue the supply chain to an unsustainable level, and therefore it is critical that suppliers and farmers have access to effective dispute resolution processes.

27 CHOICE, *Committee Hansard*, 29 March 2011, p. 84.

28 CHOICE, *Committee Hansard*, 29 March 2011, p. 89.

29 Associate Professor Frank Zumbo, *Committee Hansard*, 9 March 2011, p. 52.

1.68 Further, given the concern that supply, quality and choice of milk available to consumers could suffer as a result of price discounting, the establishment of an ombudsman is warranted.

Recommendation 5

1.69 That the Federal Government establish an Office of the Australian Small Business and Farming Commissioner.

Conduct Issues

1.70 The committee heard evidence about conduct issues along the supermarket supply chain. The behaviour of industry participants can be dealt with effectively through a new mandatory industry code of conduct under the *Competition and Consumer Act 2010*.

Given the ongoing relationship between milk processors and dairy farmers it is important that there is full transparency between the two groups regarding the immediate and future challenges in their business relationship. It is also important that dairy farmers and milk processor have access to timely and cost effective dispute resolution processes.

A framework for full transparency and timely and cost effective dispute resolution could be usefully provided by a mandatory dairy industry code of conduct under the *Competition and Consumer Act*.³⁰

1.71 Such a mandatory code could extend across the supermarket supply chain and include the major supermarket chains. An Australian mandatory code of conduct could usefully draw on the work done in the United Kingdom in developing a Supermarket Code of Practice.

1.72 A mandatory code would need to be backed up by financial penalties for breaches of the code.

1.73 Concerns have also been expressed regarding possible abuses of contractual power along the supermarket supply chain, including by the major supermarket chains. In this regard, it would be appropriate to extend the Australian Consumer Law to deal with unfair contract terms in business to business agreement involving small businesses and farmers.

Ensuring proper judicial scrutiny of unfair terms in business to business agreements involving small businesses and farmers would go a long way to promoting better business relationships within the Australian dairy industry. Such judicial scrutiny of unfair contract terms is currently lacking and unfortunately can act as a green light to, for example, milk processors that are intent on including contract terms that go beyond what is reasonably necessary to protecting their legitimate interests. In such circumstances, the

30 Associate Professor Frank Zumbo, *Submission 99*, p. 18.

new national legislative framework against unfair terms in consumer contracts could quite easily be extended to deal with unfair terms within business to business agreements.³¹

1.74 It is worthwhile looking at actions taken in the United Kingdom, where similar discounting strategies already played out with their harmful consequences on farmers and processors.

1.75 In the United Kingdom, the Competition Commission (CC) found that one of the features that adversely affected competition in the market was the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers.

1.76 The CC found that there was a detrimental effect on customers resulting from the adverse affect on competition.

1.77 In its April 2008 report titled 'The supply of groceries in the UK market investigation', the CC considered that a package of remedies consisting of the following key elements would be effective and proportionate in dealing with the various features of the market identified as having an adverse effect on competition:

- (a) The establishment of a Groceries Supply Code of Practice (GSCOP); and
- (b) The establishment of a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP.³²

1.78 The new UK Code of Practice (the Groceries Code) was designed to improve the relationship between big retailers and their suppliers by preventing certain practices from occurring.

1.79 The Groceries Code came into force on 4 February 2010 and applies to all retailers with an annual turnover of more than £1 billion in groceries in the UK (there are ten such retailers in the UK) and it must be incorporated into contracts with suppliers.

Recommendation 6

1.80 That the Federal Government develop a mandatory industry code of conduct under the *Competition and Consumer Act 2010* dealing with relationships between industry participants along the supermarket supply chain. Such a code should also include the major supermarket chains.

31 Associate Professor Frank Zumbo, *Submission 99*, p. 20.

32 Competition Commission (UK), 'The supply of groceries in the UK market investigation', April 2008, www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf, accessed 1 November 2011.

Recommendation 7

1.81 That the Federal Government extend the Australian Consumer Law framework dealing with unfair contract terms to business to business agreements involving small businesses and farmers.

**Senator Nick Xenophon
Independent Senator for South Australia**

**Senator John Williams
Nationals Senator for New South Wales**

**Senator the Hon. Bill Heffernan
Liberal Senator for New South Wales**

**Senator John Madigan
Democratic Labor Party Senator for Victoria**

**Senator Christine Milne
Australian Greens Senator for Tasmania**

APPENDIX 1

Submissions received

Submission number	Submitter
1	Ms Kath Robb
2	Mr John Macrae
3	Mr Graham Brown
4	Mr/Ms Garry, Alica, Barbara and Raymond Mauch; Shirley Ryan; Katrina Steketee
5	Normandie Farm (Dairy) Pty Ltd
6	National Baking Industry Association
7	Mr Philip Lever
8	Ms Camille Hogan
9	Dr James Neal, Neals Dairy
10	Mr Fred Haskins
11	Mr and Mrs Trevor and Lyn Garrett
12	Name Withheld
13	North Coast (NSW) Dairy Industry Group
14	Mr Paul Weir
15	Ms Leigh Shearman and Mr Don Shedden
16	Ms Anne Kermode
17	Mr David Binney
18	Mr David Hodges
19	Mr/Ms Michael and Rebecca Sneath, Andrew and Jackie Sneath
20	Mrs Michelle Martens
21	Mr Dougal Pottie
22	Mr Kerry Wilson
23	Norco Co-operative Limited

24	Mr Mervyn Mison
25	Motor Trades Association of Queensland
25a	Motor Trades Association of Queensland, supplementary submission
26	Name Withheld
27	Name Withheld
28	Mr Graham Forbes
29	Richmond Dairies Pty Ltd
30	Mr David Grainger
31	Mr Robert Miller
32	Cr Thomas Cooper, Kyogle Local Government Area
33	APCO Service Stations Pty Ltd
34	Mr Murray Johnston (and on behalf of the Johnston family)
35	Mr Jean Hoffman
36	Mr Patrick Neal
37	Mr and Mrs Adam and Donna Darley
38	Mr and Mrs Greg and Carmen Billing
39	Ms Louise Arber
40	Ms Madeleine Love
41	Consumer
42	Mr John Redgrove
43	Mr Tim Bale
44	Mr and Mrs Dallas and Juliet Clarke
44a	Mr and Mrs Dallas and Juliet Clarke, supplementary submission
45	Mrs Kayleen Tommerup
46	Mr and Mrs Darryl and Coral Rose
47	Mr and Mrs Heath and Joanne Cook
48	Mr Tony Crook MP, Member for O'Connor
49	The Hon. Thomas George MP, Member for Lismore

50	National Association of Retail Grocers of Australia Pty Ltd
50a	National Association of Retail Grocers of Australia Pty Ltd, supplementary submission
50b	National Association of Retail Grocers of Australia Pty Ltd, supplementary submission
50c	National Association of Retail Grocers of Australia Pty Ltd, supplementary submission
51	CHOICE
52	Bega Cheese Limited
53	Clover Hill Dairies
54	Mr Andrew McNamara
55	Mr and Mrs Max and Robyn Wake
56	Mr and Mrs Greg and Jenny Easlea
57	Produce and Grocery Industry Code Administration Committee
58	Mr James Geraghty
58a	Mr James Geraghty, supplementary submission
59	Mr and Mrs Robert and Suzanne Harnett
60	Ms Nola Marino MP, Member for Forrest
61	ALDI Stores
62	Mr Pat Daley
63	Name Withheld
64	Name Withheld
65	Leppington Pastoral Company
66	Dairy Farmers Milk Co-operative
67	The Hon. Robert Brokenshire MLC, Member of the SA Legislative Council
67a	The Hon. Robert Brokenshire MLC, Member of the SA Legislative Council, supplementary submission
68	Name Withheld
69	Name Withheld

70	Name Withheld
71	Name Withheld
72	Mr David Pryor
73	Mr and Mrs Ken and Kendal Bryant
73a	Mr and Mrs Ken and Kendal Bryant, supplementary submission
74	Mr Brett Kelly, Norco Co-operative Limited
75	Mr Richard Bovill
76	Mr and Mrs Peter and Suzanne Graham
77	Kiama Municipal Council
78	Cr Paul Green, Shoalhaven City Council
79	Dairy Youth Australia Inc
80	Mr Edward Wallwork
81	Fonterra Co-operative Group Limited
82	Ms Dee Margetts
83	Mr Jamie Nietschke
84	South Australian Dairyfarmers' Association
84a	South Australian Dairyfarmers' Association, supplementary submission
85	Name Withheld
86	Mr and Mrs David and Wendy Jones
86a	Mr and Mrs David and Wendy Jones, supplementary submission
87	Name Withheld
88	The Western Australian Farmers Federation Inc. (WAFarmers)
88a	The Western Australian Farmers Federation Inc. (WAFarmers), supplementary submission
89	Barossa Mid North Co-op Dairymen Ltd
90	Mr Terry Toohey
91	Amalgamated Milk Vendors Association Inc
92	NSW Dairy Industry Conference

92a	NSW Dairy Industry Conference, supplementary submission
93	W.S. Partridge and Sons "White Rocks"
94	Queensland Dairyfarmers' Organisation
94a	Queensland Dairyfarmers' Organisation, supplementary submission
94b	Queensland Dairyfarmers' Organisation, supplementary submission
95	Mr Wayne Burley
96	Australian Dairy Industry Council
97	National Foods
98	Woolworths Limited
99	Associate Professor Frank Zumbo
100	Australian Food and Grocery Council
101	Ms Marian Macdonald
102	Mr Peter Lever, Sunningdale Dairy
103	Tasmanian Farmers and Graziers Association
103a	Tasmanian Farmers and Graziers Association, supplementary submission
104	Mr Allan Baldey and Mr Dan Portegys
105	Southern Collective Bargaining Group
105a	Southern Collective Bargaining Group, supplementary submission
106	Dr Mark McGovern, Queensland University of Technology
107	Mr and Mrs Jason and Lisa Rozynski
108	Mr and Mrs Craig and Natalie Mellor
109	Mr and Mrs Michael and Paula Gray
110	Dr Carol Steiner
111	The Treasury
112	IGA Retail Network Limited
113	Queensland Dairy Organisation
114	Mr Paul Johnson
115	Law Council of Australia

116	Department of Agriculture, Fisheries and Forestry
117	Parmalat Australia Ltd
118	Ms Catherine Burley
119	Tasmanian Suppliers Collective Bargaining Group
120	Maleny Dairies
121	Ms Lis Beattie
122	Mr Steven Wilkinson
123	Ms Kym McHugh, Mayor, Alexandrina Council
124	NSW Farmers Association
124a	NSW Farmers Association, supplementary submission
125	Mr Alex Peterkin
126	Mr Richard Peterkin
127	Mr Geoffrey Quinn
128	Mr Col Peterkin
129	Ms Raelene Rosevear
130	Mr and Mrs Jack and Dorothy Haaksma
131	Coles Supermarkets Australia Pty Ltd
131a	Coles Supermarkets Australia Pty Ltd, supplementary submission
132	Mr Malcolm Fechner
133	Fleurieu Collective Bargaining Group
134	Jersey Fresh Milk Products
135	Mr and Mrs DL and JV Golinski
136	Mr Jan Darlington
137	Ms Carol Neil
138	Mr John Crompton AM, Rivington Dairy Partners
139	Name Withheld
140	Southern Councils Group
141	Mr Graeme Waugh

141a	Mr Graeme Waugh, supplementary submission
142	Foodland Supermarkets
145	AgBiz Alliance
145a	AgBiz Alliance, supplementary submission
147	Richmond Valley Council
148	Australian Egg Industry Association
149	Mr J L Carter
150	Australian Dairy Farmers Ltd
150a	Australian Dairy Farmers Ltd, supplementary submission
150b	Australian Dairy Farmers Ltd, supplementary submission
151	The Hon Tim Mulherin MP, Queensland Government
152	CHOICE and the Australian Food and Grocery Council
153	The Australian and New Zealand Ombudsman Association
154	Ms Lisa Armstrong
155	The Treasury
156	Mr Warrick Tyrrell
157	Mr Philip Depiazzi
158	Mr Keith Dunn
159	Lion Dairy & Drinks (formerly National Foods)
160	North Coast Dairy Industry Group

Additional information received

- Letter and Coles milk pricing fact sheet sent from Coles to Senator Alan Eggleston on 18 February 2011, regarding Coles' milk price reductions.
- Freshlogic study received from Coles on 21 June 2011, regarding cuts in home brand milk prices.
- Dairy Farmers Milk Co-operative, copy of contract from 8 March 2011: Flat Price Defined Volume Fixed term Contract (FP Contract).

- Letter from Australian Dairy Farmers Ltd regarding Coles' supplementary submission from 9 September 2011.
- Received from Norco Co-operative Limited on 23 March 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 March 2011.
- Received from South Australian Dairyfarmers' Association on 25 March 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 March 2011.
- Received from Queensland Dairyfarmers' Organisation on 27 March 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 March 2011.
- Received from the National Association of Retail Grocers of Australia on 25 March 2011; answers to Questions on Notice taken at a public hearing in Sydney on 9 March 2011.
- Received from the Amalgamated Milk Vendors Association on 25 March 2011; answers to Questions on Notice taken at a public hearing in Sydney on 9 March 2011.
- Received from Australian Dairy Farmers on 28 March 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 March 2011.
- Received from Foodland on 28 March 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 March 2011.
- Received from Clover Hill Dairies on 29 March 2011; answers to Questions on Notice taken at a public hearing in Canberra on 10 March 2011.
- Received from the Australian Bureau of Agricultural and Resource Economics and Sciences on 30 March 2011; answers to Questions on Notice taken at a public hearing in Canberra on 10 March 2011.
- Received from the Australian Competition and Consumer Commission on 6 April 2011; answers to Questions on Notice taken at a public hearing in Sydney on 9 March 2011.
- Received from Coles on 19 April 2011; answers to Question on Notice taken at a public hearing in Canberra on 29 March 2011.
- Received from Australian Dairy Farmers on 17 October 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 6 October 2011.
- Received from the National Association of Retail Grocers of Australia on 18 October 2011; answer to a Question on Notice taken at a public hearing in Melbourne on 6 October 2011.
- Received from the Australian Competition and Consumer Commission on 20 October 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 6 October 2011.
- Received from the National Association of Retail Grocers of Australia on 20 October 2011; answer to a Question on Notice taken at a public hearing in Melbourne on 6 October 2011.

Tabled documents

MELBOURNE, 8 March 2011

- A graph depicting branded milk market share, tabled by Ms Nola Marino MP.
- Cost structure for milk sold in Perth in one litre cartons as at June 1989, tabled by Ms Nola Marino MP.
- Letter from Ms Nikki Slee, tabled by Ms Nola Marino MP.
- Media article from Countryman from 17 February 2011, entitled "Academic questions cut-price milk battle," tabled by Ms Nola Marino MP.

SYDNEY, 9 March 2011

- Supplementary submission tabled by the National Association of Retail Grocers of Australia.
- Approximate costs in the milk supply chain in Western Australia, tabled by the National Association of Retail Grocers of Australia.

CANBERRA, 10 March 2011

- Media articles written by Professor Stephen King, "Milk headlines" from 9 March 2011 and "Milkonomics" from 27 February 2011.
- A letter from National Foods dated 4 March 2011, regarding discounting on milk, tabled by the Hon. Robert Brokenshire MLC.
- A letter from the Australian Competition and Consumer Commission dated 3 March 2011, regarding Coles and Woolworths home brand fresh milk pricing, tabled by the Hon. Robert Brokenshire MLC.
- South Australian dairy industry's strategic plan for 2010, tabled by the Hon. Robert Brokenshire MLC.
- Article from 1 February 2011 from the website Fat Prophets, entitled "Milk run," tabled by Clover Hill Dairies.
- Opening statement tabled by the Department of Agriculture, Fisheries and Forestry.
- Dairy Farmers Milk Co-operative's Central Pricing Letter, tabled by Clover Hill Dairies.
- A table entitled "Price increases on basic products compared to gate prices increases," tabled by Mr David White.

CANBERRA, 29 March 2011

- Documents referred to as 'Appendices 1-8' tabled by Coles.
- A table entitled "Spring water prices, Coles Manuka ACT (29 March 2011)" tabled by Senator the Hon. Bill Heffernan.

MELBOURNE, 6 October 2011

- A graph depicting a comparison of international retail milk prices, tabled by the Queensland Dairyfarmers' Organisation.
- A table depicting the cost of freighting milk to Queensland, tabled by the Queensland Dairyfarmers' Organisation.
- Five charts depicting the impact of the price cuts in Queensland, tabled by the Australian Dairy Farmers.
- A table depicting the growth in milk sales, tabled by the Australian Dairy Farmers.

APPENDIX 2

Public Hearings and Witnesses

MELBOURNE, 8 MARCH 2011

BASHAM, Mr David, President, South Australian Dairyfarmers Association

DAVIS, Mr Francis, Chairman, Warrnambool Cheese and Butter

DRURY, Mr Adrian, Vice President, Australian Dairy Farmers Ltd

GRIFFIN, Mr Christopher, Vice President, Australian Dairy Farmers Ltd

GRIFFITH, Mr Gregory, Executive Officer, Dairy Farmers Milk Cooperative

HOGAN, Ms Camille, Chief Financial Officer, Norco Cooperative Ltd

LORD, Mr David, Chief Executive Officer and Managing Director,
Warrnambool Cheese and Butter

LYONS, Mr Kenneth, Chief Executive Officer,
South Australian Dairyfarmers Association

McINNES, Mr Ross, Vice-President, Queensland Dairyfarmers Organisation Ltd

McNAMARA, Mr Gregory, Chairman, Board of Directors,
Norco Cooperative Ltd

MARINO, Ms Nola, Member for Forrest, Commonwealth Parliament

MARKHAM, Mr Russell, Chief Executive Officer, Foodland Supermarkets

PEAKE, Mr Robert Bowen, Executive Officer,
Queensland Dairyfarmers' Organisation Ltd

PHILLIPS, Mr Christopher, General Manager, Trade and Strategy, Dairy Australia

REYNOLDS, Mr David, Owner-Operator, Yentrac, trading as Goolwa Foodland

STACEY, Mr James, Vice President, South Australian Dairyfarmers Association

TESSMANN, Mr Brian, President, Queensland Dairyfarmers' Organisation Ltd

ZANDSTRA, Mr Ian, Chairman, Dairy Farmers Milk Cooperative

SYDNEY, 9 MARCH 2011

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

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

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

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

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

LAWSON, Mr Colin, Manager, Industry Relations,
Amalgamated Milk Vendors Association

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

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

PATON, Mr Robert, Secretary, Amalgamated Milk Vendors Association

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

ZUMBO, Associate Professor Frank, Private capacity

CANBERRA, 10 MARCH 2011

ANNISON, Dr Geoffrey, Deputy Chief Executive,
Australian Food and Grocery Council

ARCHER, Mr Bradford, Principal Adviser,
Infrastructure, Competition and Consumer Division, Department of the Treasury

BROKENSHIRE, the Hon. Robert, Private capacity

BURCH, Mr John, Manager, Infrastructure, Competition and Consumer Division,
Department of the Treasury

CARNELL, Mrs Kate, Chief Executive, Australian Food and Grocery Council

DEITZ, Mr Andrew, Manager, Infrastructure, Competition and Consumer Division,
Department of the Treasury

GRATION, Ms Julie, Owner, Flatout Programming and Consultancy Pty Ltd,
Macarthur Milk

KING, Professor Stephen, Dean of Faculty of Business and Economics,
Monash University

MORRIS, Mr Paul, Deputy Executive Director,
Australian Bureau of Agricultural and Resource Economics and Sciences

MOSS, Dr Neil, Senior Consultant, SBScibus

MURNANE, Mr Simon, General Manager,
Livestock Industries and Animal Welfare Branch, Agricultural Productivity,
Department of Agriculture, Fisheries and Forestry

STRONG, Mrs Lynne, Co-owner/operator, Clover Hill Dairies

WHITE, Mr David, Authorised Representative,
Flatout Programming and Consultancy Pty Ltd

WRITER, Mr Simon, Manager, Competition and Consumer Policy Division,
Department of the Treasury

CANBERRA, 29 MARCH 2011

DURKAN, Mr John, Merchandise Director, Coles Supermarkets

LEVEY, Mr Matt, Campaigns Manager, Choice

McENTEE, Mr Pat, General Manager, Fresh Foods, Woolworths

McLEOD, Mr Ian, Managing Director, Coles Supermarkets

SAMIA, Ms Nathalie, Group Manager, Government Relations and Industry Affairs,
Woolworths

ZINN, Mr Christopher, Director, Campaigns and Communications, Choice

MELBOURNE, 6 OCTOBER 2011

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

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

COMLEY, Mr Shane, Finance Director, Lion Dairy & Drinks

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

GRIFFIN, Mr Chris, President, Australian Dairy Farmers

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

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

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

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

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

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

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

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

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

APPENDIX 3



AUSTRALIAN GOVERNMENT RESPONSE

**TO THE SENATE ECONOMICS REFERENCES COMMITTEE
INTERIM REPORT:**

**“THE IMPACTS OF SUPERMARKET PRICE DECISIONS ON THE
DAIRY INDUSTRY”**

MAY 2011

Recommendation: The Committee calls on the Government to table a formal response to the Committee's report *Milking it for all it's worth—competition and pricing in the Australian dairy industry* by 13 May 2011, which will be a year after it was tabled.

The Government takes seriously the recommendations of the Committee.

As noted in the interim report, there are complex issues at play in the interactions between farmers, milk processors and retailers. Furthermore, there have been significant developments since the release of the Committee's first report in May 2010.

Any regulatory change, in particular an amendment to Australia's competition law which would have economy-wide effects, could result in unintended consequences.

For these reasons, the Government response to the Committee's report needs to take into account all of the available evidence. The Government will continue to consider the first report and will very carefully consider the recommendations of the final report of the second inquiry when it is delivered later this year.

The Government will respond after all the evidence has been examined and the Committee has delivered its final report.