Chapter 5

Retrospective step-downs in 2015–16 milk pricing

5.1 The retrospective farm gate milk price step-downs in the Southern Milk Region in the final two months of the 2015–16 season resulted in dismay and despair across the entire Australian dairy industry, not just to the suppliers of Murray Goulburn and Fonterra. This chapter outlines the events that led to the retrospective step-downs and examines the response by the processors and Australian Government.

5.2 Although Murray Goulburn and Fonterra have attempted to atone for their actions almost a year after the step-downs, the damage to the industry has already been done with many farmers reducing production, changing processors (or considering changing processors when fixed term contracts expire) or exiting the industry.

Murray Goulburn's strategic change and capital restructure

5.3 Murray Goulburn (MG) is Australia's largest dairy foods company and is a 100 per cent dairy farmer controlled cooperative run by approximately 2200 farmer-suppliers, with all suppliers holding shares in MG.[1] In 2015–16, MG received approximately 3.5 billion litres of milk, representing around 36.6 per cent of Australia's total milk production. Approximately 60 per cent of MG's revenue was generated from the domestic market with the remaining 40 per cent of revenue coming from international exports; MG is Australia's largest dairy exporter.[2]

5.4 In 2011, Mr Gary Helou was appointed Managing Director of MG and set about changing the strategic direction of the cooperative. Mr Brett Findlay, a MG supplier and shareholder, provided his perspective of the subsequent events:

> Gary Helou suggested a new direction for the co-op, moving toward more high value branded product and reducing emphasis on commodities. 2013 saw MG signing a 10 year contract with Coles to supply their private label milk in Victoria and New South Wales. This involved MG taking on suppliers throughout NSW. MG expanded its geographic reach significantly during this period, also extending further into SA and buying out its joint venture partners in Tasmanian Dairy Products to take on suppliers directly in that state…[3]

5.5 Mr Findlay further explained how the capital restructure was beneficial:

> To build the new state of the art bottling plants in Melbourne and Sydney for the Coles contract and its own private label milk, the co-op sold and leased back its tanker fleet and warehousing, and increased its bank debt to near maximum prudent levels. Further investment would require a

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1 Murray Goulburn, *Submission 8*, p. 3.

2 Murray Goulburn, *Submission 8*, p. 3.

3 Mr Brett Findlay, *Submission 30*, [p. 3].

> significant injection of capital and it was decided to follow the example set by Fonterra and several large European co-ops in conducting a partial float to list non-voting units on the ASX [Australian Stock Exchange]. This occurred in July 2015 and significantly strengthened the co-ops balance sheet…[4]

5.6 Under Mr Helou's leadership, the MG Board undertook a capital structure review of which the outcomes were presented to supplier shareholders at the Annual General Meeting in 2013. That review proposed a funding model that maintained 100 per cent farmer control, but allowed external investors to invest in MG. This approach was deemed to be a more flexible capital restructure than traditional bank debt.[5]

5.7 The proposed capital restructure would enable MG to simultaneously meet the following key objectives:

- retaining 100 per cent supplier control of MG;
- reducing MG's reliance on debt funding;
- creating a market value for supplier's shares through the operation of the Shareholder Trading Platform as opposed to the $1 value that had historically existed prior to the capital structure;
- strengthening supplier's balance sheets by facilitating the recognition of the value of their shares as an asset;
- helping to fund MG growth strategy of operational excellence and innovation to deliver over time a sustainably high Farm Milk Price (FMP); and
- ensuring MG not only remained competitive with other processors, but became the first choice dairy foods company for its suppliers, customers and consumers.[6]

5.8 The capital restructure was approved at an extraordinary general meeting on 8 May 2015, and on 3 July 2015 the MG Unit Trust was listed on the Australian Stock Exchange. Of the $500 million raised, $438 million was raised through the Unit Trust—which was the main vehicle for external investment. The balance, some $62 million, was raised from supplier shareholders through the Supplier Share Offer (SSO).[7] As noted in at paragraph 3.20, suppliers were offered discounted MG shares if they signed supply agreements with MG for between one and three years.

5.9 The capital restructure implemented a profit sharing mechanism (PSM) that aligns unitholders' and suppliers' economic interests by linking the dividend rate to the FMP. In summary:

4 Mr Brett Findlay, *Submission 30*, [p. 3].

5 Murray Goulburn, *Submission 8*, p. 4.

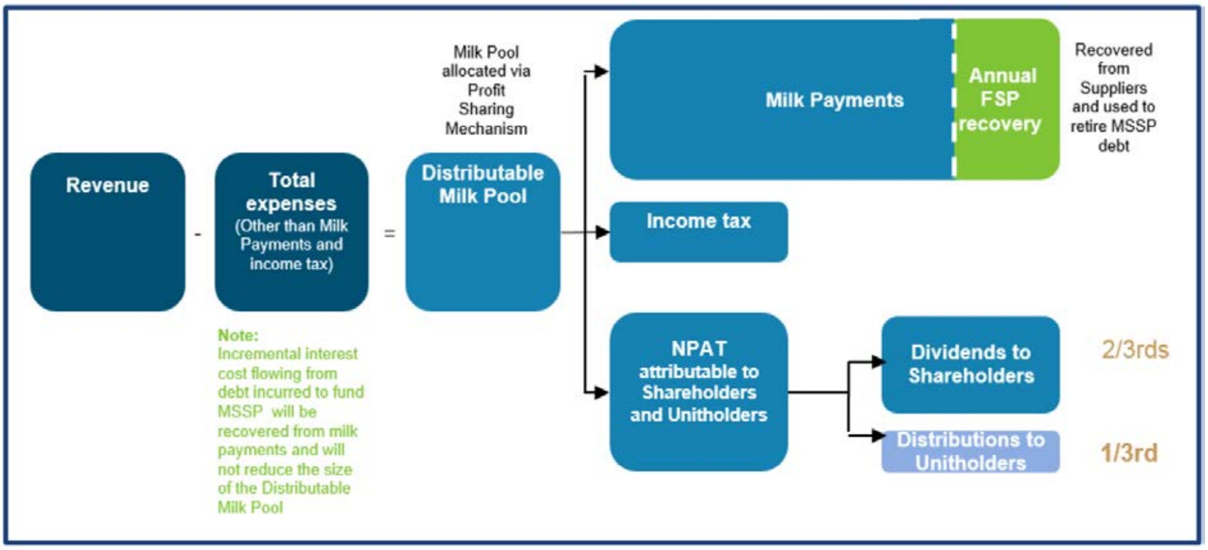
6 Murray Goulburn, *Submission 8*, p. 4.

7 Murray Goulburn, *Submission 8*, pp. 4–5.

- when the FMP is relatively high, MG will allocate a higher proportion of the Milk Pool to Net Profit After Tax (NPAT) available for dividends to shareholders and distributions to unit holders; and
- when the FMP is relatively low, MG will allocate a lower proportion of the Milk Pool to NPAT available for dividends to shareholders and distributions to unitholders.[8]

5.10 Figure 5.1 provides an illustration of how the PSM operates.

Figure 5.1: MG's Profit Sharing Mechanism



Source: MG, *Submission 8*, p. 24.

5.11 In certain abnormal circumstances, there is also a provision for the Board to decide that, for the benefit of all stakeholders, the PSM should be deviated from when allocating the milk pool to milk payments, income tax and NPAT. Examples of abnormal circumstances may include extreme prolonged drought conditions, prolonged levels of materially increased competition for milk supply, or other circumstances determined with the unanimous consent of MG's Special Directors to warrant deviation to protect MG's milk supply and profitability and support its supplier base.[9]

Fonterra's milk pricing structure in the Southern Region

5.12 Although Fonterra was aware of the difficulties in the international dairy market and the impact that would have on its production (that was highly skewed towards skim milk powder), it was not able to reduce its farm gate milk price due to its agreement with the Bonlac Supply Company:

> Fonterra Australia has an agreement with the Bonlac Supply Company to pay farmers no less than the price paid for that season by the leading Victorian processor (by milk volume), which for the term of the agreement

8 Murray Goulburn, *Submission 8*, p. 5.

9 Murray Goulburn, *Submission 8*, p. 5.

> has been Murray Goulburn. This guarantee operates for the benefit of farmers and was insisted upon by them to ensure Fonterra did not pay them a price that was too low. It reflects the trust farmers have traditionally placed in Murray Goulburn, as the leading processor and a farmer-owned cooperative, to protect farmers' interests in setting the milk price that it pays, and to exercise good corporate governance and be realistic in making price forecasts.[10]

5.13 According to Fonterra, they warned farmers of the possibility of a milk price step-down as early as August 2015:

> Fonterra shifted from bi-monthly to monthly price reviews in August 2015 to provide more regular price advice to suppliers, and warned suppliers that a step down was possible if the global market did not materially improve. In late August 2015 Fonterra Co-operative CEO Theo Spierings made public comments that the Australian domestic milk price was too high…prompting widespread criticism that Fonterra was talking the Australian industry down.[11]

5.14 And despite Fonterra's warnings, Bonlac Supply Company farmers knew that Fonterra was obliged to pay not less than the price paid by Murray Goulburn and so Fonterra could not act until Murray Goulburn revised their price down.[12]

Events leading to the milk price step-down in 2015–16

5.15 A chronology of events leading the milk price step-down in May 2016 is presented below:

- **June 2015**—MG announces opening milk price of $5.60/kgMS and reconfirms full year FMP of $6.05, consistent with that provided in the MG Unit Trust prospectus.[13]
- **August 2015**—MG announces that FMP was likely to be the range of $5.60 and $5.90 unless there was a strengthening of commodity prices in the balance of 2015–16.
- **February 2016**—mixed trading conditions lead MG to advise that the full year forecast for FMP was now $5.60 subject to there being no further material deterioration in dairy commodity prices or unfavourable change in exchange rates.
- **April 2016**—MG Board meets to review sales figures and requests management to review sales expectations for the full year. Unit Trust is placed in a trading halt while a review of the impact of market conditions on the 2015-16 outlook is conducted. On 27 April 2016, MG makes a trading

10 Fonterra Co-operative Group, *Submission 38*, p. 3.

11 Fonterra Co-operative Group, *Submission 38*, p. 4.

12 Fonterra Co-operative Group, *Submission 38*, p. 4.

13 Murray Goulburn, *Murray Goulburn sets opening price for 2015/16 and re-confirms full year forecast*, 24 June 2015.

update announcement which outlines the need to reduce the 2015–16 FMP to $4.75 for the Southern Milk Region only.[14] MG introduces a Milk Supply Support Package (MSSP) to lessen the impact of the price step-down (see paragraph 5.41 for more detail).

- **May 2016**—Fonterra reduces the FMP for its suppliers to an average of $5/kgMS, effective 5 May 2016.[15] This corresponded to an average milk price of $1.91/kgMS for milk supplied between 5 May and 30 June 2016.[16]

5.16 According to MG, dairy farmers and processors around the world were hit by a series of unprecedented conditions that have seen the commodity price for dairy remain lower for longer than ever before:

> During FY16, a surge in European dairy production following the removal of dairy quotas for the first time in 30 years, a continuation of Russian trade bans and a slowdown in demand out of China converged to create a 'perfect storm', driving commodity prices down to historic low levels, where they have remained for a longer period than expected or predicted.[17]

5.17 However, significant and important questions remain about whether the management and Board of MG understood the ramifications of not adjusting their expectations regarding final milk price earlier. Many of these questions are finally being answered in a case being brought forward by the ACCC against MG, Mr Helou and former Chief Financial Officer Mr Bradley Hingle. The ACCC claims that MG, Mr Helou and Mr Hingle engaged in unconscionable conduct by not updating the forecast final farm gate milk price in 2015-16 to reflect changing market conditions.[18]

5.18 During testimony to the committee, Mr Helou was adamant that announcements made regarding farm gate milk pricing in 2015–16 were appropriate during his tenure, noting that he resigned before the retrospective step-down was announced. Mr Helou was also adamant that $5.60/kgMS could still have been achieved for the 2015–16 season if not for the issues in China which removed the products that were driving profitability and mitigating against low commodity prices:

> It was gettable up until the interruption of that e-commerce, cross-border regulatory announcement, which basically removed our two bestsellers off the selling platforms.[19]

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14 The final 2015–16 FMP for the Southern Milk Region was $4.80/kgMS.

15 Due to lower volumes of milk from 5 May 2016, the average milk price for 2015–16 was $5.13/kgMS.

16 Fonterra Co-operative Group, *Submission 38*, p. 4.

17 Murray Goulburn, *Submission 8*, p. 12.

18 Matthew Dunkley and Darren Gray, 'How Murray Goulburn fooled its farmers, shareholders and its own board', *Sydney Morning Herald*, 30 July 2017, http://www.smh.com.au/business/how-murray-goulburn-fooled-its-farmers-shareholders-and-its-own-board-20170727-gxkbd4.html (accessed 4 August 2017).

19 Mr Gary Helou, *Committee Hansard*, 1 February 2017, p. 45.

5.19 Accusations have been made that the executive management of MG stood to gain financially from a high milk price, and that every effort was made to keep the price artificially high until it was apparent that the expected final price could not be feasibly realised.[20] Mr Helou admitted that short and long term remuneration incentives were linked to the farm gate milk price and that had the price been reduced earlier, there would have been an impact on his overall remuneration, along with the rest of the management team.[21]

Views on the retrospective price step-downs

5.20 A variety of views were expressed by farmers, processors and other stakeholders regarding the actions of MG and Fonterra. Most stakeholders did not look favourably on the retrospective price step-down. However, a number of MG farmers did voice support for the MG model. Examples of these competing views are discussed below.

Criticisms of MG and Fonterra

5.21 Despite facing similar challenging market conditions, other milk processors in the Southern Milk Region did not lower their prices. A number of dairy processors spoke out strongly against the actions of MG and Fonterra. For example, Lion submitted that:

> Retrospective changes in milk price, including price cuts, are anathema to Lion as they undermine trust, drive volatility and damage farmers' ability to plan for and invest in their business. That is why, unlike some processors, Lion has not imposed retrospective cuts in response to recent market conditions and does not support them as a matter of principle.[22]

5.22 Parmalat was particularly critical of MG's actions given its role as price setter in the Southern Milk Region:

> …the wider southern region knew in mid to late 2015 (the Fonterra CEO identified it in late August 2015) that the Murray Goulburn prices set for 2015/16 were unrealistic. Murray Goulburn as the largest dairy co-operative holds a systemically important role in the southern dairy industry and our national dairy export ambitions. Murray Goulburn and its board and management therefore has an obligation to act with great responsibility and transparency. The ambition to succeed is essential but must be balanced with sensible and mature corporate behaviour.[23]

5.23 Similarly, Bega Cheese noted that:

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20 Jemima Whyte and Julie-Anne Sprague, 'Murray Goulburn price cut to be felt across the agriculture sector', *Australian Financial Review*, 29 April 2016, http://www.afr.com/business/agriculture/murray-goulburn-price-cut-to-be-felt-across-the-agriculture-sector-20160428-goht3d (accessed 23 May 2017).

21 Mr Gary Helou, *Committee Hansard*, 1 February 2017, pp. 42–43.

22 Lion Dairy and Drinks, *Submission 13*, p. 2.

23 Parmalat Australia, *Submission 16*, p. 5.

> The decision by Murray Goulburn and then Fonterra to cut prices so late in the year created turmoil for the entire industry…
>
> …Bega Cheese was vocal in its view that such an action was something that could not be managed by dairy farmers. Bega Cheese believed that given the time of the year, the risk and the outcome of aggressive competition was the companies to manage and should not be shared with its suppliers, the new financial year was two months away and opening prices are traditionally the time downward trends are reflected in price and equally it is the time that dairy farmers make their management plan for the coming year which is based on the newly announced prices.[24]

5.24 Bega Cheese went on to conclude that:

> Bega Cheese remains of the view that the late announcement of price decreases and the failure by Murray Goulburn to clearly communicate that price reductions late in the year or indeed anytime in the year were likely and the decision by Fonterra to follow Murray Goulburn's lead caused great financial harm to their suppliers and affected confidence in the whole industry.[25]

5.25 While defending the actions of MG, Mr Brett Findlay was scathing of Fonterra which, he believed, could have maintained prices and foregone paying down debt:

> Fonterra used MG's woes as an excuse to savagely cut it price in May and June to $1.90/kgMS. This caused its suppliers immense hardship and put a number out of business. Bizarrely, some of these farmers blamed MG for their hardship due to MG's position as price setter for the industry. However, Fonterra had plenty of choice in the matter.
>
> …
>
> Of more pertinence is the behaviour of Fonterra whose savage price cuts to their Australian suppliers caused great hardship including putting farmers out of business. Fonterra's large reduction in corporate debt last year clearly indicates there was little financial pressure on them to pursue such a move, or indeed for them to pay such a low price to their struggling suppliers in New Zealand. Frankly their behaviour appears nothing short of despicable.[26]

5.26 Ms Karrinjeet Singh-Mahil and Mr Brian Schuler were also critical of Fonterra's actions regarding the lack of notice given for the milk price drop, the spreading of loan repayments and interest across the supplier base, and the lack of specificity in milk statements about loan balances, terms and conditions, interest charges and the milk price. Regarding the two loan mechanisms Fonterra put in place for affected suppliers, Ms Singh-Mahil and Mr Schuler asserted that:

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24 Bega Cheese, *Submission 37*, [p. 7].

25 Bega Cheese, *Submission 37*, [p. 7].

26 Mr Brett Findlay, *Submission 30*, [pp. 5, 9].

> In neither case has Fonterra been transparent about what the loan balance is, what the terms and conditions are etc. It is all bundled into the total milk price and we are unable to work out what our actual milk price is, what repayments are being deducted for the autumn offset and what interest is being deducted for loans we didn't take out.[27]

5.27 Further, Fonterra's communication about the price step-down and associated support arrangements left much to be desired, as many farmers took action immediately following the step-down but were not told of the support arrangements until much later. Ms Singh-Mahil explained her experience:

> …we were invited to a meeting at Warrnambool with Fonterra, where they explained to us what they had done. We said, 'Do you realise what you have done to autumn calvers? You have affected us disproportionately, compared to the rest of your supplier base.' Soon after that, they sent us a note saying, 'We realise we have done this and we will fix it. We are going to give you $2.50 a kilo extra for the milk produced in May and June, but we are not going to give you that until August and September and you have to be still with us to get the money.' It was too late for us, because we had already trucked a whole stack of cows..., so that impact was already there. But we were indentured then. We could not leave until August and September, if we had wanted to, because otherwise we would not get that money.[28]

5.28 Many farmers were also scathing of MG's actions. Mr Michael Stapleton believed the MG Board and management used unrealistically aggressive forecasts when setting the opening milk price in 2015–16:

> My opinion is that the board knew, or ought to have known, that the forecast for FY16 was unachievable based on their Q1 outcomes.
>
> …
>
> The board of MG would have known the key drivers of the budget and hence should have understood whether the business was on track to meet its plans. For example, they could have tracked the:
>
> - Volume of milk intake each month.
> - Revenue/litre of milk each month.
> - Product mix each month.
> - USD exchange rate.
> - Commodity price index.
>
> The movement in these measures would have informed the board as to whether the earnings forecast remained underpinned by valid assumptions, or whether it needed reviewing and possibly changing.[29]

27 Ms Karrinjeet Singh-Mahil and Mr Brian Schuler, *Submission 20*, p. 1.

28 Ms Karrinjeet Singh-Mahil, *Committee Hansard*, 15 November 2016, p. 5.

29 MR Michael Stapleton, *Submission 19*, pp. 2–3.

5.29 Mr Stapleton was also critical that the MG Board did not implement a one-off deviation from the profit sharing mechanism:

> I cannot imagine a more abnormal "other circumstance" than the FY16 year and a need for MG to protect their milk supply and profitability and support its Supplier base. The exodus of suppliers from MG since the revision to the FMP in April is tangible evidence that Suppliers do not believe their interests have been considered adequately.[30]

5.30 Mr Peter Laverty noted that:

> …before the 2015–16 season started almost all dairy industry observers noted the market was weakening and held the view that farmers would be lucky if they received $5.00/kg solids, notwithstanding the (then) Murray Goulburn managing director's claims. Despite this, it was not until April, when the international market had deteriorated much further, that the Murray Goulburn board reacted. It is totally inexcusable for the board to have only come to a realisation of this situation at such a late stage. It is symptomatic of the complete lack of collective commercial judgement.[31]

5.31 Mr Laverty was particularly critical of the lack of commercial experience on the MG Board with only two of the eleven board members having the requisite skills to guide such a large company in a complex environment. Mr Laverty made the comparison with the governance structure of Fonterra, where there is a fully professional main board comprising two farmers and ten members with commercial backgrounds, and a 'Shareholder Council' elected by farmers to advise the Fonterra Board on matters affecting farmers.[32]

5.32 Given the nature of the dairy industry in the Southern Milk Region, Parmalat Australia noted that:

> The system of opening price and step-up may not be ideal but in all of 2 of the last 30 or more years, has given southern dairy farmers a clear 12 month price signal that enabled reliable business planning…
>
> The key to the success of the opening price and step-up system or the NZ version is in the fact the prudence and good governance of systematically important processors such Murray Goulburn. The alternative is to adopt a price system which a much shorter horizon which farmers find unworkable for their agricultural businesses.[33]

5.33 Indeed, Mr Barry Irvin noted that competition between processors within the Southern Milk Region may have contributed to the retrospective price step-down:

> So what happens when competition gets a little out of hand? Probably what you saw last year. I certainly would never want to downplay it, because it was terrible. But what happened was that there was aggressive competition

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30 Mr Michael Stapleton, *Submission 19*, p. 4.

31 Mr Peter Laverty, *Submission 27*, p. 4.

32 Mr Peter Laverty, *Submission 27*, p. 4.

33 Parmalat Australia, *Submission 16*, p. 2.

> for milk actually pushing the price up above what could be returned. Farmers, for a period, benefited from that competition, but it was, quite frankly, irresponsible. We could deal with it, but the competition was too aggressive, and the price went down for the farmers and there was not enough shared risk management or shared pain.[34]

5.34 Parmalat Australia highlighted what it considered to be MG's problem:

> Nowhere in the world has a dairy model worked where it's half listed and half cooperative without some form of pre-agreed formula that defines the farm gate price…and delivers transparency in price signals. Murray Goulburn wanted what Fonterra had, but never recognised the leadership, education, price setting practices and the continuous and early communication of price risk that underpinned the NZ story.
>
> Transparency of global market information constantly communicated to farmers in terms of forecast and outlook is essential. Murray Goulburn did the opposite.[35]

Support for the MG cooperative from affected farmers

5.35 Despite the actions of MG, a number of the cooperative's farmers expressed confidence in the cooperative model. For example, Andrew and Christine Sebire submitted that:

> Without the co-operative having set and maintained prices as high as was possible until this year, there is little doubt that other multinational processors would have cut farm gate prices substantially. The co-operative keeps the industry honest and should be supported by Government to ensure that the structure is able to continue to be the farmer advocate and price setter.[36]

5.36 That said, Andrew and Christine Sebire were understandably concerned that management and the MG Board did not take action earlier in the season:

> We are extremely disappointed that the Murray Goulburn Board and management did not see the need to reduce the milk price earlier, and with the way they then managed the situation by imposing retrospective debt.[37]

5.37 Some MG farmers questioned whether MG's price step-down was indeed retrospective. Mr Brett Findlay argued that:

> The announcement of the MSSP occurred on 27 April. A round of supplier's meetings and further written communications to suppliers continued until 10 May. The co-op continued to pay at the level announced at the start of the season until this point. On 11 May the new price, supported by borrowings, commenced. It is this borrowed money which is the subject of the repayment. The MSSP is controversial, unprecedented

34 Mr Barry Irvin, Bega Cheese, *Committee Hansard*, 2 February 2017, p. 31.

35 Parmalat Australia, *Submission 16*, p. 3.

36 Andrew and Christine Sebire, *Submission 12*, [p. 1].

37 Andrew and Christine Sebire, *Submission 12*, [p. 1].

> and deeply unpopular, but MG told us what was going to happen before they did it. It is not retrospective.[38]

5.38 Similarly, Craig and Rachel Dettlling noted that:

> This price adjustment was placed only on milk supplied in the future, which therefore is not retrospective, and had no effect on the price of milk supplied previous to 11th May 2016.[39]

5.39 However, the fact that the final farm gate milk price for the whole year was reduced in May 2016 and this meant that milk supplied in May and June 2016 was paid at a price that effectively reduced the average price for the whole year would seem to meet the definition of retrospective.

5.40 Mr Findlay also considered that the introduction of the MSSP, while unpopular, was an appropriate option:

> At the Supplier's Meetings…Executive General Manager for Supplier Relations, Robert Poole, described the MSSP as; "All of the options we had were bad. This looked like the least bad one." It is difficult to see that this too far wrong.[40]

Support for affected farmers

5.41 In response to the late retrospective step-down, MG, Fonterra and the Australian Government all sought to support dairy farmers affected by these decisions.

Murray Goulburn

5.42 Given the timing of the step-down announcement, the full impact of the step-down on MG farmers would have resulted in a weighted average price for the final two months of 2015–16 of $1.30/kgMS, or about 10 cents per litre. MG noted that:

> For some suppliers this would have meant no financial returns in these months, which would have been particularly devastating for Autumn calving herds who would have been entering two of their higher milk production months.[41]

5.43 Recognising the potential impact on suppliers, the MG Board introduced the Milk Supply Support Package (MSSP). The MSSP was a $183 million advance to suppliers. It was intended to provide a milk support payment so that suppliers received payments for the 2015–16 season equivalent to an estimated weighted average available FMP of $5.47/kgMS for the full year.[42] The support provided through the MSSP was intended to be spread across the three financial years following 2015-16.

38 Mr Brett Findlay, *Submission 30*, [p. 7].

39 Craig and Rachel Dettling, *Submission 31*, [p. 1].

40 Mr Brett Findlay, *Submission 30*, [p. 6].

41 Murray Goulburn, *Submission 8*, p. 14.

42 The final average 2015–16 cash price for the Southern Milk Region was $5.53 with the support provided by the MSSP.

In 2016–17, for example, the initial FMP of $4.31/kgMS included an initial MSSP repayment amount of $0.14/kgMS.[43]

5.44 MG also noted that structure of the MSSP allows suppliers to move to another processor, contingent on any separate fixed term contract arrangements that may be in place.[44] Indeed, many suppliers have moved to other processors as reported by MG in their 2016–17 half yearly results (see below)

5.45 In its submission of October 2016, MG noted that:

> Since the introduction of the MSSP it has become very clear that it is not considered by suppliers to have addressed their most significant concerns and is reducing MG's competitiveness whilst the sector continues to experience low commodity prices.[45]

5.46 Subsequently, MG undertook a review of the operation of the MSSP and, on 27 October 2016, decided to amend the MSSP by:

- suspending MSSP recoupment in 2016–17 from 1 October 2016 in recognition of climatic conditions and low 2016–17 FMP;
- extending the recoupment period for the MSSP from three years to six years;
- reducing the annual recoupment to 1c per litre from 1 July 2017, with the option to accelerate recoupment in high FMP years;
- capping recoupment from suppliers, meaning recoupment from individual suppliers will not exceed individual support received during 2015–16;
- a $31.8 million impairment of the MSSP asset reflecting MG's estimate of future recoupment; and
- step-up payments in 2016–17 to suppliers totalling $0.25/kgMS, reflecting a forecast 2016–17 FMP of $4.95/kgMS.[46]

5.47 In addition, MG announced an $81.8 million deviation from the PSM to allow MG to pay a competitive milk price, regain supplier confidence and arrest the decline in milk supply.[47]

5.48 The impact of the 2015-16 price step-down was reflected in MG's 2016-17 first half year results, where MG announced that milk received by the company had reduced by over 20 per cent compared the first half of the 2015-16 season. Increased competition was responsible for around 60 per cent of the milk intake decline during

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43 Murray Goulburn, *Submission 8*, p. 15.

44 Murray Goulburn, *Submission 8*, p. 15.

45 Murray Goulburn, *Submission 8*, p. 15.

46 Murray Goulburn, *Murray Goulburn announces completion of Milk Supply Support Package review*, ASX announcement, 27 October 2017, p. 2.

47 Grant Samuel & Associates, *Letter to Murray Goulburn Co-operative Co.*, p. 2; attachment to Murray Goulburn, *Murray Goulburn announces completion of Milk Supply Support Package review*, ASX announcement, 27 October 2017.

this period with retirements and 'seasonal reduction' responsible for 15 and 25 per cent respectively.[48]

5.49 Indeed, it could have been far worse for MG had suppliers not been locked into supply contracts through the SSO and other processors had the capacity to take more milk. Some suppliers have indicated that they would have left MG if they were not contracted through the SSOs to supply milk.[49]

5.50 Bega Cheese also noted that, while other processors in the Southern Milk Region did have some capacity to accept requests from suppliers to transfer processors, this excess capacity was limited, and many farmer suppliers had limited or no choice but to accept the price cuts and claw backs from MG and Fonterra.[50]

5.51 Recognising the impact on its milk supply and supplier base, MG announced on 2 May 2017 that it was undertaking a number of measures to address its cost base, improve efficiencies and ultimately, increase earnings and the farm gate milk price. Most notably, MG announced that it would forgive the MSSP, meaning that all future repayments would cease and MSSP contributions made between July and September 2016 would be repaid to continuing and retired suppliers and to any suppliers that recommence supplying Murray Goulburn by 1 July 2017.[51]

Fonterra

5.52 Following their retrospective price step-down, Fonterra put in place a number of support measures to assist suppliers following the price revision:

- Fonterra Australia Support Loans—a low-interest loan program that offered suppliers a loan of up to $0.60/kgMS, repayable from 2017–18 onwards, to assist with cash flow in the short term. Approximately 40 per cent of suppliers have taken out these loans.
- Extension of the Employee Assistance Program to all suppliers, their staff and families, so that they could access free, independent and confidential counselling services.
- Additional offset of $2.50/kgMS for milk supplied between 5 May and 30 June 2016, payable in July and August, to recognise the disproportionate effect of the price revision on autumn and split calving herds.

5.53 Fonterra did not consider the value of the MSSP in determining the final price it was required to pay under the Bonlac Supply Agreement. Some Fonterra farmers

48 Murray Goulburn, *Murray Goulburn 2017 half-year results presentation*, 24 February 2017, p. 6.

49 See, for example, Ben and Rennae McInnes, *Committee Hansard*, 2 February 2017, p. 14.

50 Bega Cheese, *Submission 37*, [p. 7].

51 Murray Goulburn, *Murray Goulburn asset and footprint review conclusions*, http://www.mgc.com.au/media/46199/asx.pdf (accessed 23 May 2017).

were critical of this decision given that MG suppliers actually received $5.53/kgMS with the MSSP compared to the $5.13/kgMS that Fonterra suppliers were paid.[52]

5.54 Following MG's announcement to forgive the MSSP, Fonterra announced that it would make an additional payment of 40c/kgMS on top of the milk price for the 2017–18 season to all current, retired and recommencing suppliers. Fonterra considers that the additional payment does compensate suppliers for the retrospective price step-down in the 2015–16 season, even though it will be applied prospectively on future milk production. Fonterra has also indicated that it will reimburse the interest charge of 0.85c/kgMS for milk supplied in the 2016–17 season.[53]

Government's Dairy Support Package

5.55 On 25 May 2016, the Australian Government announced a Dairy Support Package to help dairy farmers affected by the MG and Fonterra decisions to reduce farm gate milk prices. The key elements of the package are:

- new concessional loans specifically for dairy farmers;
- more rural financial counsellors in dairy regions;
- more staff to process new claims for income support (Farm Household Allowance);
- a new Dairy Liaison Officer;
- Mobile Service Centres redirected to affected dairy regions; and
- additional funding for Dairy Australia's Tactics for Tight Times program.[54]

5.56 Dairy Recovery Concessional Loans are available to assist commercially viable dairy farm businesses affected by the retrospective decisions of MG and Fonterra to reduce farm gate milk prices in 2015–16. Loans are available for a maximum of 10 years, for up to 50 per cent of a farm business's final debt position to a maximum of $1 million in total.[55]

5.57 From 2 May 2016 to 30 September 2016, the number of dairy industry customers receiving Farm Household Allowance increased from 255 to 476, with the majority of this increase attributable to dairy farmers and their partners in Victoria.[56]

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52 Ms Karrinjeet Singh-Mahil, *Committee Hansard*, 15 November 2016, p. 5.

53 Fonterra, *The facts – Australian milk price announcement*, https://www.fonterra.com/nz/en/news-and-media/articles/The_facts_Australian_milk_price_announcement.html (accessed 29 May 2017).

54 Department of Agriculture and Water Resources, *Submission 23*, p. 1.

55 Department of Agriculture and Water Resources, *Dairy Recovery Concessional Loans*, http://www.agriculture.gov.au/ag-farm-food/drought/assistance/farm-business-concessional-loans-scheme/dairy-recovery-concessional-loans (accessed 28 March 2017).

56 Department of Agriculture and Water Resources, *Submission 23*, p. 2.

5.58 A variety of views were expressed by stakeholders about the concessional loans and access to Farm Household Allowance. For example, Mr Brett Findlay submitted that:

> The Federal Government's efforts to help dairy farmers have been significant and appreciated. The low interest loan scheme can cause some challenges, particularly if existing lenders are reluctant to free up security, but the benefits are substantial if farmers are successful.[57]

5.59 Mr Findlay went on to relay the concerns of some farmers about accessing the Farm Household Allowance:

> The Farm Household Allowance is a good concept, however, most farmers regard dealing with Centrelink as extremely stressful. The glacial pace of progress, excessive bureaucracy and sometimes limited physical access to Centrelink offices involved are problematic.[58]

5.60 Mrs Sarah Parker was also critical of the administration of the Farm Household Allowance, which she considered to have 'been disaster in its planning and implementation'.[59] Mrs Parker went on to explain that it was often easier to find an off farm job cleaning or stacking shelves, rather than wait for up to six months and/or get constantly harassed for paperwork that had already been submitted.

5.61 Australian Dairy Farmers commented that very few dairy farmers had taken out concessional loans:

> …partly because of the complexity of the conditions that are applied…in terms of who can have access to the equity that is there to be held against a loan, for example.[60]

5.62 At the hearing in Shepparton, Mr Patrick Nicholson explained why farmers were reluctant to access these concessional loans:

> The problem was it was just…more debt for a business. A lot of people chose not to go into more debt and either got out of the industry or reduced their business to a size where they did not actually have to go into further debt. I think that was the problem. The answer to the problem was not just to increase your debt load. A lot of people just did not have the opportunity. They were already in debt to a high level and they did not want to go further into debt.
>
> …
>
> I believe you had to change from your old bank to rural finance to actually qualify. So that is a problem in itself. If you have had a long relationship with your own bank and if you are with the way you have been treated and

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57 Mr Brett Findlay, *Submission 30*, [p. 9].

58 Mr Brett Findlay, *Submission 30*, [p. 9].

59 Mrs Sarah Parker, *Committee Hansard*, 2 February 2017, p. 17

60 Mr John McQueen, Australian Dairy Farmers, *Committee Hansard*, 2 February 2017, p. 41.

> with the dealings you have had, why should you have to change who you bank with just to have access to support?[61]

5.63 While some stakeholders were supportive of the government's effort, the majority of stakeholders considered that the best way the government could support dairy farmers was by creating an environment whereby the farm gate milk price reflected a level that is sustainable and encourages farm investment.

Committee view

5.64 There is no doubt that the imposition of retrospective price step-downs had a devastating impact on farmers supplying Murray Goulburn and Fonterra, and had broader consequences for other dairy farmers and the surrounding businesses and communities that support dairy farmers.

5.65 Murray Goulburn has recognised that its actions in April and May 2016 were inappropriate and caused significant damage to its reputation. While it has attempted to make amends through a range of measures, including forgiving the MSSP, it is likely that it will take a long time for the nation's largest dairy cooperative to regain the trust of its suppliers. The committee is concerned that a considered and measured response that limited the impact on farmers was not devised earlier and steps taken to prevent the initial crisis.

5.66 While the intense competition for milk in the Southern Milk Region may have contributed to the setting of an inappropriate opening price in 2015–16, responsibility ultimately rests on the executive management team who it appears were overly ambitious and self-motivated in their attempts to grow Murray Goulburn quickly. The Murray Goulburn Board must also take responsibility for not providing appropriate oversight to the actions of the executive management team. The committee believes that Murray Goulburn should consider adopting a board structure which has greater reliance on business acumen.

5.67 The committee considers that the dairy industry benefits from a strong, industry leading cooperative and urges Murray Goulburn to reconsider whether its current capital structure, as a partially-listed cooperative, is in its members' best interests moving forward.

5.68 In relation to the actions of Fonterra, the committee notes that its decision to reduce the farm gate milk price late in the season was within the terms of its contract with its supplier group. However, the committee is concerned that the way Fonterra undertook to impose the retrospective step-down without due regard to the impacts this would have on suppliers showed poor judgement and has broken the relationship of trust with many suppliers. Given the competitive nature of dairy industry in the Southern Milk Region, dairy farmers should consider whether they wish to be associated with a company that willingly takes opportunistic measures at their expense.

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61 Mr Patrick Nicholson, *Committee Hansard*, 2 February 2017, pp. 10–11.

5.69 Given that the farm gate milk price has been retrospectively reduced twice in the last decade but only once in the preceding 40 years, there would appear to be issues in the current price setting mechanism. Accordingly, the committee recommends that processors set opening prices conservatively to ensure that any downward pressure from market forces will not result in retrospective price step-downs that have devastating impacts on dairy farmers.

5.70 As noted in chapter 3, the committee also considers that the industry, as a whole, should take measures to stabilise farm gate prices and restrict the circumstances in which processors can impose retrospective price step-downs.

5.71 The committee is disappointed that the government support package has failed to deliver meaningful outcomes for farmers affected by the dairy crisis. By not understanding the true issues faced by farmers, the government support package cannot provide assistance that is relevant and accessible, and, as such, does not have the potential to make a real difference. Indeed, many farmers already have significant debts and do not want the government to assist them to increase these debts further. Further, farmer access to income support in times of need should be relatively easy and the associated administration requests not burdensome.

Recommendation 5

5.72 The committee recommends that dairy processors set opening prices conservatively so that any downward pressure from market forces will not result in retrospective price step-downs that have devastating impacts on dairy farmers.

Recommendation 6

5.73 The committee considers that an independent review of the government's dairy support package be undertaken to determine whether it has been effective in improving outcomes for affected dairy farmers and whether it has delivered value for money.