



Dairy Farmers Milk Co-operative Submission to the ACCC's Inquiry into the Dairy Industry (Part 1)

Dairy Farmers Milk Co-operative Limited is pleased to have an opportunity to express its views on potential improvements in the functioning of the Dairy Industry in Australia.

We have broken the submission into two separate submissions. Part 1 relates to Collective Bargaining and its operation, while Part 2 addresses a number of other matters raised in the ACCC's Issues Paper. The reason for the separation is that we believe that effective Collective Bargaining Groups hold the solution to a number of important issues.

COLLECTIVE BARGAINING IN THE DAIRY INDUSTRY

INTRODUCTION

Collective Bargaining Groups (**CBGs**) for the most part have been ineffective in improving the bargaining position of farmers. The "playing field" is decidedly still in favour of the processor.

The dairy industry needs effective CBGs. Dairy Farmers Milk Cooperative Limited (**DFMC**) has been operating as an effective CBG for the past eight years. DFMC has been successful for three main reasons, namely:

1. it is well-funded and resourced;
2. Lion Dairy & Drinks (**LDD**) is contractually-bound to deal with DFMC via its Milk Supply Agreement (**MSA**); and
3. in the event of a dispute (including on price), the dispute can be resolved by binding independent expert determination.

Sadly, in the absence of the above conditions, CBGs are mostly ignored by processors and have little impact in the marketplace.

The purpose of this paper is to highlight the success of the current arrangement between DFMC and LDD and to recommend the model be supported and more widely adopted within the industry.

Dairy Farmers Milk Co-operative Limited

DFMC is a co-operative registered under the Co-operatives National Law.

DFMC currently has 345 farmer members in five regions – Far North Queensland, South East Queensland, Central NSW, Northern Victoria and Central South Australia. DFMC currently supplies approximately 270 million litres of milk per year to LDD, representing around 50% of LDD's overall milk pool purchased from farmers within the regions in which we operate.

DFMC has a board of directors (Board) comprising of seven farmer directors, representing the five regions, together with one independent director. Each of the directors has extensive experience in the dairy industry and a brief outline of each of the directors is attached as Appendix 1.

In addition to the Board, DFMC has a Ward Representative Advisory Council, which currently consists of 14 DFMC farmer members from the five regions. The Advisory Council consults with the Board on policy, strategy and regional issues.

Milk Supply Agreement

DFMC came into being in 2004 when Australian Co-operative Foods Ltd (trading as Dairy Farmers), was preparing to sell the marketing and processing part of the business. The farmer co-operative was then reborn as DFMC. In 2008, as part of the arrangements to sell Dairy Farmers to National Foods Limited (now LDD), DFMC entered into a long-term MSA with LDD. The MSA currently terminates in 2019. A copy of the MSA is attached as Appendix 2.

The MSA contains a number of key features:

- **Guaranteed offtake** - LDD agrees to take (and collect) all of the milk supplied by DFMC's farmer members;
- **Back-to-back pricing/milk policy** - The price paid by LDD to DFMC is the same as the price paid by DFMC to the farmers;
- **Anticipated Full Demand** - LDD can indicate its future milk needs through what is termed 'Anticipated Full Demand' (AFD) in each region;
- **Market price** - Farmers are to be paid the market value or price in each region for the milk required to meet the AFD;
- **Dispute** - In the event of disagreement regarding the AFD or the market price, there is a process of mediation and then binding Independent Expert determination - whose decision is final; and
- **Aggregation fee** - LDD must pay DFMC an 'Aggregation Fee' to cover the costs of aggregating the farmers' milk pool.

In 2008, ACCC issued an authorisation in respect of the MSA allowing for “back-to-back pricing/milk policy” (see Appendix 3). This authorisation was renewed in 2013 (see Appendix 4).

A short history of the dairy world in our part of Australia

For many years, the majority of milk produced by farmers was supplied to farmer-owned co-operatives. Over time, a number of these co-operatives have been bought by proprietary operators or have listed on the ASX so there are fewer co-operatives now. Examples of former processor co-operatives include Australian Co-operative Foods, Warrnambool Cheese & Butter, Bega and Bonlac Foods. So far as we are aware, the only remaining processor co-operatives are Devondale Murray Goulburn (which has introduced external investors) and Norco.

Similarly, before its sale, Australian Co-operative Foods (trading as Dairy Farmers) was itself the end product of many amalgamations of co-operatives – (NSW) Hunter Valley Coop, Shoalhaven Coop, the original Dairy Farmers Coop, (QLD) Atherton Tablelands Coop, Queensco Unity Dairyfoods Coop and (SA) Dairy Vale – and all of them, in turn, were amalgamations of other smaller cooperatives.

By and large, co-operatives were run for the benefit of the farmer members and profits distributed to farmer members by way of milk price and/or dividend. The demutualisation/de-cooperatisation of entities within the dairy industry is largely explained by the inability of farmer members to continue to fund the ongoing capital requirements of the business and the increased consolidation of the retail sector (i.e. the supermarkets and convenience stores). As the retail sector became more and more consolidated, dairy businesses needed to similarly consolidate.

How does the MSA work?

Prior to the end of each calendar year, DFMC and LDD discuss any changes (such as changes to quality, composition, logistics and contract terms) that may be required to milk policy.

Before the start of the following financial year, DFMC and LDD discuss any changes to the AFD which might affect pricing negotiations.

The pricing arrangements for each region, taking into account any milk policy changes, are then negotiated with both sides having developed their own independent data about competitive milk pricing.

Any change to the milk policy, AFD or pricing arrangements needs to be agreed by both DFMC and LDD. Should the parties be unable to agree, the dispute may be referred to an Independent Expert to determine the issue. The Independent Expert’s decision is final and binding on the parties.

The Independent Expert determination is conducted in accordance with the independent expert rules of the Australian Disputes Centre.

Resolving Issues

During the past eight years, DFMC and LDD have been in dispute a number of times.

On some occasions the dispute has been resolved by mediation but the Independent Expert has been used three times. The Independent Expert has generally been a QC, such as Walter Sofronoff QC, former Solicitor-General for Queensland and has presided over a range of matters relating to the level of milk payments, the composition of those payments and terms of supply.

The Independent Expert determination process has led to the resolution of some difficult issues, such as the reduction in DFMC's farm milk supply base in the face of the reality of LDD losing retailer milk contracts (and thus a lower AFD). This has all been achieved with little public comment made despite this being a very difficult time for some farmers.

During the past three years, neither the use of the Independent Expert nor mediation has been necessary. It is our view that the availability of Independent Expert determination ensures the parties do not stray too far into unreasonable territory. The compulsory nature of the process most certainly also plays a part in ensuring disputes are resolved by both parties acting reasonably.

In DFMC's opinion, having the ability to approach an Independent Expert (who is capable of 'sifting the wheat from the chaff') has been the key to the successful collective bargaining arrangements with LDD.

Costs of resolving issues

Generally, DFMC and LDD each bear their own costs associated with the Independent Expert's determination. In addition to the Independent Expert's own costs, the costs include lawyers' fees and the fees of appropriate experts.

LDD is a large and well-resourced organisation. In order for any Independent Expert determination process to be effective, DFMC (or any other CBG) needs to be able to fund the process (including obtaining appropriate third-party advice).

Whilst the ability to approach an Independent Expert is central to any successful collective bargaining arrangements, the ability to approach the expert must be real and not illusionary. In DFMC's opinion, it is of critical importance that any CBG has the financial resources to be able to properly fund an Independent Expert determination process.

Other Collective Bargaining Groups (CBGs)

In the dairy industry, there are few operating CBGs, other than DFMC.

Many CBGs have been authorised or have sought authorisation, but few are working examples. The ACCC website indicates there have been 18 CBG authorisations registered covering some

500 farming families¹. In practice, DFMC is aware of only one other significant group active at this time – Premium Milk in SE Queensland (who supply Parmalat). There are two or three small CBGs who supply relatively small quantities of milk to Woolworths. There are also CBGs in other agricultural pursuits and other non-agricultural applications.

So, why has the practice not been more widely or actively used in our industry?

In DFMC's view, in the absence of a compulsory obligation to collectively bargain, collective bargaining arrangements are entirely dependent upon the goodwill of the processor with whom the group is negotiating. The problem is that a processor may or may not choose to deal with a CBG – such an example was Progressive Dairy Group in SE Queensland. This means that the processor still has all the power in the relationship – if they think the CBG is a threat or has some real 'power' or negotiating expertise, they simply say they are not interested in dealing with the collective bargaining group and deal with the individual farmers directly.

Many processors appear to resent having to negotiate price and terms rather than behave in a similar manner to when they are purchasing other business inputs. Even when processors do deal (on a voluntary basis) with CBGs, an apparent reasonable outcome will only be reached if it suits the processor.

Balance of power

The balance of power in the relationship between processor and farmer, clearly lies with the processor. Even though a market may be dysfunctional in economic terms (e.g. in SE Queensland where there is rising demand but falling long term supply, the processor still has the opportunity to take a short-term view and protect itself at the expense of the farmers. Clearly, some processors view the farmers as a 'safety valve' which will allow them to maintain profitability. They do not wish to be in a position where they MUST pay the market price as they would have to with other business inputs such as HDPE plastic pellets or sugar.

Farmers are not necessarily aware of the prices, terms and conditions that they can achieve for their production and do not have the same market information as the processor. The processor knows what they are paying others in the area and often applies confidentiality clauses to keep it that way. Even if the farmer's market knowledge was the same or similar to the processor's, the farmer generally only has one processor to choose from whereas the processor can choose from many farmers. In addition, individual farmers are unlikely to be able to have the resources (both financial and otherwise) to seriously challenge the processor's price, terms and conditions.

Unlike other organisations, DFMC publishes its prices and pricing policies (that have been negotiated and agreed with LDD) in each region so there is complete transparency in relation to individual farmer's arrangements. In DFMC's opinion, the overall lack of transparency within the Dairy Industry around pricing is a substantial impediment to determining whether farmers are being paid the market value or price for their milk.

¹ <http://www.accc.gov.au/media-release/accc-extends-dairy-farmer-collective-bargaining-arrangements>

In DFMC's opinion, an effective collective bargaining mechanism, both on price and terms and conditions, is fundamental to the dairy market being fair to everyone (and, in particular, the farmers).

The future of the MSA

DFMC is currently in negotiations with LDD as to the nature of the MSA post-2019.

At this time, there is little certainty around whether LDD will extend the MSA beyond 2019 and/or on what terms. DFMC and LDD have an agreement unlike any other in the dairy industry – one that ensures balance through a means of determining a fair price for farmers for their product while at the same time allowing LDD to buy milk at a price similar to its competitors.

DFMC is encouraging LDD to renew the MSA on the same or similar terms as the current MSA. In the event LDD does not renew the MSA, DFMC's current 345 farmer members will not have an effective collective bargaining platform.

DFMC is also of the view that dairy farmers who currently supply LDD directly have received the benefit of DFMC's collective bargaining platform. Generally, benefits achieved by DFMC in respect of its farmer members, are pass on by LDD to its approximately 80 direct suppliers.

In short, the non-renewal of the MSA would leave a substantial number of dairy farmers without an effective collective bargaining platform.

Achieving more effective CBGs

In DFMC's opinion, a successful collective bargaining arrangement requires three key conditions, namely:

1. the CBG must be well-funded and resourced;
2. the processor must be bound to deal with the CBG; and
3. in the event of a dispute (including as to price), the dispute can be resolved by binding independent expert determination.

Some of the above components could be achieved by the introduction of a Dairy Industry Code of Conduct, similar to the Food and Grocery Code of Conduct. We note there are current industry discussions being held around the development of an industry code but these discussions are mainly focusing on pricing and contract terms. The current discussions do not address collective bargaining and do not include a mechanism to compel the processor to negotiate with CBGs or otherwise address the current inadequacies around collective bargaining in the industry.

In order to address the key components for successful collective bargaining, for example, any code needs to:

- (a) require the processor to pay an **“aggregation fee”** to the CBG in order to ensure it is funded and properly resourced – *the cost of the “aggregation fee” to the processor should be offset against reduced transaction costs for the processor in having to only deal with a single entity;*
- (b) allow individual farmers to **“roll over” their milk supply contracts** into a CBG and thereafter require the processor to deal with the CBG – *different expiry dates and contract periods make it difficult for farmers to group together at any one time;*
- (c) provide a suitable **template or recommended model for CBGs** (such as the current DFMC/LDD model) – *a suitable template or recommended model would reduce the costs for farmers and assist in the negotiation with the processor;*
- (d) require the processor to **pay the market value** or price for milk – *currently, many farmer contracts do not directly link milk price to market value, which is particularly an issue for farmers who wish to enter into longer term contracts in order to obtain “security of offtake”;*
- (e) set out acceptable (and unacceptable) **terms and conditions** relating to the supply of milk – *for example, a common expiry date, notice periods and no confidentiality provision;* and
- (f) incorporate **Independent Expert** determination provisions to resolve disputes – *in the absence of a compulsory obligation on the processor to deal with CBGs and compulsory Independent Expert determination provisions, CBGs are entirely reliant on the “goodwill” of the processor.*

DFMC is uniquely placed in the dairy industry and has substantial experience in respect of the operation and effectiveness of collective bargaining platforms within the dairy industry. DFMC would be pleased to assist the ACCC with its enquiries involving collective bargaining and/or the development of effective collective bargaining platforms and/or the development of an appropriate code of conduct for the dairy industry.

CONCLUSION

Individual dairy farmers have a low level of bargaining power when negotiating with processors. We have all seen the recent example where a number of Western Australian dairy farmers were abandoned by their current processor.

In DFMC’s opinion, an effective collective bargaining mechanism, both on price and terms and conditions, is fundamental to the dairy market being fair to everyone (and, in particular, the farmers).

DFMC encourages the ACCC to take appropriate steps to ensure the Dairy Industry has effective collective bargaining and is ready to assist the ACCC in the development of effective collective bargaining platforms.



Duncan McInnes
Chairman
Dairy Farmers Milk Co-operative Limited

DFMC Contacts:

| | | |
|----------------|------------------------|--------------|
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Other Information:

- Appendix 1 The DFMC Board of Directors
- Appendix 2 The current Milk Supply Agreement
- Appendix 3 ACCC Authorisation 2008
- Appendix 4 ACCC Authorisation 2013

Appendix 1 – DFMC’s Directors

Duncan McInnes - Chairman

Duncan McInnes was appointed to the DFMC Board in 2004 and was elected Chairman in 2013. He first bought part of the family farm at Harrisville at the age of 19. Today, along with his wife, two brothers and their families, the dairy at Harrisville in Queensland now produces 4 million litres of milk annually. Duncan has extensive management experience, previously serving on a number of boards including Dairy Farmers Limited. He has also held elected positions within the Queensland Dairyfarmers' Organisation and has represented the industry at local, state and national levels. He is also a Councillor with the Royal National Association and a Councillor for Scenic Rim Regional Council.

John Bywater - Independent Director

John Bywater became a Director of the DFMC Board in 2011 having spent more than 20 years in supply management in the dairy industry. John is in a unique position on the Board as he has worked on both sides of the supply chain having previously worked for Dairy Farmers Limited (responsible for Strategic Sourcing, including milk) and then National Foods when it bought Dairy Farmers in 2008. Following the sale, he worked in a transition role to integrate the milk supply bases and dairy supplier services of both organisations. He has also worked for the Queensland Department of Primary Industries. He holds a Bachelor of Business (Rural Management) from the University of Queensland and a Post Graduate Diploma in Information Processing from the University of Southern Queensland. He lives in Sydney.

Andrew Burnett - Director

Andrew Burnett was elected to the Board in 2011 and is currently the Chair of the Member Services and Milk Supply Committee. He has an Associate Diploma in Applied Science and has completed the Rabobank Executive Development Program for primary producers. Andrew has previously worked in the cotton industry and now runs a farm in Gympie in South East Queensland with his wife, Fiona, and their two sons. Their dairy business produces around 2.3 million litres of milk from 350 cows.

Steven Downes - Director

Steven Downes was appointed to the DFMC board in November 2013. Steven is a fourth generation dairy farmer at Jamberoo on the South Coast of New South Wales and is currently building his herd of 120 milkers. Before taking over his family's dairy business in 2010, he worked at Macquarie Bank and National Australia Bank where he specialised in currency markets and agribusiness. He has a Bachelor of Science in Agriculture from the University of Sydney.

James Geraghty - Director

James Geraghty has been a member of the DFMC Board since 2009, and works with his wife Sari, on their dairy farm in Millaa Millaa on the Atherton Tablelands in Far North Queensland. His family moved to the area from Lismore in 1932 and have been dairy farming since then. James purchased his farm with his parents in 1981. James and his wife currently milk 230 cows year round and have an annual production of 1.4 million litres a year. James is the District Chairman and State Councillor for Far North Queensland for the Queensland Dairyfarmers' Organisation and has an Advanced Diploma in Agriculture.

Grant Sherborne - Director

Grant Sherborne was appointed to the DFMC board in November 2013. His dairy, Willow Vale, is located at Burrawang in the Southern Highlands, New South Wales. He has been involved in the day to day running of the farm since he left school. Grant is a passionate advocate for the industry and served as a DFMC ward representative for Southern Highlands from 2002 to 2013. He has been involved with the Cows Create Careers program and his local dairy industry group, DIG South Coast. Grant has an Advanced Diploma of Agriculture and has also completed a director training course.

Cameron Hodge - Director

Cameron was elected to the DFMC board in November 2014 and sits on the Member Services and Milk Supply Committee. He has a diploma in irrigated agriculture and has completed the Australian Institute of Company Directors course. He has served as chairman of the Cohuna Hospital Board of Management and is a keen pilot. Cameron his wife Ann and their three daughters run a pasture and grazing based 300 ha fully irrigated dairy farm at Leitchville in northern Victoria. They currently produce around 3.2 million litres from 350 cows.

Adrian Dauk – Director

Adrian Joined the DFMC Board in November 2016 as an interim Director, passionate & driven about the dairy industry. Along with his wife Holly & 3 young children bought Holly's parents dairy business 18 months ago. The dairy is a pasture based system that employs 2 staff and milks 180 Holstiens. Adrian participates in Dairybase benchmarking and has 10 years experience in the dairy industry. Being a part of a cooperative such as DFMC is important to him. His farm produces 1.4 million litres annually.

Appendix 2 – Milk Supply Agreement

DATED

2004

Between

AUSTRALIAN CO-OPERATIVE FOODS LIMITED

(ARBN 010 308 068)

("ACF")

and

DAIRY FARMERS MILK CO-OPERATIVE LIMITED

(ARBN 108 690 384)

("Supply Co-operative")

**MILK SUPPLY
AGREEMENT**

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THIS AGREEMENT made on the _____ day of _____ 2004

BETWEEN: **AUSTRALIAN CO-OPERATIVE FOODS LIMITED** (ARBN 010 308 068) trading as Dairy Farmers of Quad 1, 8 Parkview Drive, Homebush Bay ("ACF")

AND: **DAIRY FARMERS MILK CO-OPERATIVE LIMITED** (ARBN 108 690 384) of Quad 1, 8 Parkview Drive, Homebush Bay ("Supply Co-operative")

RECITALS

- A. ACF and some of its subsidiaries are processors of milk and sellers of dairy products.
 - B. ACF and some of its subsidiaries currently process milk in New South Wales, Australian Capital Territory, Queensland, Victoria and South Australia.
 - C. Since the commencement date, the majority of the members of the Supply Co-operative have been producers and suppliers of milk to the Supply Co-operative.
 - D. The Supply Co-operative is authorised by its Rules to enter into a contract with a member containing provisions that require the member to have any specified dealings with the co-operative for a fixed period.
 - E. ACF and the Supply Co-operative have entered into this agreement so that:
 - (a) the Supply Co-operative will secure:
 - (i) a long term dependable outlet for milk produced by its farmer members which accommodates on farm growth; and
 - (ii) a commercial price for milk produced by its farmer members taking into account relevant market conditions and ACF's product mix;
 - (b) ACF will secure;
 - (i) an assured and consistent long-term source of milk for ACF and its subsidiaries; and
 - (ii) reasonable control over the quality of milk obtained for processing; and
 - (iii) a consistent supply of milk at a commercial price taking into account ACF's product mix.
 - F. The Supply Co-operative acknowledges ACF's need to obtain a year round source of quality milk. ACF acknowledges the security of the Supply Co-operative's milk supply is in part dependent upon the Supply Co-operative providing its farmer members a consistent and orderly opportunity to grow on farm milk production.
 - G. ACF will provide field advisory services to the Supply Co-operative's direct farmer members.
 - H. There are transaction costs savings to ACF in dealing with farmers on a consolidated basis via the Supply Co-operative.
 - I. ACF has agreed to provide the field advisory services on the basis that the Supply Co-operative is controlled by farmers and the Supply Co-operative will be responsible for the implementation of contracts for the supply of milk from farmers to the Supply Co-operative in accordance with the terms of this agreement.
 - J. It is unlikely that ACF will achieve sufficient transaction costs savings to justify the continuation of this agreement, if the Supply Co-operative ceased to be controlled by farmers or the number of farmer members of the Supply Co-operative was less than two hundred (200).
 - K. The regional supply base and the traditional role of regional co-operatives have made a significant and important contribution to the commercial success and development of ACF's business. Subject to ACF's directors' fiduciary and statutory duties to ACF and its shareholders, ACF shall use its reasonable endeavours to:
-

- (a) pursue commercial opportunities (producing a reasonable commercial rate of return) which will sustain and grow the current regional supply of milk to ACF and its subsidiaries; and
 - (b) preserve the viability of ACF's and its subsidiaries' businesses on a regional basis.
- L. Subject to its obligations at law it is the Supply Co-operative's current policy to ensure that the price paid by ACF for milk flows through to the individual farmer members of the Supply Co-operative subject to any adjustment that may be necessary for cartage.
- M. The Supply Co-operative acknowledges the importance of market signals being passed through to individual farmer members of the Supply Co-operative in order to gain the best advantage for its farmer members from ACF's marketing and production efforts.
- N. ACF acknowledges the sustainability and viability of the Supply Co-operative may be dependent upon ACF acquiring substantially all of the milk supplied by farmers to the Supply Co-operative from the Supply Co-operative.

OPERATIVE PROVISIONS

1 INTERPRETATION

1.1 Dictionary

In this agreement unless the context otherwise requires:

"ACCC" means Australian Competition and Consumer Commission.

"ACF's freight and cartage procedures" means the freight and cartage procedures from time to time agreed in writing between ACF and the Supply Co-operative (acting reasonably).

"ACF's quality standards and control procedures" means:

- (a) the quality standards and control procedures for milk from time to time required by law; and
- (b) such other quality standards and control procedures for milk from time to time agreed in writing between ACF and the Supply Co-operative (acting reasonably) having regard to all relevant circumstances including any applicable codes of practice or industry standards.

"ACF's Purchasing Policy" means the purchasing policy referred to in Clause 4.1.

"act of insolvency" in relation to a party means any one or more of the following:

- (a) if a party goes into liquidation;
- (b) if a party is dissolved;
- (c) a party resolves to wind itself up or otherwise dissolve;
- (d) if a provisional liquidator is appointed to a party;
- (e) an application is made to a court for an order that a party be wound up and the application is not withdrawn, struck out or dismissed within fourteen (14) days;

- (f) an application is made to a court for an order appointing a liquidator or provisional liquidator to a party and the application is not withdrawn, struck out or dismissed within fourteen (14) days;
- (g) if a receiver or receiver and manager is appointed to a party or to the assets of a party;
- (h) if a controller is appointed to a party; and
- (i) anything having a substantially similar effect to any of the above events happens to a party.

"ADR" means:

- (a) Australian Commercial Disputes Centre Limited ("**ACDC**"); or
- (b) in the event ACDC shall cease to exist, be replaced or cease to carry on its functions in expert determination, the body established in lieu thereof to carry on expert determination or which exercises substantially the same powers or functions in expert determination as ACDC (the "**replacement body**"); or
- (c) in the event there is no replacement body, such other body performing alternative dispute resolution functions, nominated by the President (or other senior officer) from time to time of the New South Wales Law Society.

"Administrative Services Fee" means for each financial year commencing after 30 June 2008, a reasonable estimate of the full costs (being direct costs and an appropriate proportion of indirect costs) to be incurred by ACF in providing the Administrative Services to the Supply Co-operative during that financial year.

"Administrative Services" means the administrative facilities and administrative services which are reasonably necessary or desirable to enable the Supply Co-operative to properly and efficiently administer its business of acquiring milk and on supplying that milk to ACF including:

- (a) software and hardware computer resources and the maintenance of those resources;
- (b) office accommodation, communication facilities (including facsimile, telephone and email) and boardroom facilities;
- (c) accounting, taxation, administration and secretarial services (including the preparation of all statutory statements, accounts, returns and reports and maintaining all registers required by law).

For the avoidance of doubt, the Administrative Services do not include the field advisory services referred to in Clause 8.1.

"Aggregation Fee" means:

- (a) for each financial year commencing after 30 June 2008, a reasonable estimate of the direct costs to be incurred by the Supply Co-operative in connection with the consolidation or aggregation of the milk supply for on sale to ACF. The direct costs shall be limited to the following items:
 - (i) the Administrative Services Fee, or if ACF does not provide all of the Administrative Services, the costs of obtaining those Administrative Services not provided by ACF (either from an external services provider or through the engagement of staff) provided that such costs do not exceed the amount that would have been payable to ACF if ACF had provided the Administrative Services in that financial year;
 - (ii) the directors' fees and on costs;

- (iii) director training and conferences;
- (iv) director travel and accommodation;
- (v) meeting and ballot costs for having meeting facilities, postage and printing;
- (vi) insurance premiums for insurance cover against risks which a prudent person would ensure against in the Supply Co-operative's circumstances;
- (vii) consulting, legal and accounting fees in relation to the conduct of the Supply Co-operative's business including the negotiation of milk prices under this agreement;
- (viii) bank charges and sundry administrative charges; and
- (ix) audit fees.

"Anticipated Full Demand" means the volumes of qualifying farmer member's milk, per region, for each quarter following the end of the 2009/2010 financial year, as determined in accordance with Clause 3.4 and schedule 4.

"approval" includes any consent, licence, permit, approval or registration.

"Authorisation Application" means the authorisation of milk supply arrangements sought by the Supply Co-operative and ACF from the ACCC on 22 May 2008 and any amendment to such application.

"Authorisation" means the grant by the ACCC of authorisation of milk supply arrangements under this agreement as contained in any final Determination issued by the ACCC and includes any amendment to such Determination(s).

"Authority" means any:

- (a) government or governmental, semi governmental or judicial entity or authority; or
- (b) minister, department, office, commission, delegate, instrumentality, agency, board, authority or organisation of any government.

and an authority includes any regulatory organisation established under statute or any stock exchange.

"business day" means any day on which trading banks are open for business in Sydney.

"CPI" means:

- (a) the Consumer Price Index Weighted Average of 8 Capital Cities; or
- (b) if that index is suspended or discontinued and another index is substituted by the Australian Statistician, that index; or
- (c) if there is no index under paragraph (b), such other index nominated or determined by the Supply Co-operative (acting reasonably) which reflects the general inflation rate in Australia as used by the Commonwealth Treasury for the relevant period.

"commercial price" means the market value or price of milk (on a GST exclusive basis) determined pursuant to Clause 5.

"commencement date" means 1 July 2004.

"completion date" means the date on which the scheme of arrangement, under the *Co-operatives Act 1992* (NSW), between Kirin Holdings (Australia) Pty Ltd ABN 50 128 004 268 (**Kirin**), or one of its subsidiaries, and ACF is implemented, so that Kirin or one of its subsidiaries acquires all the shares in ACF and ACF is converted from a co-operative to a company under the Corporations Act.

"controller" has the same meaning as in the Corporations Act.

"Corporations Act" means the *Corporations Act 2001 (Cth)*.

"dairy farm" means any land or premises (including dairy premises) used for or in connection with the stalling, grazing, feeding or milking of cows for the purpose of producing milk that is supplied or to be supplied for sale.

"dairy premises" means any building used for the milking of cows for the purpose of producing milk that is supplied or to be supplied for sale.

"direct farmer member" means a farmer member that supplies milk directly to the Supply Co-operative.

"existing farmer members" means the farmer members as at the completion date.

"expert" means the expert appointed by ADR in accordance with ADR Rules pursuant to Clause 14.

"expert's determination" means the expert's determination of the dispute or disagreement in accordance with Clause 14.

"farmer" means a person who carries on the business of producing milk on a dairy farm and includes a person who conducts or is otherwise involved in such activity as a share farmer.

"farmer member" means a member who is a farmer.

"force majeure event" means any occurrence or omission as a direct or indirect result of which the party relying on it is prevented from or delayed in performing any of its obligations (other than a payment obligation) under this agreement and that is beyond the reasonable control of that party, including forces of nature, industrial action and action or inaction by an Authority.

"GST Act" means A New Tax System (Goods and Services Tax) Act 1999 (Cth).

"GST" has the same meaning as in the GST Act.

"initial term" means the initial term of this agreement expiring on 30 June 2017 in accordance with Clause 2.1.

"interest rate" means on any day the rate of interest per annum equal to the Bank Bill Swap Reference Rate: Average Bid for one hundred and eighty (180) days as published in the Australian Financial Review for that day (or if that day is not a business day in Sydney, the immediately preceding business day in Sydney) plus two (2) per cent per annum. In the event the Bank Bill Swap Reference Rate: Average Bid is not published, then interest rate shall mean such other interest rate as a senior manager (appointed by the Supply Co-operative) of the Australia and New Zealand Banking Group Limited shall determine as being approximately equivalent to the Bank Bill Swap Reference Rate: Average Bid had that rate been published.

"Interim Authorisation" means the grant on an interim basis by the ACCC of authorisation of milk supply arrangements under this agreement.

"law" means the provisions of all statutes, the provisions of all rules, regulations, ordinances, by laws, instruments and proclamations made pursuant to the authority direct or indirect of any statute and rules of common law and equity.

"loss" means any and all losses (including loss of profit and loss of expected profit), claims, actions, liabilities, damages, expenses, diminutions in value or deficiencies of any kind or character including all interest and other amounts payable to any person, all liabilities on account of any tax and all legal (on a full indemnity basis) and other expenses reasonably incurred in connection with investigating or defending any claims or actions, whether or not resulting in any liability and all amounts paid in settlement of claims and actions.

"member" means a member of the Supply Co-operative.

"milk" means the lacteal secretion of a dairy cow, whether processed or unprocessed.

"milk receival depot" means any premises where milk is received direct from a dairy farm.

"milk receival member" means The Bega Co-operative Society Limited (ABN 81 008 358 503), The Berry Rural Co-operative Society Limited (ABN 49 380 535 075) or any other person (other than ACF) who owns or occupies a milk receival depot and who is a member on the commencement date.

"Milk Receival Supply Contract" means a contract between the Supply Co-operative and a milk receival member relating to the year round supply of milk to the Supply Co-operative.

"Milk Receival Supply Contract Maximum Volume" in relation to a Milk Receival Supply Contract, means:

- (a) if the milk receival Member has during the whole of the twelve (12) month period immediately prior to the date of commencement of the Milk Receival Supply Contract supplied milk on a year round basis to the Supply Cooperative and that milk has been on supplied to ACF, the volume of milk supplied by the milk receival Member to the Supply Co-operative during that twelve (12) month period; or
- (b) in any other case, the volume of milk supplied to ACF by the milk receival Member in the twelve (12) month period immediately prior to the commencement date.

"Minimum Volume" means the volumes of qualifying farmer member's milk:

- (a) specified in part 1 of Schedule 1, per region, for each quarter of the 2008/2009 and 2009/2010 financial years; and
- (b) for each quarter of the following financial years, per region, as determined in accordance with Clause 3.4.

"new farmer Member" means a farmer Member who is not an existing farmer Member.

"parties" means ACF and the Supply Co-operative and their respective successors and permitted assigns and **"party"** means any one of them and that party's successors and permitted assigns.

"pricing period" means any period determined by ACF pursuant to Clause 5.3.

"processor" means any person who carries on the business of pasteurising milk.

"qualifying farmer member's milk" means:

- (a) milk produced by a farmer member (being the produce of the Member and not acquired from a third party) at a dairy farm at which ACF or its subsidiaries collected milk at any time within the eight (8) week period immediately prior to the completion date; or
- (b) milk produced at a dairy farm which is deemed to be qualifying farmer member's milk pursuant to Clause 3.7(b).

For example, if an existing farmer member sold its existing dairy farm, the milk produced by the purchaser of the dairy farm will continue to be qualifying farmer member's milk provided the purchaser becomes a farmer member of the Supply Co-operative.

"quarter" for the purposes of the definition of Anticipated Full Demand and Minimum Volume in this Clause 1.1 and Clauses 3.4 and 3.7 only shall mean periods made up of consecutive '4,4,5 weeks' (four weeks, followed by four weeks, followed by 5 weeks) specified by ACF from time to time. Each quarter is 13 weeks in duration and otherwise where used in this agreement shall mean a consecutive period of three (3) calendar months' in any year during the term. ending on 31 March, 30 June, 30 September or 31 December.

"**record**" includes information stored or recorded by means of a computer.

"**regions**" means such geographical areas as may be agreed by the Supply Co-operative and ACF from time to time for the purposes of this agreement. At the completion date, the regions shall be the Supply Co-operative's current member regions, being:

- (a) Far North Queensland;
- (b) South East Queensland / Northern NSW;
- (c) Central NSW;
- (d) South Australia / Victoria West;
- (e) Riverina / North Victoria.

Each of (a) to (e) above is a "**region**".

As the Supply Co-operative obtains membership of farmers located in Western Australia and Tasmania, these geographical areas will also become regions.

"**related body corporate**" has the same meaning as in the *Corporations Act*.

"**review date**" means each anniversary of the commencement date.

"**Revenue**" means the Supply Co-operative's revenue from its operating activities excluding all revenue from:

- (a) the sale, forfeiture or disposal of shares in ACF;
- (b) dividends payable on the shares in ACF;
- (c) interest on monies invested;
- (d) amounts received from members (including any levy) relating to the subscription or acquisition of shares or co-operative capital units in the Supply Co-operative;
or
- (e) amounts lent to the Supply Co-operative by a member.

"**schedule**" means a schedule to this agreement.

"**seasonal milk supplier**" means a farmer who is not a year round milk supplier.

"**subsidiary**" has the same meaning as in the *Corporations Act*.

"**tax**" includes any tax, levy, charge, impost, fee, deduction, stamp duty, financial institutions duty, bank account debit tax or other tax or withholdings of any nature whatsoever imposed, levied, collected, withheld or assessed by any Authority and includes any interest, expense, fine, penalty or other charge payable or claimed in respect of any such impost.

"**year round milk supplier**" means a farmer who normally produces milk daily on a year round basis.

1.2 General

In this agreement unless the context otherwise requires:

- (a) a reference to a person includes an Authority, corporation, association, body or any other entity recognised by law and vice versa;

- (b) words importing the singular and plural number and the masculine gender shall be read as also importing the plural or singular number and the feminine or neuter gender as the case may require;
- (c) a reference to a party includes that party's successors and permitted assigns;
- (d) clause or subclause headings are for reference purposes only and do not affect interpretation;
- (e) where any word or phrase is given a defined meaning in this agreement, any other part of speech or other grammatical form in respect of such word or phrase shall have a corresponding meaning;
- (f) references to this agreement. Supply Co-operative's Rules or any other instrument, policy, rules, guidelines or document includes the agreement, rules, instrument, policy, guidelines or document as varied, amended, modified or replaced, notwithstanding any change in the identity of the parties;
- (g) a reference to a statute includes all regulations, rules, by laws or ordinances under that statute, any amendments to that statute and any statute passed in substitution for that statute or incorporating any of its provisions to the extent that they are incorporated;
- (h) a reference to a monetary amount is a reference to Australian currency;
- (i) references to writing include any mode of representing or reproducing words in tangible visible form, and includes telex and facsimile transmission;
- (j) "including" and similar expressions are not words of limitation;
- (k) except for ACDC, a reference to any authorities, associations, bodies and entities whether statutory or otherwise shall, in the event of such Authority, association, body or entity ceasing to exist or being reconstituted, replaced or the powers or functions thereof being transferred to or taken over by any other Authority, association, body or entity, be deemed to refer respectively to the Authority, association, body or entity established, constituted or substituted in lieu thereof or which exercises substantially the same powers or functions in lieu thereof;
- (l) any covenant, agreement, warranty or indemnity on the part or for the benefit of two or more persons shall bind them and be for the benefit of them jointly and severally respectively;
- (m) where time is to be reckoned from a day or event, such day or the day of such event shall be excluded;
- (n) any thing (including any amount) is a reference to the whole or any part of it and a reference to a group of things or persons is a reference to any one or more of them;
- (o) a breach in the performance of an obligation within a time specified in this agreement shall be capable of remedy, unless the obligation is incapable of being performed after the end of the time specified;
- (p) a right includes a benefit, remedy, discretion, authority or power;
- (q) month means calendar month;
- (r) year means calendar year;

- (s) examples do not affect the interpretation of this agreement; and
- (t) schedules to this agreement form part of this agreement.

1.3 Supplied

Unless the context otherwise requires, a reference to milk supplied to the Supply Co-operative includes milk purchased by the Supply Co-operative.

1.4 Material Terms

In construing this agreement, the fact that a term is not expressed to be material, while some other terms are expressed to be material, is not to be taken as indicating that the term is not material.

2 TERM

2.1 Initial Term

Subject to Clauses 2.2 and 15, the term of this agreement shall expire on 30 June 2017.

2.2 Rolling Ten Years

Three (3) months prior to each review date, the parties shall consult to review the term of this agreement and may, if the parties so agree in writing and subject to Clause 15, extend the term by a period which extends the term to a date being ten (10) years from that review date.

2.3 Authorisation

In the event that any Authorisation expires prior to the end of the initial term, the parties shall do all things reasonably necessary to obtain renewal of the Authorisation from the ACCC for such further period as may be necessary to allow the parties to meet their respective obligations under this agreement for the remainder of the initial term and any extension of the term pursuant to Clause 2.2.

3 SUPPLY

3.1 Regional Supply

The regional supply base and the traditional role of regional co-operatives have made a significant and important contribution to the commercial success and development of ACF's business. Subject to ACF's directors' fiduciary and statutory duties to ACF and its shareholders, ACF shall use its reasonable endeavours to:

- (a) pursue commercial opportunities (producing a reasonable commercial rate of return) which will sustain and grow the current regional supply of milk to ACF and its subsidiaries;

- (b) assist the Supply Co-operative to provide its farmer members, on a regional basis, with a consistent and orderly opportunity to grow on farm production; and
- (c) preserve the viability of ACF and its subsidiaries' businesses on a regional basis.

3.2 Supply Co-operative

- 3.2.1 Subject to Clauses 3.2.3, 4.4 and 5.6, the Supply Co-operative will purchase (on terms and conditions acceptable to the Supply Co-operative) all of the qualifying farmer member's milk which is offered for sale to the Supply Co-operative and supply it to ACF.
- 3.2.2 The Supply Co-operative must use its reasonable endeavours to enhance the competitiveness of its farmer members to optimal levels in the geographical area in which they are located. ACF acknowledges in order for the Supply Co-operative to be able to enhance the competitiveness of its farmer members, ACF must provide the Supply Co-operative's farmer members on a regional basis with a consistent and orderly opportunity to grow on farm production.
- 3.2.3 The Supply Co-operative is not required to purchase qualifying farmer member's milk if ACF may refuse to purchase or collect that milk under Clauses 3.5 or 3.6.
- 3.2.4 The Supply Co-operative must use its reasonable endeavours to supply qualifying farmer members milk to ACF, under Clauses 3.2.1 and 3.3, each year of the term over a 12 month period on even daily and monthly basis consistent with normal seasonal cycles.
- 3.2.5 The Supply Co-operative must use its reasonable endeavours to supply the ACF with the Minimum Volume for each region during each quarter of the term of this Agreement.

3.3 ACF

Subject to Clauses 3.5 and 3.6, ACF will purchase from the Supply Co-operative and the Supply Co-operative will sell to ACF:

- (a) all of the qualifying farmer member's milk purchased by the Supply Co-operative; and
- (b) all milk purchased by the Supply Co-operative pursuant to a Milk Reveal Supply Contract approved in writing by ACF (such approval not to be unreasonably withheld) and transported to the place nominated by ACF (acting reasonably); and
- (c) such other milk as ACF and the Supply Co-operative may from time to time agree in writing.

For example, ACF and the Supply Co-operative have agreed that ACF will purchase and collect milk purchased by the Supply Co-operative from certain suppliers of ACF who were not Members of ACF immediately prior to the commencement date. In addition, ACF has agreed to purchase from the Supply Co-operative milk acquired from The Bega Co-operative Society Limited and The Berry Rural Co-operative Society Limited pursuant to certain existing agreements with ACF which the Supply Co-operative took over on the commencement date.

3.4 Setting Minimum Volume and Anticipated Full Demand

- 3.4.1 The parties agree that the intent of the:
- (a) Minimum Volume is to provide ACF (on a reasonable endeavours basis), with the minimum volumes of Milk required by ACF to meet its operational requirements; and
 - (b) Anticipated Full Demand is to provide guidance to the Supply Co-operative to ensure that the long range planning of both the Supply Co-operative and the farmer members for Milk supply align with ACF's anticipated value-added operational demand for Milk.
- 3.4.2 Not later than twelve (12) months prior to:
- (a) the end of the 2009/2010 financial year; and
 - (b) the end of each subsequent financial year,
ACF and the Supply Co-operative shall commence, negotiations to agree in writing in accordance with the principles set out in schedule 4, the Minimum Volumes and the Anticipated Full Demand for each quarter of the next financial year for each Region.
- 3.4.3 If ACF and the Supply Co-operative shall, no later than six (6) months prior to the commencement of the next financial year, agree in writing:
- (a) the Minimum Volumes for a Region for each of the quarters of that financial year, then such volumes shall become the Minimum Volumes for that Region with effect from the commencement of the next financial year; and
 - (b) the Anticipated Full Demand for a Region for each of the quarters of that financial year, then such volumes shall become the Anticipated Full Demand for that Region with effect from the commencement of the next financial year.
- 3.4.4 If ACF and the Supply Co-operative have not agreed in writing the Minimum Volumes and/or the Anticipated Full Demand for a Region six (6) months prior to the commencement of the relevant financial year:
- (a) there shall be deemed to have occurred a dispute in relation to such of the Minimum Volumes and/or the Anticipated Full Demand which are not agreed and the provisions of Clause 14 shall apply; and
 - (b) each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.
- 3.4.5 Pending the determination of the Minimum Volumes and/or the Anticipated Full Demand, in accordance with the provisions of Clause 14:
- (a) the Minimum Volumes for that Region for each quarter of the next financial year will be the same as the Minimum Volumes for each respective quarter of the then current financial year; and/or
 - (b) the Anticipated Full Demand for that Region for each quarter of the next financial year will be the same as the Anticipated Volume for each respective quarter of the then current financial year
- 3.4.6 All decisions regarding the Minimum Volumes and Anticipated Full Demand in each Region will be subject to:
- (a) a requirement that the outcome delivers competitive sourcing of Milk for ACF in each Region on a basis that fairly and reasonably reflects the then current market conditions;

- (b) a requirement that such decisions take into account the volumes of milk which farmers are required to supply the Supply Co-operative under contracts in existence at the time of commencement of negotiations in accordance with Clause 3.2;
- (c) the equitable treatment of the Supply Co-operative and its farmer members on the one hand and ACF and its related body corporates' other suppliers on the other hand in relation to the overall milk pool of ACF and its related bodies corporate in each region; and
- (d) the principles set out in schedule 4.

3.4.7 The Minimum Volumes will be adjusted in the following circumstances:

- (a) **decrease of Minimum Volumes:** if the contract between a farmer member (who supplies qualifying farmer members milk to the Supply Co-operative) and the Supply Co-operative expires or is terminated and that farmer member contracts directly with ACF, National Foods Limited, or National Foods Limited's related bodies corporate (the "Processors") then for term of that new contract with the Processor the Minimum Volumes will be decreased by the volume of Milk which that farmer is contracted to supply (in the relevant quarter) to the Processor; and
- (b) **increase of Minimum Volumes:** if the contract between a farmer (who supplies Milk directly to a Processor) and the Processor expires or is terminated and that farmer member becomes a member of DFMC and contracts directly with the Supply Co-operative (and is approved by ACF under Clause 3.7), then for term of that new contract with Supply Co-operative the Minimum Volumes will be increased by the volume of Milk which that farmer is contracted to supply (in the relevant quarter) to the Supply Co-operative.

3.5 Standards and Access

3.5.1 ACF may refuse to purchase or collect qualifying farmer member's milk:

- (a) if reasonable vehicle access is not available to the dairy premises; or
- (b) if ACF's quality standards and control procedures have not been observed in respect of that milk; or
- (c) in accordance with ACF's quality standards and control procedures.

3.5.2 Subject to Clause 16, ACF and the Supply Co-operative shall, as between themselves, comply with ACF's freight and cartage procedures.

3.5.3 Despite any other provision of this agreement, ACF (acting reasonably) may at any time change ACF's quality standards and control procedures and ACF's freight and cartage procedures in order to:

- (a) ensure that those policies comply with all laws and applicable standards; or
- (b) to address any urgent, unforeseen or unexpected public health and safety concerns regarding milk quality.

For example, ACF would be able to change the policies to address public health and safety concerns if there was an outbreak of anthrax on or around a farm.

3.6 Continuous Supply

ACF may refuse to purchase or collect qualifying farmer member's milk if:

- (a) in the case of a year round milk supplier who is an existing farmer member, the farmer does not continuously supply milk to the Supply Co-operative after the completion date; or
- (b) in the case of a year round milk supplier who is not an existing farmer member, the farmer does not continuously supply milk to the Supply Co-operative as and from the date the farmer commences supplying milk to the Supply Co-operative; or
- (c) in the case of a seasonal milk supplier who is an existing farmer member, the farmer does not continuously supply milk to the Supply Co-operative after the completion date during the periods in which the farmer's herd is producing milk; or
- (d) in the case of a seasonal milk supplier who is not an existing farmer member, the farmer does not continuously supply milk to the Supply Co-operative, during the periods in which the farmer's herd is producing milk, as and from the date the farmer commences supplying milk to the Supply Co-operative;

other than:

- (e) to resolve a contamination or other quality issue; or
- (f) due to circumstances beyond the reasonable control of the farmer; or
- (g) with the written approval of ACF.

Continuous supply is taken to have occurred despite a temporary cessation of supply not exceeding three (3) months or such longer period as agreed in writing by ACF in connection with the sale or relocation of a farmer's dairy farm.

3.7 New farmer members

If the Supply Co-operative agrees, whether as trustee, principal, agent or contractor, to purchase or supply milk produced at a dairy farm and which is not otherwise required to be sold by the Supply Co-operative to ACF pursuant to this agreement then:

- (a) where in the opinion of ACF, reasonably held, the supply by the Supply Co-operative to ACF of such milk would cause the Supply Co-operative to exceed the Anticipated Full Demand for the region in which such dairy farm operates for two (2) consecutive quarters immediately following such purchase, ACF may elect, but is not obliged, to purchase from the Supply Co-operative the milk produced at that dairy farm and otherwise ACF shall be obliged to purchase from the Supply Co-operative the milk produced at that dairy farm;
- (b) if ACF is obliged to, or elects to, purchase the milk produced at that dairy farm, the milk shall be deemed to be qualifying farmer member's milk and the Supply Co-operative must invite the farmer to become a member of the Supply Co-operative if the farmer is not already a member; and
- (c) if ACF does not elect to purchase the milk produced at the dairy farm, the Supply Co-operative may sell or supply that milk to another person.

ACF shall in deciding whether or not to purchase the milk produced at the dairy farm have due regard to the anticipated quality and quantity of milk required by ACF and the time of supply.

3.8 Non-exclusive milk arrangements

- 3.8.1 The milk supply arrangements contemplated in this agreement between ACF and the Supply Co-operative are non-exclusive.
- 3.8.2 Nothing in this agreement will restrict ACF from purchasing milk or products similar to milk from any third party.

4 ACF's PURCHASING POLICY

4.1 ACF's Purchasing Policy

4.1.1 Not later than six (6) months prior to the commencement of each financial year (the "**relevant financial year**"), ACF and the Supply Co-operative shall negotiate to agree in writing on the terms of ACF's Purchasing Policy (including the pricing structure for milk but excluding the commercial price for milk) which is to apply as between the Supply Co-operative and ACF in relation to the purchase of milk for the relevant financial year. The terms of ACF's Purchasing Policy shall:

- (a) be consistent with the objectives stated in Clause 4.2;
- (b) set out the pricing structure (including volume, quality and other incentives) for milk as determined pursuant to Clause 5.2;
- (c) set out the terms of ACF's freight and cartage procedures and ACF's quality standards and control procedures;
- (d) cover such other matters as may be agreed between ACF and the Supply Co-operative from time to time.

For the avoidance of doubt, ACF's Purchasing Policy will not set out the commercial price of milk. The commercial price for each pricing period will be determined pursuant to Clause 5.3.

4.1.2 If ACF and the Supply Co-operative shall no later than three (3) months prior to the commencement of the relevant financial year agree in writing on the terms of the ACF's Purchasing Policy, then such terms shall become ACF's Purchasing Policy with effect from the commencement of the relevant financial year.

4.1.3 If ACF and the Supply Co-operative have not agreed in writing on the terms of ACF's Purchasing Policy no later than three (3) months prior to the commencement of the relevant financial year:

- (i) there shall be deemed to have occurred a dispute in relation to such of the terms of ACF's Purchasing Policy which have not been agreed and the provisions of Clause 14 shall apply; and
- (ii) each party shall immediately commence and pursue the procedure in Clause 14 so that the dispute is determined as soon as possible.

4.1.4 Pending the determination of ACF's Purchasing Policy, in accordance with the provision of Clause 14, ACF's Purchasing Policy for the previous financial year shall continue to apply.

4.1.5 Upon determination, in accordance with the provisions of Clause 14, of the terms of ACF's Purchasing Policy such terms shall, so far as is practicable, be deemed to apply with effect from the commencement of the relevant financial

year and any necessary adjustments shall, within twenty eight (28) days of the determination, occur between the parties.

4.2 Objectives

- 4.2.1 The objectives of ACF's Purchasing Policy are to:
- (a) assist ACF in planning its marketing and production efforts and provide market signals to the Supply Co-operative and its farmer members; and
 - (b) encourage milk production which is in balance with the capital investment and market developments of ACF; and
 - (c) encourage milk supply patterns in balance with ACF's commercial requirements and, in the case of milk supplied in excess of Anticipated Full Demand levels, balance the need for farmers to be able to sell all milk produced with the need to protect the commercial interests of ACF in respect of milk supplied that is in excess of its requirements or capacity to process; and
 - (d) encourage farmers to enhance their competitiveness (for example by providing farmers with a consistent and orderly opportunity to grow on farm production thereby enabling farmers to be competitive in terms of scale of production); and
 - (e) ensure the efficient operation of ACF's production and transportation facilities; and
 - (f) encourage milk quantity and quality which is consistent with ACF's requirements.
- 4.2.2 Without limiting Clause 4.1, the objectives of ACF's Purchasing Policy may if agreed by ACF and the Supply Co-operative be implemented:
- (a) by the establishment of different levels or categories of milk; or
 - (b) through a differential pricing system for different levels or categories of milk; or
 - (c) by providing volume, quality or other incentives to suppliers.

4.3 Compliance

The Supply Co-operative and ACF shall as between themselves at all times comply with the terms of ACF's Purchasing Policy.

4.4 Supply Co-operative's Purchasing Policy

- (a) For so long as the Authorisation, any renewal or extension thereof, or any Interim Authorisation is in force, the Supply Co-operative shall, so far as is relevant, adopt the same milk purchasing policy (including pricing structure) as ACF in relation to the purchase by the Supply Co-operative from its farmer suppliers of milk which is sold to ACF. This is to ensure that the market signals (including pricing structure) incorporated into ACF's Purchasing Policy are directly passed through to the Supply Co-operative's farmer suppliers. Nothing in this Clause 4.4 limits or restricts the ability of the Supply Co-operative to maintain a compulsory share or investment scheme pursuant to the *Co-operatives Act 1992 (NSW)* or any similar or like arrangement;

- (b) In the event that no decision has been made by the ACCC in respect of the grant of Authorisation (including any grant of Interim Authorisation) as at the completion date, the parties agree that there is no obligation on the Supply Co-operative to, nor any arrangement, expectation or understanding between the parties that the Supply Co-operative will, comply with the provisions of Clause 4.4(a) unless and until the ACCC grants Interim Authorisation or Authorisation whichever is the first to occur.

4.5 Inconsistency

The terms of ACF's Purchasing Policy must be consistent with the terms of this agreement and in the event of any inconsistency between this agreement and ACF's Purchasing Policy, the terms of this agreement shall prevail to the extent of the inconsistency.

4.6 Contracts with farmer members

4.6.1 The Supply Co-operative:

- (a) will not amend the terms of any existing supply contracts between the Supply Co-operative and farmer members without the consent of ACF, or agree to allow a farmer to terminate a supply contract between a farmer member and the Supply Co-operative without the consent of ACF (except where the farmer is entitled to do so under the terms of the contract).
- (b) will agree with ACF the form of the contract to be used for any new supply contracts between the Supply Co-operative and farmer members. The form of the Contract must be consistent with the principles and objectives of this agreement;
- (c) will ensure that any new supply contracts between the Supply Co-operative and farmer members, including renewals of existing contracts, will contain the right for the Supply Co-operative to assign the contract to ACF without the consent of the farmer member provided that nothing in this Clause 4.6 shall oblige the Supply Co-operative to give effect to such assignment where such assignment would breach, or would give rise to a material risk of breach, of the *Trade Practices Act, 1974* (Cth); and

4.6.2 For so long as the Authorisation, any renewal or extension thereof, or any Interim Authorisation is in force, all milk acquired by the Supply Co-operative pursuant to any supply contract between the Supply Co-operative and its farmer members (which is in the standard form agreed by the Supply Co-operative and ACF from time to time) will be sold by the Supply Co-operative to ACF on the same terms and conditions relating to payment, pricing, collection and quality as contained in those contracts as if the Supply Co-operative was named in those contracts as the supplier instead of the farmer member and ACF was named in the Contract as the Milk Co-operative instead of the Supply Co-operative provided that any obligation of the Supply Co-operative to pay liquidated or general damages to ACF shall be conditional upon the Supply Co-operative recovering the same amount from the relevant farmer member.

4.6.3 In the event that there is any dispute between the Supply Co-operative and ACF as to the interpretation or operation of this Clause 4.6, each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.

5 MILK PRICES

5.1 Milk Price

5.1.1 The commercial price for milk will be:

- (a) in the period up to 30 June 2010, for all milk, and in the period after 30 June 2010, for all milk up to Anticipated Full Demand level and any additional variance tolerance provided for in schedule 4 to this agreement for a region, the market value or price of milk ; and
- (b) in the case of milk supplied in excess of Anticipated Full Demand level and any additional variance tolerance provided for in schedule 4 to this agreement for a region after 30 June 2010, a commercially reasonable price having regard to the best end use (subject to logistical and administrative costs) to which that milk is likely to put,

in each case, on a GST exclusive basis.

5.1.2 For all milk supplied in excess of Anticipated Full Demand for a region and any additional variance tolerance provided for in schedule 4 to this agreement, ACF must use all reasonable efforts to achieve the best end use which provides the Supply Co-operative the highest commercial price for such milk.

5.1.3 The determination of the commercial price for milk shall take into account all relevant factors, including:

- (a) the need to maintain a year round continuing source of quality milk to ACF having regard to regional requirements;
- (b) the quality and quantity of milk reasonably available to ACF;
- (c) the effective competitive price for milk paid to farmers in the relevant geographical area and in other geographical areas by ACF, ACF's related bodies corporate and other processors with a similar product mix and milk supply pattern to that of ACF and its related bodies corporate having regard to dividends and other distributions payable to the farmer by that processor and the freight and cartage arrangements of that processor;
- (d) all factors which materially influence the prices of dairy products sold by ACF;
- (e) the terms of ACF's Purchasing Policy;
- (f) the anticipated quality and quantity of milk reasonably required by ACF and the time of supply;
- (g) the cost of transporting and handling the milk (including who bears the cost of cartage and handling the milk);
- (h) the cost to ACF of paying members directly pursuant to Clause 7.2;
- (i) ACF's quality standards and control procedures;
- (j) the farm gate pricing protocols stipulated in schedule 2 to this agreement which, as regards milk supplied up to Anticipated Full Demand level and any additional tolerance variance provided for in schedule 4 of this agreement, for the 2010 to 2011 financial year, shall be of paramount consideration in the context of the other factors set out in this Clause 5.1.3.

- 5.1.4 If ACF reasonably determines that milk of a different specification, composition or quality to milk can be sold by it in a processed form more profitably or at a higher price, it may require the Supply Co-operative to agree, as a separate item from any other category of milk, a price for milk of that different specification, composition or quality.

5.2 Pricing Structure

As part of the negotiations for ACF's Purchasing Policy, ACF and the Supply Co-operative must agree in writing upon a pricing structure for milk. The pricing structure must have regard to all relevant circumstances at the time including ACF's Purchasing Policy (so far as it is relevant) and may differ between geographical areas. ACF and the Supply Co-operative acknowledge that the pricing structure from time to time will need to be flexible so as to adapt to the changing environment.

5.3 Pricing Periods

- 5.3.1 Each financial year shall be divided into periods of between one (1) and twelve (12) months duration. Each financial year must be covered by one (1) or more consecutive pricing periods. Different geographical areas may have different pricing periods.
- 5.3.2 Not later than six (6) months prior to the commencement of each financial year, ACF after consultation with the Supply Co-operative shall determine the pricing periods for the next financial year and notify the Supply Co-operative in writing of those pricing periods.

5.4 Price Negotiations

- 5.4.1 No later than one (1) month prior to the commencement of each pricing period, ACF and the Supply Co-operative shall negotiate to agree in writing the commercial prices payable by ACF to the Supply Co-operative for milk for the next pricing period. The commercial price for milk may differ between geographical areas.
- 5.4.2 If ACF and the Supply Co-operative shall prior to the commencement of the relevant pricing period agree in writing such commercial prices, then such commercial prices shall become the commercial prices payable by ACF to the Supply Co-operative for milk with effect from the commencement of the pricing period.
- 5.4.3 If ACF and the Supply Co-operative have not agreed in writing all such commercial prices prior to the commencement of the relevant pricing period:
- (a) there shall be deemed to have occurred a dispute in relation to such of the commercial prices which are not agreed and the provisions of Clause 14 shall apply; and
 - (b) each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.
- 5.4.4 Pending the determination of the commercial price, in accordance with the provisions of Clause 14, ACF shall, in respect of each geographical area, pay to the Supply Co-operative the lower of:
- (a) the commercial price payable by ACF during the corresponding period in the previous year for that geographical area; and
 - (b) the commercial price proposed by ACF for that geographical area.

- 5.4.5 Upon determination, in accordance with the provisions of Clause 14, of the commercial price to apply in respect of the pricing period, such commercial price as determined shall be deemed to apply with effect from the commencement of the relevant pricing period and an adjustment shall within twenty eight (28) days of the determination occur in respect of any underpayment or overpayment made by ACF to the Supply Co-operative in respect of the period between the commencement of the relevant pricing period and the date of such determination. The parties agree that any expert appointed to determine the commercial price of milk must apply the principles set out in Clause 5.1.

5.5 Information

- 5.5.1 Subject to their obligations of confidentiality, and their respective obligations at law (including under the *Trade Practices Act (1974)*) ACF and the Supply Co-operative will disclose to each other:
- (a) any information known to them which may materially affect the commercial price of milk;
 - (b) where available, prices for milk being paid by other comparable processors.
- 5.5.2 Without limiting Clause 5.5.1, ACF will upon request by the Supply Co-operative disclose to the Supply Co-operative the quantity of milk acquired by ACF and its subsidiaries each month during the twelve (12) month period immediately prior to the Supply Co-operative's request.
- 5.5.3 The Supply Co-operative will, whenever prices are announced to its farmer members, disclose to its farmer members, where available, prices for milk being paid by other comparable processors,
- 5.5.4 ACF and the Supply Co-operative shall keep confidential all information disclosed to them by the other party pursuant to Clauses 5.5.1(a) or 5.5.2. The obligation of confidentiality does not extend to information that:
- (a) is disclosed to a party, but at the time of disclosure is already known to that party; or
 - (b) is in the public domain (otherwise than as a result of a breach of this agreement); or
 - (c) is required by law to be disclosed and the party required to make the disclosure has taken all reasonable steps to oppose or prevent the disclosure and to limit, as far as reasonably possible, the extent of the disclosure.

5.6 Supply Co-operative's Price

- (a) For so long as the ACCC Authorisation or any renewal or extension thereof or any Interim Authorisation is in force, the Supply Co-operative shall adopt the same milk price in relation to the purchase by the Supply Co-operative from its farmer suppliers of milk which is on sold to ACF. This is to ensure that the market pricing signals are directly passed through to the Supply Co-operative's farmer suppliers. Nothing in this Clause 5.6 limits or restricts the ability of the Supply Co-operative to maintain a compulsory share or investment scheme pursuant to the *Co-operatives Act 1992 (NSW)* or any similar or like arrangement.

- (b) In the event that no decision has been made by the ACCC in respect of the grant of authorisation (including any grant of Interim Authorisation) as at the completion date, the parties agree that there is no obligation on the Supply Co-operative to nor any arrangement, expectation or understanding between the parties that the Supply Co-operative will, comply with the provisions of Clause 5.6(a) unless and until the ACCC grants Interim Authorisation or the Authorisation whichever is first to occur.

6 MILK COLLECTION

6.1 Collection

Subject to Clause 3, ACF will cause the qualifying farmer member's milk which is offered for sale to the Supply Co-operative by farmers and required to be purchased by ACF pursuant to Clause 3.3 to be collected from:

- (a) in the case of milk produced by a farmer member at a dairy farm at which ACF or its subsidiaries collected milk at any time within the eight (8) week period immediately prior to the completion date, the dairy premises located on that dairy farm as at the completion date or any replacement or renewal of those premises; and
- (b) in any other case, the dairy premises located on the dairy farm as at the date ACF elects to purchase the milk produced at that dairy farm pursuant to Clause 3.7(b), or any replacement or renewal of those premises.

6.2 Collection Basis

- 6.2.1 Subject to Clauses 3.5 and 6.2.2, ACF will cause the milk to be collected at the election of the farmer on either a "skip a day" or daily basis.
- 6.2.2 Despite the farmer's election that milk be collected on a "skip a day" or daily basis, ACF may collect milk on a more frequent basis provided ACF bears the additional cartage costs.

6.3 Price of Milk

Cartage costs shall be taken into account when determining the price for milk under Clause 5.

6.4 Records

ACF shall make available to the Supply Co-operative for inspection all records relating to the collection, cartage, testing and grading of milk. ACF shall supply copies of any records reasonably requested by the Supply Co-operative.

6.5 Efficient Collection

- 6.5.1 In order that milk collection by ACF can be as efficient and as cost effective as possible, the Supply Co-operative must use its reasonable endeavours to provide to ACF from time to time, the following information:

- (a) farm milk production estimates or forecasts for each farm on a monthly basis for the following twelve (12) months; and
 - (b) total milk production estimates or forecasts for each geographic area specified by ACF on a monthly basis for the following twelve (12) months.
- 6.5.2 The Supply Co-operative shall use its reasonable endeavours to provide ACF with the information referred to in Clause 6.5.1 within thirty (30) days of being requested to do so by ACF.

7 PAYMENT

7.1 Payment to Supply Co-operative

- 7.1.1 Subject to Clauses 7.1.2 and 7.2, on the 14th day of each month ACF shall pay the Supply Co-operative (or as it may otherwise direct) for milk supplied to ACF by the Supply Co-operative during the immediately preceding month.

For example, as a result of Clause 7.2, ACF will pay the Supply Co-operative's members directly on the 14th day of each month for milk supplied to the Supply Co-operative and on supplied to ACF during the immediately preceding month.

- 7.1.2 If the 14th day of the month is a Saturday, ACF shall pay the Supply Co-operative on the immediately preceding business day. If the 14th day of the month is a Sunday, ACF shall pay the Supply Co-operative on the next business day. If the 14th day of the month is a public holiday or bank holiday, ACF shall pay the Supply Co-operative on the next day if that day is a business day or if that day is not a business day, ACF shall pay the Supply Co-operative on the nearest business day to the 14th day of the month.

For example, if the 14th day of the month was Good Friday (being a public holiday), ACF would pay the Supply Co-operative on the Thursday (being a business day) immediately before Good Friday.

7.2 Payments to Members

The Supply Co-operative shall direct ACF to pay, on behalf of the Supply Co-operative, payments to members (or as the members may otherwise direct) for milk collected from members and such payments to members shall be in reduction of monies owing by ACF to the Supply Co-operative for the purchase of that milk.

7.3 Member Deductions

ACF is authorised to deduct from any payments to be made by it to any member under Clause 7.2 any amount such member owes to ACF and ACF will not in any respect become or be liable to the Supply Co-operative in respect of such deductions.

8 FIELD ADVISORY SERVICES

8.1 Field Advisory Services

- 8.1.1 ACF at its cost, shall in consultation with the Supply Co-operative, provide reasonable field advisory services to the Supply Co-operative's direct farmer members to assist the Supply Co-operative's direct farmer members in:
- (a) producing high quality milk and increasing milk volumes; and
 - (b) planning and implementing dairy improvements including the provision of incentives or advances to farmers to install on farm storage capacity; and
 - (c) maintaining or improving quality standards for milk and milking herds; and
 - (d) maintaining or improving the cost efficiency of dairy operations including technical matters.
- 8.1.2 Without limiting Clause 8.1.1 as part of the field advisory services, ACF at its cost, shall in consultation with the Supply Co-operative, develop and maintain a reasonable supplier communication system (including a farmer representative system) between ACF, the Supply Co-operative and the Supply Co-operative's direct farmer members. The communication system shall deal with supplier related issues including milk quality, milk supply, farming practices and market trends.
- 8.1.3 In order for the Supply Co-operative to enhance the competitiveness of its farmer members it will encourage its farmer members to use the field advisory services provided for this purpose.
- 8.1.4 Subject to Clause 8.1.5, the provision of field advisory services by ACF does not include the negotiation of contracts (including new and renewed contracts) between the Supply Co-operative and farmers, which negotiations will be exclusively conducted by the Supply Co-operative for a period of three (3) years from the commencement date and thereafter as agreed between the parties in accordance with Clauses 8.1.7 and 8.1.8.
- 8.1.5 During the period described in Clause 8.1.4, ACF will provide to the Supply Co-operative on secondment three (3) suitably trained and qualified employees of ACF, acceptable to the Supply Co-operative acting reasonably, who will carry out the negotiating and management and implementation of contracts (including new and renewed contracts) between the Supply Co-operative and farmers and provide further related services to the Supply Co-operative such as managing the Supply Co-operative's compliance with its obligations in respect of Minimum Volumes and Anticipated Full Demand pursuant to this agreement, subject to the directions and control of the Supply Co-operative. The employees referred to above will work exclusively and on a full time basis for the Supply Co-operative, but may carry out work for ACF that is not adverse to the interests of the Supply Co-operative from time to time with the consent of the Supply Co-operative (which will not be unreasonably withheld if the relevant employee is not occupied full time in carrying out the functions referred to above), and the employees may also participate in training and career planning programs conducted by ACF.
- 8.1.6 No later than three (3) months subsequent to the commencement date the parties will agree a set of criteria or performance measures including but not limited to achievement of those performance measures set out in schedule 3 by which the parties will agree whether or not the services to be provided in accordance with Clause 8.1.5 have been carried out efficiently and effectively.

- 8.1.7 No later than three (3) months prior to the third anniversary of the commencement date the parties will meet and determine whether the services provided in accordance with Clause 8.1.5 have been provided efficiently and effectively in accordance with the criteria or performance measures agreed in accordance with Clause 8.1.6 and, if so, will extend the term for the provision of such services in accordance with clause 8.1.5 for a further period of not less than two (2) years.
- 8.1.8 No later than three (3) months prior to the expiry of any further period agreed by the parties in accordance with Clause 8.1.7 the parties will again meet and carry out the determination described in Clause 8.1.7 and, if so, will extend the term for the provision of such services for a further period of not less than two (2) years which process will continue three (3) months prior to the expiry of any such further period throughout the term of this agreement.
- 8.1.9 In the event of a dispute regarding any of the matters described in any of Clauses 8.1.6, 8.1.7 and 8.1.8, each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.
- 8.1.10 The provision of employees to the Supply Co-operative in accordance with clause 8.1.5 shall be at no cost to the Supply Co-operative and shall not form any part of the Administrative Services Fee.
- 8.1.11 Despite any other provision of this clause ACF shall not be obliged to provide the employees to carry out the services described in clause 8.1.5 where in any 12 month period during the term the Supply Co-operative sells 10% or greater of its milk volumes to processors other than ACF and its related bodies corporate.

8.2 Level of Field Advisory Services

- 8.2.1 Subject to Clause 8.1.4 and 8.2.2, the type and extent of field advisory services to be provided to the Supply Co-operative's direct farmer members by ACF following the completion date shall (having regard to the factors in Clause 8.2.2) be comparable to the type and extent of field advisory services historically provided by ACF.
- 8.2.2 The level of field advisory services to be provided to the Supply Co-operative's direct farmer members by ACF shall take into account:
- (a) the level of field services provided by ACF's competitors;
 - (b) the number of dairy farms from which milk is directly supplied to the Supply Co-operative;
 - (c) the volume of milk supplied directly to the Supply Co-operative;
 - (d) the commercial benefit derived by ACF (as determined by key performance indicators agreed between ACF and the Supply Co-operative within a reasonable time of a party requesting the other party to so agree, and failing such agreement as determined pursuant to Clause 14); and
 - (e) the reduction after the completion date in any similar or like services provided by an Authority.

9 [Not Used]

10 PROPERTY AND RISK

- 10.1** Property in the milk being purchased by ACF from the Supply Co-operative shall pass to ACF at the same time as property in the milk which is being purchased by the Supply Co-operative passes to the Supply Co-operative.
- 10.2** Risk of loss or damage to the milk being purchased by ACF from the Supply Co-operative shall pass to ACF as soon as it is collected by ACF.

11 ADMINISTRATIVE SERVICES

11.1 Administrative Services

Subject to Clauses 11.4, 11.6 and 13, ACF will provide to the Supply Co-operative the Administrative Services with all due care and skill in a manner suitable for the purpose for which the Administrative Services are required.

11.2 Administrative Services Fee

So long as ACF provides the Administrative Services, the Supply Co-operative shall pay to ACF the Administrative Services Fee by quarterly instalments (and proportionately for any part of a quarter) in advance on the first day of each quarter provided that the first instalment shall be paid on the commencement date.

11.3 Administrative Services Fee Agreement

- 11.3.1 Not later than one (1) month prior to the commencement of each financial year commencing after 30 June 2008 (the "**relevant financial year**"), ACF and the Supply Co-operative shall agree in writing on the Administrative Services Fee which is to apply for the relevant financial year.
- 11.3.2 If ACF and the Supply Co-operative shall prior to the commencement of the relevant financial year agree in writing on the Administrative Services Fee, then such Administrative Services Fee shall become payable by the Supply Co-operative to ACF with effect from the commencement of the relevant financial year.
- 11.3.3 If ACF and the Supply Co-operative have not agreed in writing on the Administrative Services Fee prior to the commencement of the relevant financial year:
- (a) there shall be deemed to have occurred a dispute in relation to the Administrative Services Fee and the provisions of Clause 14 shall apply; and
 - (b) each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.
- 11.3.4 Pending the determination of Administrative Services Fee, in accordance with the provisions of Clause 14, the Administrative Services Fee for the previous financial year shall continue to be paid by the Supply Co-operative to ACF.

- 11.3.5 Upon determination, in accordance with the provisions of Clause 14, of the Administrative Services Fee to apply in respect of the commencement of the relevant financial year, the Administrative Services Fee as determined shall be deemed to apply with effect from the commencement of the relevant financial year and an adjustment shall within twenty eight (28) days of the determination occur in respect of any underpayment or overpayment made by the Supply Co-operative to ACF in respect of the period between the commencement of the relevant financial year and the date of such determination.

11.4 Ninety (90) Per Cent Test

After 30 June 2008, ACF shall only be required to provide the Administrative Services if, during the quarter ending immediately prior to the time the Service was provided, at least 90 per cent of the Supply Co-operative's Revenue for that quarter was derived from ACF. The Supply Co-operative shall provide ACF with reasonable access to all of its records relating to the Supply Co-operative's Revenue. ACF may at its cost make copies of any such records.

11.5 Reasonable

Despite any other provision of this agreement, ACF and the Supply Co-operative agree that:

- (a) the amount of \$100,000 per annum (exclusive of GST) is currently a reasonable amount for the Administrative Services Fee; and
- (b) for each financial year commencing after 30 June 2008, the Administrative Services Fee for the relevant financial year shall not be increased to an amount exceeding \$100,000 per annum (exclusive of GST) multiplied by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the commencement of the relevant financial year and divided by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the commencement date, unless the expected level of membership of the Supply Co-operative during the relevant financial year is 10% or more than the level of membership of the Supply Co-operative as at the commencement date; and
- (c) the Administrative Services Fee shall not exceed a reasonable amount having regard to all the circumstances including the level or anticipated level of membership of the Supply Co-operative; and
- (d) they shall regularly consult with each other to agree on a proposed budget in relation to the Administrative Services and the Administrative Services Fee.

11.6 Election

The Supply Co-operative may elect to have ACF not provide all or any of the Administrative Services by giving to ACF a written notice which indicates such election and the date (being at least 3 months after the date of notice) from which the specified Administrative Services should cease to be provided.

12 AGGREGATION FEE

12.1 Aggregation Fee

Subject to Clauses 12.4 and 13, ACF shall pay to the Supply Co-operative the Aggregation Fee in order to cover or reimburse the Supply Co-operative for the costs and expenses connected with the consolidation or aggregation of the milk supply for on sale to ACF.

12.2 Quarterly Instalments

The Aggregation Fee shall be paid by equal quarterly instalments (and proportionately for any part of a quarter) in advance on the first day of each quarter provided that the first instalment shall be paid on the commencement date.

12.3 Aggregation Fee Agreement

12.3.1 Not later than one (1) month prior to the commencement of each financial year commencing after 30 June 2008 (the "**relevant financial year**"), ACF and the Supply Co-operative shall agree in writing on the Aggregation Fee which is to apply for the relevant financial year.

12.3.2 If ACF and the Supply Co-operative shall prior to the commencement of the relevant financial year agree in writing on the Aggregation Fee, then such Aggregation Fee shall become payable by the ACF to the Supply Co-operative with effect from the commencement of the relevant financial year.

12.3.3 If ACF and the Supply Co-operative have not agreed in writing on the Aggregation Fee prior to the commencement of the relevant financial year:

- (a) there shall be deemed to have occurred a dispute in relation to the Aggregation Fee and the provisions of Clause 14 shall apply; and
- (b) each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible.

12.3.4 Pending the determination of the Aggregation Fee, in accordance with the provisions of Clause 14, the Aggregation Fee for the previous financial year shall continue to be paid by ACF to the Supply Co-operative.

12.3.5 Upon determination, in accordance with the provisions of Clause 14, of the Aggregation Fee to apply in respect of the commencement of the relevant financial year, the Aggregation Fee as determined shall be deemed to apply with effect from the commencement of the relevant financial year and an adjustment shall within twenty eight (28) days of the determination occur in respect of any underpayment or overpayment made by the ACF to the Supply Co-operative in respect of the period between the commencement of the relevant financial year and the date of such determination.

12.4 Ninety (90) Per Cent Test

After 30 June 2008, ACF shall only be required to pay a quarterly instalment of the Aggregation Fee if, during the quarter ending immediately prior to the due date for payment of that quarterly instalment:

- (a) at least ninety per cent (90%) of the Supply Co-operative's Revenue for that quarter was derived from ACF; and

- (b) at least ninety-five per cent (95%) of the milk acquired by the Supply Co-operative during that quarter in each region was on-sold to ACF or its related bodies corporate.

The Supply Co-operative shall provide ACF with reasonable access to all of its records relating to the Supply Co-operative's Revenue and milk acquisitions and disposal. ACF may at its cost make copies of any such records.

12.5 Reasonable

Despite any other provision of this agreement ACF and the Supply Co-operative agree that:

- (a) the amount of \$1,100,000 per annum (exclusive of GST) is currently a reasonable amount for the Aggregation Fee; and
- (b) for each financial year commencing after 30 June 2008, the Aggregation Fee for the relevant financial year shall not be reduced to an amount less than \$1,100,000 per annum (exclusive of GST) multiplied by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the commencement of the relevant financial year and divided by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the completion date; and
- (c) for each financial year commencing after 30 June 2008, the Aggregation Fee for the relevant financial year shall not, unless otherwise agreed in writing by ACF, exceed \$1,100,000 per annum (exclusive of GST) multiplied by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the commencement of the relevant financial year and divided by 50% of the CPI published by the Australian Statistician for the last quarter ending immediately before the completion date; and
- (d) subject to paragraphs (b) and (c), the Aggregation Fee shall not exceed a reasonable amount having regard to all the circumstances including the number or expected number of dairy farms from which milk is directly supplied to the Supply Co-operative and the volume of qualifying farmer members milk supplied, or expected to be supplied, by the Supply Co-operative for on sale to ACF; and
- (e) they shall regularly consult with each other to agree on a proposed budget in relation to the Aggregation Fee.

12.6 Change to Supply Co-operative

The Aggregation Fee will immediately cease to be payable by ACF if the Supply Co-operative changes its operations such that its principal activity is no longer the consolidation or aggregation of the milk supply for on sale to ACF or other processors.

13 [Not Used]

14 DISPUTE RESOLUTION

14.1 Disputes

Subject to Clause 14.5, if a dispute or disagreement arises out of or under Clauses 3, 4, 5, 6, 7, 8, 11, 12, 13 and 20 of this agreement ("**dispute**"), the parties shall endeavour to settle the dispute by mediation in accordance with Clause 14.2 and in the event that the mediation does not settle the dispute, the parties shall submit the dispute to expert determination in accordance with Clause 14.3.

14.2 Mediation

The mediation shall be conducted in accordance with the ADR rules or guidelines (if any) for commercial mediation operating at the time the dispute is referred to ADR ("**ADR Guidelines**") The ADR Guidelines are deemed to be incorporated into this agreement. The mediator shall be appointed by ADR in accordance with the ADR Guidelines.

14.3 Expert Determination

- 14.3.1 In the event the dispute has not been settled within twenty eight (28) days after the appointment of the mediator, or such other period as agreed to in writing between the parties, the dispute shall be submitted to an expert for expert determination (administered by ADR) in accordance with ADR rules (if any) for expert determination operating at the time the dispute is referred to ADR ("**ADR Rules**"). The ADR Rules are deemed to be incorporated into this agreement.
- 14.3.2 The expert shall be appointed by ADR in accordance with ADR Rules. The expert shall not be the same person as the mediator.
- 14.3.3 The parties shall accept the determination of the expert as final and binding. The expert shall act as an expert and not as an arbitrator.
- 14.3.4 Unless contrary to ADR Rules, the expert shall:
- (a) proceed in a manner which the expert thinks fit without being bound to follow the rules of natural justice or the rules of evidence;
 - (b) take into account all documents, information and other written and oral material that the parties may place before the expert, including documents, information and material relating to the matters in dispute and arguments and submissions upon such matters;
 - (c) promptly determine the dispute in a manner which has regard to and is consistent with the terms of this agreement;
 - (d) where the dispute relates to the commercial price payable by ACF for milk, determine the dispute in a manner which has regard to and is consistent with the provisions of this agreement which relate to the commercial price payable by ACF for milk including Clauses 5.1 and 6.3; and
 - (e) promptly provide the parties with written notification of his or her determination and a summary of the reasons for such determination.

14.3.5 Each party shall render all reasonable assistance to the expert and in particular, provide the expert with access to any records of the party. The parties shall do all things reasonably necessary to ensure that the dispute is determined by the expert as soon as possible.

14.4 Costs

Unless otherwise provided in ADR Guidelines or ADR Rules (as the case may be), the costs incurred by the mediator or expert shall be borne by the parties equally.

14.5 Interlocutory Proceedings

Clause 14.1 shall not restrain a party from at any time commencing urgent interlocutory proceedings for injunctive relief in connection with an alleged breach of this agreement.

14.6 Termination

For the avoidance of doubt, this Clause 14 shall survive termination of this agreement.

15 TERMINATION

15.1 Act of Default

Subject to Clause 15.2 a party may terminate this agreement by notice in writing if:

- (a) an act of insolvency occurs in respect of the other party;
- (b) the other party breaches a material term of this agreement.

15.2 Restrictions

Subject to Clause 15.3, a party (the "**non defaulting party**") may not terminate this agreement for a breach by the other party (the "**defaulting party**") of a material term of this agreement unless the non defaulting party has given to the defaulting party written notice:

- (a) specifying the particular breach complained of; and
- (b) if the breach is capable of remedy requiring the defaulting party to remedy the breach; and
- (c) if the breach is not capable of remedy, requiring the defaulting party to pay reasonable compensation to the non defaulting party;
- (d) and the defaulting party fails within twenty eight (28) days thereafter to:
- (e) remedy the breach, if it is capable of remedy; or
- (f) where compensation in money is required, to pay reasonable compensation to the non defaulting party.

15.3 Termination by ACF

ACF may terminate this agreement immediately by notice in writing to the Supply Co-operative if the matter referred to in Clause 12.6 occurs in relation the Supply Co-operative.

15.4 Assignment of Supply Co-operative contracts with Farmer Members

- (a) Upon termination of this agreement by ACF, pursuant to Clause 15.1 or 15.3, all contracts between the Supply Co-operative and the farmer members for the supply of milk (“**Farmer Member Contracts**”) will automatically be assigned by the Supply Co-operative to ACF, with no further action required.
- (b) The Supply Co-operative warrants that it has, and will have at all times during the term of this agreement, the right to assign all Farmer Member Contracts (except for Farmer Member Contracts in force on the completion date which are for an initial term of one (1) year or less) to ACF at any time without the consent of the Farmer Members, including after ACF is converted to a company under the Corporations Act and ceases to be a related party of the Supply Co-operative.
- (c) Despite any other provision of this agreement, the Supply Co-operative may at any time assign all or any of the Farmer Member Contracts to ACF.
- (d) If for any reason the assignment of the Farmer Member Contracts under Clause 15.4 (a) or (c) is ineffective:
 - (i) the Supply Co-operative must permit ACF to have the benefit of and exercise the Supply Co-operative rights under the relevant Farmer Member Contracts; and
 - (ii) ACF must perform all of the Supply Co-operative’s obligations under the relevant Farmer Member Contracts;as and from the date of the purported assignment of the relevant Farmer Member Contracts.
- (e) In respect of any Farmer Member Contract which is assigned or is purported to be assigned to ACF, ACF indemnifies the Supply Co-operative in respect of any loss which the Supply Co-operative pays, suffers, incurs or is liable for at any time after the assignment or purported assignment as a result of any act or default of ACF in performing the Supply Co-operative obligations under the Farmer Member Contract.

15.5 Prejudice

Termination under this Clause 15, shall be without prejudice to the rights of either party in respect of any antecedent breach.

16 FORCE MAJEURE

16.1 Subject to Clause 16.2 a party shall not:

- (a) be responsible for any injury or loss caused to the other party; or
- (b) be entitled to terminate this agreement because of a breach of a term of this agreement by the other party;

due to a force majeure event.

- 16.2** Clause 16.1 will not apply in respect of a breach of Clause 3.2.5 where failure to comply with that Clause is the result of a force majeure event, the occurrence or consequences of which and the extent thereof in either case, were anticipated at the time the Minimum Volume was set, for example an ongoing draught in the relevant region.

17 WARRANTIES

- 17.1** To the maximum extent permitted by law, all express and implied warranties, guarantees and conditions under statute or general law as to merchantability, description, quality, suitability or fitness of:

- (a) the milk sold to ACF; and
- (b) any advice or services given by, or on behalf of, ACF as part of the field advisory services or administrative services,
- (c) are expressly excluded.

18 INTEREST

18.1 Rate

If ACF does not pay any amount payable under this agreement to the Supply Co-operative on the due date for payment, interest shall be payable on that amount calculated at the interest rate from the due date for payment up until the date of actual payment.

18.2 Calculation

Interest shall accrue and be calculated from day to day and shall be computed on the basis of actual days elapsed and a 365 day year.

18.3 Compound

Interest shall be payable on demand by the Supply Co-operative which may be made at any time and from time to time. Interest which is not paid as and when due, shall itself bear interest as and from the relevant date for payment.

18.4 Merger

In the event of the liability of ACF becoming merged in any judgment or order, ACF must pay interest on the amount for the time being owed under the judgment or order at the rate charged or chargeable under this Clause 18 or the judgment or order, whichever is the greater.

19 PREMISES

19.1 ACF shall ensure that:

- (a) any premises which it or any of its subsidiaries receive or treat milk supplied by the Supply Co-operative comply with all laws;
- (b) the collection, cartage, testing, grading, treating and processing of milk supplied by the Supply Co-operative comply with all laws; and
- (c) milk supplied by the Supply Co-operative to ACF is not sold or delivered for human consumption until after it has been treated and processed as required by law.

20 RELATED PARTIES

20.1 Prior to each anniversary of the completion date (the "variation date") the parties shall vary this agreement to the extent necessary to ensure the provisions of this agreement comply with all laws (including the *Trade Practices Act 1974 (Cth)*) (the "**variation**"). If the parties have not made the variation:

- (a) within fourteen (14) days of either party, prior to the variation date, requesting the other party to review this agreement; or
- (b) at least fourteen (14) days prior to the variation date; or
- (c) at least fourteen (14) days prior to an anniversary of the variation date;

there shall be deemed to have occurred a dispute in relation to the variation and the provisions of Clause 14 shall apply and each party shall immediately commence and pursue the procedures in Clause 14 so that the dispute is determined as soon as possible

20.2 Without the need for the parties to execute any further document, this agreement shall be automatically varied in accordance with the expert's determination in relation to the variation as and from the variation date or relevant anniversary of the variation date (as the case may be).

21 GST

21.1 All consideration provided under this agreement is exclusive of GST unless it is expressly stated otherwise.

21.2 If GST is payable by the supplier on any supply made under this agreement, the recipient will pay to the supplier an amount equal to the GST payable on the supply.

21.3 The amount payable, if any, under Clause 21.2 shall be paid at the same time and in the same manner that the consideration for the supply is paid or provided under this agreement.

21.4 The supplier shall provide to the recipient a tax invoice in accordance with the GST Act at or before the time that GST is payable by the recipient to the supplier under Clause 21.3.

21.5 If this agreement requires a party to pay for, reimburse or contribute to any cost, expense, loss or outgoing ("**reimbursable expense**") suffered or incurred by the other

party, the amount required to be paid, reimbursed, or contributed by the party is the amount of the reimbursable expense net of any input tax credit or reduced input tax credit to which the other party is entitled in respect of the reimbursable expense.

21.6 Where the recipient of a supply under this agreement has an adjustment event that decreased the amount of GST that the recipient is required to remit to the Commissioner of Taxation, the supplier shall issue to the recipient an adjustment note in accordance with the GST Act within 14 days of becoming aware of the need to make the adjustment.

21.7 Terms that are defined in the GST Act have the same meaning in this agreement, except where the context makes it clear that a different meaning is intended.

22 [Not Used]

23 MEMBERSHIP

23.1 The Supply Co-operative must, for the duration of this agreement, ensure:

- (a) the Supply Co-operative is controlled by members who are farmer members; and
- (b) the number of farmer members of the Supply Co-operative is not less than two hundred (200).

23.2 Despite Clause 15.2, the parties agree:

- (a) Clause 23.1 is a material term of this agreement;
- (b) a breach of Clause 23.1 shall entitle ACF to terminate this agreement by giving not less than six (6) months written notice to the Supply Co-operative; and
- (c) the Supply Co-operative shall not otherwise be liable to pay ACF any damages, costs or expenses because of a breach of Clause 23.1.

24 EXERCISE OF RIGHTS

24.1 A party may exercise a right, at its discretion, and separately or concurrently with another right. A single or partial exercise of a right, by a party does not prevent a further exercise of that or of any other right. Failure by a party to exercise or delay in exercising a right does not prevent its exercise.

25 INDEMNITY

25.1 Subject to Clause 16, a party (the "**indemnifying party**") indemnifies the other party against any loss arising from a breach of this agreement by the indemnifying party.

26 ENUREMENT

26.1 The provisions of this agreement shall enure for the benefit of and be binding upon the parties and each of their executors successors and permitted assigns.

27 GOVERNING LAW AND JURISDICTION

27.1 This agreement is governed by the law in force in New South Wales.

27.2 Each party irrevocably and unconditionally submits to the non-exclusive jurisdiction of the courts of New South Wales.

28 NOTICES

28.1 Procedure

All notices authorised or required under this agreement to be given by a party to the other party shall be in writing sent by facsimile or delivered personally or sent by pre-paid security post and in each case addressed to the other party at the party's address set forth hereunder or as the case may be at such other address as a party may from time to time notify to the other party,

28.2 Receipt of Notice

A notice is taken to be received:

- (a) if delivered personally, at the time of delivery;
- (b) if sent by prepaid security post, on the second business day after posting; and
- (c) if sent by facsimile, upon production by the sender's machine of a report indicating that the notice was transmitted in its entirety to the facsimile number of the recipient.

28.3 Address for Service

The initial address and facsimile number of the parties shall be as follows:

| | |
|----------------------|---|
| Supply Co-operative: | Quad 1, 8 Parkview Drive, Homebush Bay Facsimile: (02) 8732 5181 |
|----------------------|---|

| | |
|------|---|
| ACF: | Quad 1, 8 Parkview Drive, Homebush Bay Facsimile: (02) 8732 5181 |
|------|---|

29 FURTHER ASSURANCES

29.1 Each party agrees, at its own expense, on the request of the other party, to do everything necessary to give effect to this agreement and the transactions

contemplated by it (including the execution of documents) and to use all reasonable endeavours to cause relevant third parties to do likewise.

30 ENTIRE UNDERSTANDING

30.1 Entire Understanding

This agreement embodies the entire understanding and agreements between the parties as to the subject matter of this agreement.

30.2 Previous Negotiations

All previous negotiations understandings representations warranties memoranda or commitments in relation to or in any way affecting the subject matter of this agreement are merged in and superseded by this agreement and shall be of no further force and effect and the parties shall not be liable to each other in respect of such matters.

30.3 No Collateral Agreements

No oral explanation or information provided by any party to another shall affect the meaning or interpretation of this agreement or constitute any collateral agreement warranty or understanding between the parties.

30.4 September 2005 Agreement

The parties agree that the supplement to this agreement dated 1 September 2005 is merged in and superseded by this agreement and shall be of no further force and effect.

31 WAIVER AND VARIATION

31.1 A provision of or a right created under this agreement may not be:

- (a) waived except in writing signed by the party granting the waiver; or
- (b) varied except in writing signed by the parties.

31.2 The parties may vary this agreement in writing signed by the parties.

32 INVALIDITY

32.1 If the whole or any part of a provision of this agreement (including Clause 9.1) is invalid or unenforceable in a jurisdiction it shall if possible be read down for the purposes of that jurisdiction so as to be valid and enforceable. If however, the whole or any part of a provision of this agreement is not capable of being read down it is severed to the extent of the invalidity or unenforceability without affecting the remaining provisions of this agreement or affecting the validity or enforceability of that provision in any other jurisdiction.

33 REMEDIES CUMULATIVE

- 33.1** The rights provided in this agreement are cumulative with and not exclusive of the rights, powers or remedies provided by law independently of this agreement.

34 COSTS

- 34.1** ACF shall pay all stamp duty and costs of and incidental to the preparation and execution of this agreement.

35 PARTNERSHIP

- 35.1** Nothing contained in this agreement shall be construed as creating the relationship of partnership, joint venture, or of principal and agent.

36 CONSENT

- 36.1** A party may give conditionally or unconditionally or withhold its approval or consent in its absolute discretion unless this agreement expressly provides otherwise.

37 ENFORCEMENT OF INDEMNITIES

- 37.1** It is not necessary for a party to incur expense or make payment before enforcing a right of indemnity conferred by this agreement,

38 SURVIVAL OF INDEMNITIES

- 38.1** Each indemnity in this agreement is a continuing obligation, separate and independent from the other obligations of the parties and survives termination of this agreement.

39 NO MEMBERS' RIGHTS UNDER THIS AGREEMENT

- 39.1** Nothing contained in this agreement shall give the members of the Supply Co-operative any rights whatsoever against ACF.

40 ASSIGNMENT

40.1 Neither party may assign its interest in this agreement without the consent in writing of the other party, which consent will not unreasonably be withheld.

EXECUTED as an **AGREEMENT**

THE COMMON SEAL of AUSTRALIAN)
CO-OPERATIVE FOODS LIMITED was)
affixed in accordance with its Rules)
and in the presence of:)

Secretary

Director

Print Name

Print Name

THE COMMON SEAL of DAIRY)
FARMERS MILK CO-OPERATIVE)
LIMITED was affixed in accordance)
with its Rules and in the presence of:)

Secretary

Director

Print Name

Print Name

Appendix 3 – ACCC Authorisation 2008



Australian
Competition &
Consumer
Commission

Determination

Application for authorisation

lodged by

**Dairy Farmers Milk Co-operative Limited (DFMC) and
Australian Co-operative Foods Limited (ACF)**

in respect of

Milk Supply Arrangements between the parties following the sale of ACF

Date: 22 October 2008

Authorisation no.: A91089

Public Register no.: C2008/851

Commissioners: Samuel
Schaper
King
Martin

Summary

The ACCC grants authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended Milk Supply Agreement (which will come into effect following the completion of the sale of ACF) (amended MSA) to apply to various contracts between ACF, DFMC and dairy farmers. Authorisation is granted for a period of five years.

The authorisation process

The Australian Competition and Consumer Commission (ACCC) can grant protection from the application of the competition provisions of the *Trade Practices Act 1974* (the Act) if it is satisfied that the benefit to the public from the conduct outweighs any public detriment. The ACCC conducts a public consultation process to assist it to determine whether a proposed arrangement results in a net public benefit.

The application for authorisation

Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Co-operative Foods Limited (ACF) (the applicants) are related parties. On 25 August 2008, ACF, DFMC and National Foods entered into a Tripartite Deed in the context of an agreement for the sale of ACF to National Foods Limited (National Foods). Following the sale of ACF, DFMC and ACF will cease to be related bodies corporate and may be regarded as potential competitors for the acquisition of raw milk from DFMC farmers.

Broadly, the applicants have sought authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended Milk Supply Agreement which will take effect as and from the Scheme Implementation Date (amended MSA). The back to back pricing and back to back purchasing policies are to apply to several agreements between ACF, DFMC and farmer members.

The key effect of the clauses are:

- DFMC must adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members, as ACF applies to its purchase of milk from DFMC (clause 4.4)
- DFMC must adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk, as DFMC received from ACF for the milk it sells to ACF (clause 5.6) and
- DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts (clause 4.6.2).

The applicants submit that following the sale of ACF, the continuation of the milk pricing and purchasing policies may amount to conduct, including price fixing, in breach of the Act.

The applicants seek authorisation of the pricing and purchasing policies to apply in existing supply contracts and Revised Farmer Supply Contracts until their expiry, and to apply to future supply contracts for a period of five years.

Public detriment

The ACCC considers that authorisation of the back to back pricing and back to back milk purchasing policies will not enable the parties to set prices at a level that is too high or too low relative to the market price. Prices will continue to be negotiated in an environment where world prices have a significant impact on domestic prices for raw milk.

Further, the non-exclusive nature of the amended MSA enables ACF to acquire milk from parties in addition to DFMC. The ACCC also notes that farmers are free to choose whether to enter into a supply contract with DFMC, and following the expiry of any contractual obligations, DFMC members can negotiate to supply raw milk to ACF, or other processors directly.

The ACCC considers that any barrier for processors who wish to enter or expand into particular regions are not increased by the proposed arrangements for which authorisation is sought.

Public benefit

The ACCC is satisfied that the continuation of the back to back pricing and back to back milk purchasing policies are likely to result in the following public benefits:

- certainty of supply in the short to medium term through the continuation of existing supply arrangements and
- transaction cost savings and efficiency gains for DFMC farmers and ACF.

Balance of public benefit and detriment

Overall, the ACCC considers that in all the circumstances the public benefits will outweigh the public detriment.

Length of authorisation

The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in light of any changed circumstances.

The applicants sought authorisation with respect to the making and giving effect to the agreement in respect of the prices to be offered to dairy farmers, the offering of and inclusion of such prices, as well as the payment of such prices in Revised Farmer Supply Contracts, for a period of five years.

The ACCC grants authorisation for the back to back pricing and back to back purchasing policies as outlined in clauses 4.4, 4.6.2 and 5.6 of the amended MSA for a period of five years.

Interim authorisation

At the time of amending the application for authorisation, the applicants also requested interim authorisation for the offering of, and entering into, Revised Farmer Supply Contracts and any future supply contracts which include agreed prices. The applicants note that interim authorisation is not being sought to pay the prices set out in the Revised Farmer Supply Contracts, because such payment will not occur unless authorisation for implementation of back to back pricing is granted by the ACCC.

The ACCC considered the request for interim authorisation at the time of the draft determination, and granted interim authorisation to allow the applicants to offer, and enter into, Revised Farmer Supply Contracts which include agreed prices consistent with the back to back pricing policies.

Interim authorisation will remain in place until the date this final determination comes into effect or until the ACCC decides to revoke interim authorisation.

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List of abbreviations

| | |
|---------------------------------|--|
| ACCC | Australian Competition and Consumer Commission |
| ACF | Australian Co-operative Foods Limited. Where relevant it also refers to the entity after it has been acquired by National Foods |
| amended MSA | Amended Milk Supply Agreement to take effect as and from the Scheme Implementation Date |
| Anticipated Full Demand | is a concept implemented to ensure that the long range planning of both DFMC and the farmer members for milk supply align with ACF's anticipated value-added operational demand for milk |
| current MSA | Milk Supply Agreement dated 1 July 2004 which is currently in force between ACF and DFMC. Following the completion of the sale of ACF it will be replaced by the Amended MSA |
| DFMC | Dairy Farmers Milk Co-operative Limited |
| Existing supply contracts | Supply contracts which are currently in existence, and will continue to exist after the completion of the sale of ACF, but which are not Revised Farmer Supply Contracts |
| Fleurieu | Fleurieu dairy farmers collective bargaining group |
| Fonterra | Fonterra Co-operative Group Ltd |
| Future supply contracts | Supply contracts to be entered into after the completion of the sale of ACF, including any renewals of any existing supply contracts and Revised Farmer Supply Contracts |
| Minimum Volume | a concept whereby DFMC agrees to use its reasonable endeavours to supply ACF with a 'Minimum Volume' for each region during each quarter of the term of the agreement |
| Murray Goulburn | Murray Goulburn Co-operative Limited |
| National Foods | National Foods Limited |
| Norco | Norco Co-operative Limited |
| Parmalat | Parmalat Australia Ltd |
| QDO | Queensland Dairyfarmers' Organisation |
| Revised Farmer Supply Contracts | Amended supply contracts with DFMC to take effect upon the completion of the sale |
| Supplement | Supplement to the current MSA dated September 2005 |
| the Act | <i>Trade Practices Act 1974 (Cth)</i> |

| | |
|--------------|---|
| Undertakings | Section 87B undertakings offered by National Foods and accepted by the ACCC on 24 July 2008 |
| Warrnambool | Warrnambool Cheese & Butter Factory Company Holdings Ltd |

1. Introduction

Authorisation

- 1.1 The Australian Competition and Consumer Commission (the ACCC) is the independent Australian Government agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.
- 1.2 The Act, however, allows the ACCC to grant protection from legal action in certain circumstances for conduct that might otherwise raise concerns under the competition provisions of the Act. One way in which parties may obtain protection is to apply to the ACCC for what is known as an 'authorisation'.
- 1.3 The ACCC may 'authorise' businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.
- 1.4 The ACCC conducts a public consultation process when it receives an application for authorisation. The ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.5 After considering submissions, the ACCC issues a draft determination proposing to either grant the application or deny the application.
- 1.6 Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides all parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite the applicant and interested parties to lodge written submissions commenting on the draft.
- 1.7 The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a final determination. Should the public benefit outweigh the public detriment, the ACCC may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the benefit to the public or reduce the public detriment.

The application for authorisation

- 1.8 On 22 May 2008, Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Co-operative Foods Limited (ACF) (the applicants) lodged application for authorisation A91089 with the ACCC. On 29 August, the applicants amended their application for authorisation to account for amendments arising from agreements being entered into for the sale of ACF to National Foods Limited (National Foods).
- 1.9 Broadly, the applicants have sought authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended Milk Supply Agreement which will take effect as and

from the Scheme Implementation Date¹ (amended MSA). The back to back pricing and back to back purchasing policies are to apply to several agreements between ACF, DFMC and farmer members.

- 1.10 Authorisation is sought for the back to back pricing and back to back purchasing policies to apply to existing and future supply contracts, as well as Revised Farmer Supply Contracts. The applicants have requested that authorisation be granted for the inclusion and giving effect to the pricing and purchasing policies for a period of five years.

Interim authorisation

- 1.11 At the time of lodging the original application, the applicants also requested interim authorisation to allow the parties to continue the back to back pricing and purchasing policies in contracts between ACF, DFMC and farmer members while the substantive application for authorisation is being considered by the ACCC.
- 1.12 On 18 June 2008, the ACCC considered the request for interim authorisation and noted that the legal protection provided by interim authorisation was not needed until DFMC and ACF cease to be related bodies corporate. At that time the sale process was likely to be ongoing for some months.
- 1.13 The ACCC decided not to grant interim authorisation at that time on the basis that DFMC and ACF are able to continue with the current pricing and purchasing arrangements without the need for the legal protection provided by interim authorisation.
- 1.14 At the time of amending the application for authorisation, the applicants also requested interim authorisation for the offering of, and entering into, Revised Farmer Supply Contracts and any future supply contracts which include agreed prices. The applicants note that interim authorisation is not being sought to pay the prices set out in the Revised Farmer Supply Contracts, because such payment will not occur unless final authorisation for implementation of back to back pricing is granted by the ACCC.
- 1.15 The ACCC considered this request for interim authorisation at the time of the draft determination and decided to grant interim authorisation to allow the applicants to offer, and enter into, Revised Farmer Supply Contracts which include agreed prices consistent with the back to back pricing policies.
- 1.16 Interim authorisation will remain in place until either the date that the ACCC's final determination takes effect, or until revoked by the ACCC.

Draft Determination

- 1.17 On 25 September 2008, the ACCC issued a draft determination proposing to grant authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended MSA to apply to various contracts between ACF, DFMC and dairy farmers. The ACCC proposed to grant authorisation for a period of five years.

¹ The Scheme Implementation Date refers to the date in which the agreement for the acquisition of ACF by National Foods comes into effect.

Chronology

1.18 Table 1.1 provides a chronology of significant dates in the consideration of the application.

Table 1.1: Chronology of application for authorisation A91089

| DATE | ACTION |
|-------------------|---|
| 22 May 2008 | Application for authorisation lodged with the ACCC, including an application for interim authorisation. |
| 9 June 2008 | Closing date for submissions from interested parties in relation to the request for interim authorisation. |
| 18 June 2008 | The ACCC decided not to grant interim authorisation at this time. |
| 27 June 2008 | Closing date for submissions from interested parties in relation to the substantive application for authorisation. |
| 7 July 2008 | Submission received from DFMC and ACF in response to interested party submissions. |
| 13 August 2008 | The applicants requested the ACCC delay releasing a draft determination pending possible amendments to the application. |
| 27 August 2008 | Meeting with the applicants to discuss amendments to its application for authorisation. |
| 29 August 2008 | Applicants lodge amended application for authorisation and request for interim authorisation. |
| 2 September 2008 | Applicants provide public submission supporting amended application and request for interim authorisation. |
| 3 September 2008 | Public consultation on amended application and request for interim authorisation begins. |
| 9 September 2008 | Closing date for submissions from interested parties. |
| 25 September 2008 | Draft Determination issued and interim authorisation granted. |
| 22 October 2008 | Final Determination issued. |

2. Background

The Australian dairy industry²

Dairy farming

- 2.1 In 2006-07 the Australian dairy industry produced approximately 9.5 billion litres of milk with a farm gate value of \$3.2 billion.³ Taking into account reduced national dairy herd size and higher feed costs, the industry expects that milk production for 2007-08 will fall by approximately 5% to 9.1 billion litres.⁴
- 2.2 Dairy farming occurs in all Australian states, however it is mainly concentrated in those areas which have high average rainfall or have reliable irrigation systems. Essentially, milk production is concentrated in the south-east corner of Australia, with Victoria, Tasmania and South Australia accounting for 79% of national output.⁵ Production in these regions is highly seasonal with a peak during October to November, tapering off in the cooler months of May to June. The production of long shelf-life manufactured products in the south-east region has enabled maximum milk utilisation within the seasonal cycle. However, production in Queensland, New South Wales and Western Australia is less seasonal with the focus on year round supply of local fresh drinking milk products. Farmers in these regions manage calving and feed systems to ensure more even year round production.
- 2.3 The total number of individual Australian dairy farms has been steadily declining for a number of decades. For example, in 1980 there were 22 000 dairy farms whereas in 2006-07 there were approximately 8000.⁶ While farm numbers have been decreasing, milk output has generally grown due to increasing cow numbers and improved cow yields. In particular total milk production has increased from 5432 million litres (in 1980) to 9582 million litres (in 2007)⁷ and the average herd size increased from 85 cows in 1980, to 225 in 2006-07.⁸

Dairy manufacturing and processing

- 2.4 Processors purchase raw milk from farmers (for example through farmer co-operatives, collective bargaining groups or individual farmers) and process it into various dairy products for sale domestically or export.
- 2.5 Australia's dairy manufacturing sector is diverse and includes farmer owned co-operatives and public, private and multi-national companies. Co-operatives no longer dominate the industry, but still account for approximately 55% of the milk output.

² Information outlined in this chapter was largely obtained from the applicants supporting submission, Dairy Farmers Milk Co-operative Limited and Australian Co-operative Foods Limited, *Submission accompanying application for authorisation of milk supply arrangements*, 22 May 2008.

³ Dairy Australia, *Australian Dairy Industry In Focus 2007*, p. 9.

⁴ Dairy Australia, *Dairy 2008 Situation and Outlook*, June 2008, p. 6.

⁵ Dairy Australia, *Australian Dairy Industry In Focus 2007*, p. 18.

⁶ *Ibid*, p. 11.

⁷ *Ibid*, p. 9.

⁸ *Ibid*, p. 12.

- 2.6 The major dairy processors in Australia are National Foods Limited (National Foods), Fonterra Co-operative Group Ltd (Fonterra), Parmalat Australia Ltd (Parmalat), Dairy Farmers Co-operative, Murray Goulburn Co-operative (Murray Goulburn), Warrnambool Cheese and Butter Factory Company Holdings Limited (Warrnambool) and Norco Co-operative Limited (Norco). Each of these is active in the acquisition of raw milk, and to varying degrees, in the production of dairy products.
- 2.7 Milk is processed into either drinking or manufacturing milk. Approximately 23% of total milk production is used as drinking milk with the remaining 77% used in the manufacturing of dairy products such as cheese, ice cream, skim milk power, yoghurt, butter and cream.⁹
- 2.8 Around 68% of manufactured product overall is exported with the remaining 32% sold on the Australian market. This contrasts with drinking milk, where some 96% is consumed in the domestic market.¹⁰

The export market

- 2.9 Australian dairy farmers operate in a deregulated and open market. Consequently, international prices are a major factor determining the price received by farmers for their milk.¹¹ In particular, farm gate prices paid to farmers in the south-east of Australia are heavily influenced by world dairy commodity prices.
- 2.10 Australia exports around 50% of domestic raw milk production (after processing - particularly in the form of milk powders and cheese).¹² Therefore, processors of dairy products to satisfy domestic demand compete directly for raw milk to go into production aimed at export markets. Accordingly, processors of product for domestic markets are required to match world dairy prices to ensure supply.
- 2.11 The Australian domestic dairy market is also influenced by trade from New Zealand especially in cheese products where New Zealand sourced cheese products accounts for about 15% of the national market. Butter and blended table spreads are also influenced by smaller volumes of trade from New Zealand. There are no barriers to this trade with New Zealand.

The applicants

Dairy Farmers Milk Co-operative Limited

- 2.12 DFMC is a trading Co-operative limited by shares. It was established on 2 April 2004 and commenced trading following a restructuring of ACF on 29 June 2004.
- 2.13 DFMC's principal activity is the acquisition of milk from members (pursuant to supply contracts with its members) and the sale of all such milk to ACF (pursuant to the MSA). DFMC is the owner of the milk it sells to ACF. It does not have any infrastructure for milk collection and storage and is dependant on ACF for the

⁹ Dairy Australia, *Australian Dairy Industry In Focus 2007*, p. 18, Dairy Australia, *Dairy 2008 Situation and Outlook*, June 2008, p. 12.

¹⁰ Dairy Australia, *Australian Dairy Industry In Focus 2007*, p. 21.

¹¹ *Ibid*, p. 10

¹² *Ibid*, p. 22.

collection and storage of the milk which DFMC acquires from its members and on sells to ACF.

- 2.14 Currently, there are 797 dairy farmer members of DFMC located in Queensland, New South Wales, Victoria and South Australia. Table 2.1 shows the location and number of DFMC farmer members by region.

Table 2.1: DFMC farmer members by region

| Region | Number of farmer members |
|---|---------------------------------|
| Far Northern (North Queensland) | 78 |
| Northern (South-East Queensland and Northern New South Wales) | 193 |
| Central (New South Wales excluding Northern New South Wales and Riverina) | 329 |
| Riverina / Northern Victoria (and Gippsland) | 70 |
| Western Victoria / South Australia | 127 |
| Total | 797 |

- 2.15 Membership is voluntary and members join and leave regularly. Active membership in DFMC requires satisfaction of the criteria set out in DFMC's registered Rules.¹³ This includes the supply of at least 200 litres of milk to DFMC in any relevant seven day period.

Australian Co-operative Foods Limited (ACF)

- 2.16 ACF is a Co-operative limited by shares and a trading Co-operative. ACF operates under the trading name Dairy Farmers and is one of Australia's largest dairy manufacturers, supplying fresh and processed products to both local and export markets.
- 2.17 ACF's principal activities are the collection, processing, packaging, distribution and marketing of milk and other dairy or related food products. ACF manufactures a range of dairy products including fresh and UHT milk, flavoured UHT milk, cheese, butter, spreads, yogurts, creams and dairy desserts.
- 2.18 ACF acquires almost all of its raw milk from DFMC and supplies its products nationally. Its key brands include Dairy Farmers, Oak, Coon, Cracker Barrel, Dare, Moove, Shape and Ski.
- 2.19 Currently, DFMC and ACF are related parties within the meaning of section 4A(5) of the Act. Under a restructure in June 2004, ACF was established as a separate cooperative from DFMC. The relationship between the parties is:

¹³ Rules of Dairy Farmers Milk Co-operative Limited, Rules 13.2.

- DFMC is wholly owned by its members who are almost all also members of ACF
- DFMC owns 20% of ACF¹⁴
- DFMC members own the remaining 80% of ACF and
- a new rule 50A was included in ACF's registered Rules which gives DFMC the power to remove from office a majority of directors of ACF.

2.20 The location of ACF's facilities and the products manufactured at each facility are outlined in Table 2.2.

Table 2.2: Location of ACF's facilities

| State | Location of facility | Products manufactured |
|-----------------|----------------------|--|
| NSW | Lidcombe | Fresh white and flavoured milk and fresh cream |
| | Wetherill Park | Dairy foods, sour cream, bottle and carton UHT |
| | Hexham | Fresh white milk, condensed milk and deserts, cottage cheese |
| | Baukham Hills | Fresh white milk and fresh cream |
| Queensland | Malanda | Fresh white and flavoured milk, fresh cream and cheese |
| | Booval | Fresh white and flavoured milk, fresh cream, powders |
| South Australia | Clarence Gardens | Fresh white and flavoured milk |
| | Jervois | Cheese and powders |
| Victoria | Simpson | Cheese |
| | Allansford | Cheese (cut and wrap only) |
| | Shepparton | Fresh white and flavoured milk |
| ACT | Canberra | Fresh white and fresh cream |

Sale of ACF

2.21 In February 2008 ACF announced that it was considering bids for the acquisition of its business. Informal merger clearance was sought from the ACCC by a number of potential bidders:

¹⁴ There is currently a dispute before the Courts between ACF and DFMC regarding the percentage shareholding of DFMC.

- on 24 July 2008, after accepting court enforceable undertakings from National Foods, the ACCC announced that it would not oppose the proposed acquisition of ACF by National Foods
 - on 24 July 2008, the ACCC released a Statement of Issues outlining preliminary concerns with the bid by Parmalat Australia Ltd (Parmalat) and Murray Goulburn Co-operative Limited (Murray Goulburn). On 8 August 2008 the application by these firms for ACCC clearance was withdrawn.
 - On 30 June 2008, a request for informal clearance by Fonterra Co-operative Group Ltd (Fonterra) was withdrawn.
 - on 26 August 2008, the ACCC announced it would not oppose the proposed acquisition of assets and shares of ACF by Murray Goulburn.
- 2.22 On 25 August 2008, it was announced that National Foods had entered into an agreement to acquire ACF, with Warrnambool and National Foods to form a 50:50 joint venture to acquire and operate the existing cheese business of ACF. The proposed acquisition is subject to a number of conditions, including a shareholder vote and court approvals.

Undertakings¹⁵

- 2.23 The undertakings offered by National Foods, pursuant to section 87B of the Act, and accepted by the ACCC, provide that if the bid by National Foods and Warrnambool is successful, National Foods will divest the following assets to a purchaser(s) approved by the ACCC:
- the ACF processing facilities in Clarence Gardens (South Australia) and Lidcombe (New South Wales)
 - licences of certain white milk brands - on a perpetual basis in South Australia and on a time-limited basis in New South Wales
 - licences of certain flavoured milk brands - on a perpetual basis in South Australia and New South Wales and
 - certain depots and milk distribution agreements in South Australia and New South Wales.
- 2.24 National Foods will also supply a quantity of raw milk to the approved purchaser(s) over the 12 months following the divestment date.
- 2.25 Further information about the proposed transaction can be obtained in the Public Competition Assessment for National Foods Limited – proposed acquisition of Australian Cooperative Foods Limited dated 19 September 2008 found on the ACCC’s website (www.accc.gov.au).

¹⁵ A copy of the undertakings can be found on the ACCC’s website www.accc.gov.au.

National Foods

- 2.26 National Foods is a wholly owned subsidiary of Kirin Holdings Company Limited. It supplies dairy products in every state of Australia. Its principal activities are the processing, manufacturing, packaging, distribution and marketing of milk, fresh dairy foods, juice and cheese.
- 2.27 National Foods produces:
- a range of full cream, flavoured and modified fresh and UHT milks with brands such as Pura, Pura Light Start, Masters, Farmers Union, Big M and Pura Classic
 - fresh dairy foods including a range of yoghurts, fromage frais, dairy desserts and cream under brands including Yoplait, Fruche, YoGo and Divine Classic and
 - a range of specialty cheeses under brands such as King Island, South Cape, Tasmanian Heritage, Mersey Valley, Tilba, Timboon and Heidi Farm.
- 2.28 National Foods has production facilities across every Australian state. The location of National Foods' facilities and the products manufactured at each facility are outlined in Table 2.3.

Table 2.3: Location of National Foods' facilities

| State | Location of facility | Products manufactured |
|-------------------|-----------------------|--------------------------------|
| NSW | Penrith | Fresh milk |
| | Leeton | Juice |
| | Smithfield | Juice |
| Queensland | Crestmead | Fresh milk |
| | Lytton | Juice |
| Victoria | Wodonga | Soy beverages |
| | Campbellfield | Cheese packaging |
| | Chelsea Heights | Fresh milk and cream |
| | Timboon | Specialty cheese |
| | Morwell | Fresh dairy foods |
| | Cobden | UHT flavoured milk |
| Tasmania | King Island | Specialty cheese and cream |
| | Burnie and Heidi farm | Specialty cheese |
| | Lenah Valley | Fresh milk |
| South Australia | Salisbury | Fresh milk |
| | Regency Park | Juice |
| | Murray Bridge | Dairy snacks, cream and cheese |
| | Berri | Juice |
| Western Australia | Bentley | Fresh milk, UHT milk and juice |

Milk Supply Arrangements between DFMC and ACF

- 2.29 At the time of lodging the original application for authorisation in May 2008, the competitive tender process being carried out for the sale of ACF had not reached a stage where it was possible to identify any purchaser. This situation has now been clarified upon the entry into agreements for the sale of ACF to National Foods on 25 August 2008.

2.30 The acquisition is to be effected by a Scheme of Arrangement and, subject to satisfaction of certain conditions, including a shareholder vote, is expected to be completed in or about November 2008. On 25 August 2008, ACF, DFMC and National Foods also entered into a Tripartite Deed in the context of the agreement for the sale of ACF. The agreement includes an amended Milk Supply Agreement (amended MSA) and amended supply contracts with DFMC to be entered into with farmers prior to the completion of the sale (Revised Farmer Supply Contracts).

The amended Milk Supply Agreement

2.31 The amended MSA will come into effect following the completion of the sale of ACF and will expire on 30 June 2017. The amended MSA will replace the current milk supply agreement between DFMC and ACF dated 4 July 2004 (current MSA) and the Supplement to that agreement dated September 2005 (Supplement).

2.32 The amended MSA sets out the terms on which ACF will acquire milk from DFMC following the sale of ACF. To date, ACF has been acquiring milk from DFMC according to the terms set out in the current MSA.

2.33 A summary of the key terms of the amended MSA are:

- ACF must use its reasonable endeavours to pursue commercial opportunities which will sustain and grow the current regional supply of milk to ACF (clause 3.1(a))
- ACF must assist DFMC to provide its farmer members, on a regional basis, with a consistent and orderly opportunity to grow on-farm production (clause 3.1(b))
- DFMC must purchase all of the qualifying farmer members' milk which is offered for sale to it, and supply it to ACF (clause 3.2.1)
- ACF must, subject to certain limited exceptions, purchase from DFMC all of the qualifying farmer members' milk which DFMC has purchased (clause 3.3(a))
- DFMC agrees to use its reasonable endeavours to supply ACF with a 'Minimum Volume' for each region (see table 2.1) during each quarter of the term of the amended MSA (clause 3.4).
- The amended MSA incorporates a concept referred to as 'Anticipated Full Demand', which seeks to ensure that the long range planning for milk supply of both DFMC and farmer members align with ACF's anticipated value-added operational demand for milk (clause 3.4).
- the milk supply arrangements between ACF and DFMC are non-exclusive and ACF is not restricted from purchasing milk or products similar to milk from any third party (clause 3.8).
- DFMC must adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members, as ACF applies to its purchase of milk from DFMC (clause 4.4) (**back to back milk purchasing policy**)

- DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts (clause 4.6.2) **(back to back pricing)**
- ACF is obliged to pay DFMC a commercial price for milk, being the market value or price of milk on a GST exclusive basis. However, in respect of the period after 30 June 2010 and for milk which exceeds the Anticipated Full Demand level for a region, ACF is only obliged to pay DFMC a commercially reasonable price having regard to the best end use (subject to logistical and administrative costs to which that milk is likely to be put (clause 5.1.1).
- if the parties are unable to agree on a ‘commercial price’, the issue may be resolved by mediation and then expert determination (clause 5.4.3 and 14)
- the parties must agree on a pricing structure for the acquisition of milk by ACF which has regard, among other matters, to quality, quantity, geographic, transportation and handling factors (clause 5.1.3)
- an obligation on DFMC to adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk, as DFMC received from ACF for the milk it sells to ACF (clause 5.6) **(back to back pricing)**
- DFMC must direct ACF to make, on its behalf, payment to DFMC’s farmer members for milk supplied by them to DFMC which is on sold by DFMC to ACF (clause 7.2)

2.34 The restraint in the current MSA on ACF from acquiring milk directly from a DFMC member or from any other supplier of milk other than DFMC (the restraint clause) is not part of the amended MSA.¹⁶

DFMC’s supply contracts with farmers

2.35 By virtue of clause 4.4 of the amended MSA, the milk purchasing policy agreed between DFMC and ACF for the supply of milk is reflected in the contracts and arrangements that DFMC enters into for the acquisition of milk from its members.

2.36 DFMC acquires milk from its members through the following supply contracts:

- Defined Volume Fixed Term Contracts
- Revised Farmer Supply Contracts (which only come into effect following the sale of ACF) and
- Volume Incentive Contracts.

2.37 Farmer members are free to choose whether or not they enter into a supply contract and which contract they enter into. Farmer members are free to choose not to enter into a supply contract and still supply milk to DFMC, in which case they are paid a base price

¹⁶ Clause 20 of the current MSA provides that the following provisions cease to apply in the event that ACF and DFMC cease to be related parties: back to back pricing (clause 5.6); back to back milk purchasing policies (clause 4.4); and the restraint on ACF (clause 9).

for milk price. DFMC members are required to supply a minimum amount of raw milk to DFMC in order to be considered as an active member of the co-operative.

- 2.38 The applicants note that the overwhelming majority (over 95%) of DFMC farmer members choose to enter into a contract in order to access additional benefits such as higher prices and certainty of milk off-take for the duration of the contract.¹⁷
- 2.39 The applicants advise that contracts are frequently reviewed and at any one time there are a number of supply contracts being renewed or new agreements being negotiated and entered into by DFMC. At present there are 776 supply contracts between DFMC and farmer members.

Defined Volume Fixed Term Contracts

- 2.40 Defined Volume Fixed Term Contracts are generally two to three year agreements under which a farmer agrees to supply DFMC with a defined volume of raw milk. The volume is to be supplied by that farmer member on a six monthly basis during the term of the contract. The ACCC understands that the defined volume ensures a minimum volume is supplied by the farmer but that in addition they are required to supply all their milk to DFMC.
- 2.41 Under these contracts the farmer receives a contracted base price for milk supplied each month during the contract period. The contracted base price is an amount announced by DFMC from time to time for a reference litre of milk.¹⁸ The farmer member also receives payments for supplying the defined volume referred to in their contract and are entitled to a volume incentive payment for supply of raw milk above the defined volume.
- 2.42 Neither the farmer member nor DFMC can terminate the contract without giving 180 days notice, except in limited circumstances. Even with notice the contract can only cease at the completion of the contract term.

Revised Farmer Supply Contracts

- 2.43 The Revised Farmer Supply Contracts are amended Defined Volume Fixed Term Contracts. To satisfy the condition precedent of the sale of ACF, DFMC must use reasonable endeavours to secure the entry by DFMC farmer members into Revised Farmer Supply Contracts prior to the completion of the sale of ACF.
- 2.44 The applicants advise that the purpose of these contracts is to secure a specified volume of milk, per region, which is equivalent to a proportion of the milk supplied by ACF to DFMC during the 2007-08 financial year.
- 2.45 Farmers who decide to enter into a Revised Farmer Supply Contract, contract to supply a defined volume of milk, supplying at least a minimum volume of milk over a 6 month period. However, in order to maintain security of milk, farmers are required to supply all their milk to DFMC¹⁹ even where this amount falls above the defined volume.

¹⁷ Addisons, *Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited and Australian Cooperative Foods Limited*, 7 July 2008, p. 2.

¹⁸ A reference litre of milk is defined as 3.95% fat and 3.15% protein.

¹⁹ Clause 2 of the Revised Farmer Supply Contract.

2.46 The main changes which have been incorporated in the Revised Farmer Supply Contracts, which differ from the existing Defined Volume Fixed Terms Contracts are:

- farmer members may terminate the contracts giving not less than 90 days written notice, at the completion of the contract period, subject to obtaining prior written consent of DFMC. DFMC can only withhold its consent if termination of the supply contract will be reasonably likely to result in the estimated milk supply to DFMC under Revised Farmer Supply Contracts in the relevant region for 3 quarters following the termination, to fall below the minimum regional contract level for those 3 quarters in that region. The minimum regional contract level is defined to be a volume which is 10% above the minimum volume DFMC is required to supply to ACF for that region under the amended MSA.
- farmers can terminate their supply contract during the contract period on 90 days' notice if they decide to sell their farm or cease operating a dairy business. However, before doing so, they must ensure that the farm or the farmers' dairy herd is sold to a person who agrees to continue to supply the minimum volume specified in the Revised Farmer Supply Contract to DFMC during the term of the contract period. This differs from the current Defined Volume Fixed Term Contract in that under the current contract farmers can terminate their contract during the contract period on 14 days' notice with DFMC's consent, if they decide to permanently leave the dairy industry.
- liquidated damages are payable if a farmer fails to supply the minimum volume during any six monthly period. This differs from the current Defined Volume Fixed Term Contract in that under the current contract liquidated damages are payable if a farmer fails to meet the minimum volume specified in their contract for 2 or more consecutive six monthly periods.

Volume Incentive Contracts

2.47 Volume Incentive Contracts are generally one year agreements where a farmer member agrees to supply DFMC with all of the raw milk produced at their farm.

2.48 Farmer members who are a party to a Volume Incentive Contract receive a contracted base price for their raw milk each month during the term of the agreement as fixed by DFMC and a Volume Incentive Payment.

2.49 The farmer members can terminate the contract with DFMC at any time during the term on 120 days notice or with 28 days notice after the agreement expires. Although the earliest the contract can expire is at the end of the contract term.

Pricing arrangements

2.50 The applicants advise that the prices paid by ACF to DFMC, and that DFMC pays to its farmer members, for raw milk depends on a number of factors related to the quality of milk and the geographic location from which the raw milk is sourced.

2.51 The applicants advise that prices negotiated by DFMC and ACF may differ across regions (see Table 2.1), however the same price is offered to all of DFMC's members within a region. Factors which may influence the price in a region include localised weather impacts, the nature of competition within each region, the economics of

dealing with shortfalls by transporting milk from other regions or the requirement to fill specific contracts.

2.52 As noted, ACF and DFMC agree from time to time on the price which ACF will pay to DFMC for milk. The prices are determined through commercial negotiations between DFMC and ACF. The amended MSA requires ACF and DFMC to:

- agree to the milk purchasing policy no later than six months before the commencement of each relevant financial year (clause 4.1.1)
- agree upon a pricing structure for milk (clause 5.2)
- agree pricing periods for each financial year of between one and twelve months duration (clause 5.3) and
- no later than one month prior to each pricing period, to negotiate and agree in writing the commercial price for milk for the next pricing period (clause 5.4).

2.53 The back to back pricing arrangements (under clause 5.6) provides that the prices agreed between ACF and DFMC form part of the supply contracts offered to farmer members by DFMC.

2.54 The applicants advise that DFMC and ACF hold a series of meetings and negotiations to determine the price of milk, standard contract terms and the Milk Policy Guide²⁰. Further meetings are held during the year to monitor and review:

- the competitive price of milk
- ACF's milk needs and
- the supply patterns from farmer members

in order to indicate to ACF whether the supply pool is at risk from matters such as competition or difficult seasonal or farm gate cost conditions. Following these meetings and reviews, there may be subsequent price changes. The applicants advise that for the financial year of 2007-08 there were at least five price changes.

²⁰ The applicants advise that the Milk Policy Guide is not a pricing document, although it includes a number of matters which are relevant to price including: description of the different types of supply agreements between farmers and DFMC; a definition of 'new milk'; details of 'gates charges' (ie freight and cartage costs); and an explanation of the Quality Payment Systems. Other matters included in the Milk Policy Guide include issues such as sampling of milk, animal feedstuffs, animal health and minimum volumes and pick up arrangements.

3. The application for authorisation

3.1 The applicants seek authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing clauses as set out in clauses 4.4, 4.6.2 and 5.6 of the amended Milk Supply Agreement between DFMC and ACF. The back to back pricing and back to back milk purchasing policies are to apply to several agreements between ACF, DFMC and dairy farmers. The MSA is confidential and has been excluded from the public register.

3.2 The effect of the clauses are:

- DFMC must adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members, as ACF applies to its purchase of milk from DFMC (clause 4.4)
- DFMC must adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk, as DFMC received from ACF for the milk it sells to ACF (clause 5.6) and
- DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts (clause 4.6.2).

3.3 More specifically, authorisation is sought for:

1. the inclusion in the amended MSA of amended clauses 4.4 and 5.6 which provide for the continuation of the agreement in respect of back to back milk purchasing policies and back to back pricing arrangements upon completion of the sale of ACF
2. the inclusion in the amended MSA of new clause 4.6.2 which provides, among other things, that DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts.
3. the implementation of the back to back pricing and back to back milk purchasing policies by DFMC in its dealings with farmers for the supply of milk to ACF, following completion of the sale of ACF to National Foods
4. the making and giving effect to the agreement in respect of the policies and prices which are to be the subject of back to back pricing in DFMC's Revised Farmer Supply Contracts following completion of the sale and
5. the making and giving effect to the agreement in respect of the prices ACF will pay farmers whose Revised Farmer Supply Contracts are assigned to ACF, or which contracts ACF obtains the benefit of, in accordance with the transaction agreements.

3.4 The arrangements potentially raise concerns under the anti-competitive conduct provisions of the Act. Consequently, the applicants have lodged application for authorisation A91089 under section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening

competition within the meaning of section 45 of the Act. Further, by agreeing new prices ACF and DFMC would be deemed to be making and/or giving effect to a price fixing agreement in contravention of section 45 of the Act.

3.5 Under section 88(6) of the Act, any authorisation granted by the ACCC is automatically extended to cover any person named in the authorisation as being a party or proposed party to the conduct.

3.6 The applicants seek authorisation for a period of five years.

3.7 Specifically the applicants advise that:

- in respect of existing supply contracts, which are those currently in existence and which will continue in existence after completion of the sale of ACF, until the contracts and arrangements expire
- in respect of Revised Farmer Supply Contracts, which are the amended supply contracts between DFMC and farmer members entered into prior to the completion of the sale, to take effect upon completion of the sale. Authorisation is sought for these contracts until the contracts expire and
- in respect of future supply contracts, which are those supply contracts entered into after completion of the sale of ACF, including any renewals of any existing supply contracts and Revised Farmer Supply Contracts, for five years.

3.8 The applicants also seek authorisation, for a period of five years, with respect to the offering of, and entering into, Revised Farmer Supply Contracts which include prices to be paid following the grant of final authorisation. If such contracts are assigned to ACF or ACF otherwise obtains the benefit of them, authorisation is sought for the payment of the agreed prices in any such contracts for the period from completion of the sale of ACF to National Foods until 30 June 2011.

4. Submissions received by the ACCC

Submissions from DFMC and ACF

- 4.1 The applicants submit that the conduct would not result in an anti-competitive detriment because:
- milk prices agreed between DFMC and ACF have been, and will continue to be, in line with prevailing market prices
 - membership of DFMC is voluntary and members enter into and renew supply contracts on a regular basis
 - ACF will be free to acquire from other suppliers and DFMC's farmer members will be free to supply to other processors including ACF directly
 - regional factors ensure that there will be no industry wide pricing and
 - grocery retailers exert considerable countervailing power on retail pricing in the dairy industry.
- 4.2 The applicants submit that the conduct will result in the following public benefits:
- certainty for farmers, processors and consumers by ensuring that existing supply contracts will be enforceable
 - certainty of future milk supply arrangements, providing farmers with the security necessary to plan and grow production (which is particularly important in a period of extended drought and high input costs)
 - continuation of access for farmers (particularly small to mid sized farmers) to DFMC's information and expertise on market trends which in turn lowers transaction costs and
 - facilitation of the growth of exports through security of the existing milk pool and the potential for growth of the pool.
- 4.3 The applicants also provided a supporting submission with their amended application for authorisation. The applicants submit that the conduct to which the amended authorisation application applies does not change the assessment of the likely anti-competitive detriment and public benefits because:
- the amendments to the MSA and to the Revised Farmer Supply Contracts are the product of an arms' length negotiation between National Foods and DFMC. The applicants submit that the amendments seek to balance the interests of ACF, as a processor of milk, and the interests of DFMC's farmer members. In particular:
 - the amendments to the MSA dealing with the supply of a Minimum Volume by DFMC to ACF provide ACF with security of milk supply following the sale. This is particularly important during the period immediately following the sale where National Foods must ensure that it will have sufficient milk supply to meet ACF's operational needs and

- the amended MSA does not oblige ACF to acquire milk from new farmer members where that milk exceeds ACF's Anticipated Full Demand levels. In addition, ACF is only obliged to pay DFMC 'a commercially reasonable price having regard to the best end use (subject to logistical and administrative costs) to which that milk is likely to be put', for any milk which exceeds ACF's Anticipated Full Demand levels. Those provisions of the amended MSA provide ACF with leverage in its negotiations with DFMC.
- the conduct affects only a relatively small number of farmers. Relevantly, the Minimum Volume for the 2008-09 and 2009-10 financial years is specified in the amended MSA and is a proportion only of the total milk supplied by DFMC to ACF during the 2007-08 financial year
- membership of DFMC will remain voluntary and farmers are free to enter into Revised Farmer Supply Contracts with DFMC if they wish to do so. In addition, subject to the terms of their individual agreements with DFMC, farmers will remain free to supply other processors as and when their supply contracts expire
- farmers will continue to compete among themselves including on quality and volume
- the amended MSA will continue to oblige ACF to pay a commercial price for milk which will continue to be determined by factors such as world market prices. The applicants submit this will continue to constrain the prices received by dairy farmers and paid by processors. In addition, regional factors will continue to ensure that the conduct does not give rise to industry wide pricing. The agreement in respect of the policies and prices to be the subject of back to back pricing in DFMC's Revised Farmer Supply Contracts was necessary because of the need to offer farmers Revised Farmer Supply Contracts before completion of the transaction and further, to provide farmers with a level of certainty regarding the prices to be payable by ACF following the transaction and
- supermarkets will continue to exert considerable countervailing power.

Submissions from interested parties prior to the amended application

- 4.4 The ACCC also sought submissions from 49 interested parties potentially affected by the application, including various processors, dairy farmer collective bargaining groups, government departments and the potential bidders for the purchase of ACF.
- 4.5 The ACCC received public submissions prior to the amended application from:
- National Foods and
 - Fleurieu Dairy Farmers Collective Bargaining Group

National Foods

- 4.6 National Foods supports the grant of (both interim and final) authorisation and noted that following a sale of ACF, the proposed authorisation would allow for the continuation of existing milk supply arrangements thereby providing greater certainty and reduced commercial disruption for all relevant parties.

Fleurieu dairy farmers collective bargaining group

- 4.7 Fleurieu dairy farmers collective bargaining group (Fleurieu) submits that DFMC does not provide competitive benefits for farmers as they have little or no bargaining power because they can only negotiate to sell milk purchased from members to ACF and cannot bargain with other processors.
- 4.8 However, Fleurieu submits that DFMC and ACF do pay the commercial price for milk that applies in the region. Fleurieu recognises that ACF, to receive the required volume of milk, must pay a price to farmers that is competitive.
- 4.9 Fleurieu notes that the supply contracts which DFMC has with its farmer members do not provide flexibility, and act as a barrier to the movement of supply from DFMC to another processor. Fleurieu notes that the defined volume fixed term contracts require 180 days notice to terminate the contract.
- 4.10 Fleurieu submits that when DFMC offers contracts at the beginning of the year, the prices are indicative only and may be varied throughout the contract. Fleurieu submits that farmers are under pressure to sign a contract with DFMC in order to obtain additional pricing benefits, such as being paid the defined volume contract premium and the volume incentive payment. If a farmer does not sign they will not receive these benefits.

DFMC/ACF's response to Fleurieu submission

- 4.11 In response to the issues raised by Fleurieu, the applicants note that farmers are free to supply milk to DFMC for on-sale to ACF without the need to enter into any contract. The applicants note, however, that the overwhelming majority (over 95%) of DFMC farmer members choose to enter into a supply contract. The applicants note that farmers are free to supply other processors once their supply contract is terminated.
- 4.12 The applicants submit that the reason a majority of farmers elect to enter into a supply contract with DFMC is that such contracts provide benefits to farmers in the form of higher prices and certainty of milk off-take for the duration of the contract. The applicants note that farmers value certainty of milk off-take which has been illustrated by the fact that approximately 35% of farmers enter into a 3 year supply contract as opposed to a 1 or 2 year contract. The applicants also note that farmers who are party to a defined volume fixed term contract are guaranteed minimum prices for the duration of the contract.
- 4.13 The applicants also submit that supply contracts with farmers expire on a rolling basis. DFMC offers contracts to farmers whose contracts are coming to an end as well as to new farmers throughout the year, not just in June. The applicants submit that although supply contracts specify a contract period, the contract does not automatically expire at the end of that contract period. For a contract to end, a farmer must provide notice terminating the conduct. The notice required to terminate a defined volume fixed term contract is 180 days, and for a one year supply agreement 120 days notice is required.
- 4.14 The applicants also note that a farmer who enters into an agreement does so knowing it is for a minimum period. Should a farmer wish the contract to come to an end at expiry of that term, the farmer may give the appropriate notice and does not need to wait until expiry of the contract before giving notice.

Submissions from interested parties following the amended application

- 4.15 The ACCC consulted interested parties on 3 September 2008 on the amended application for authorisation and the request for interim authorisation.
- 4.16 The ACCC received public submissions following the amended application from:
- National Foods
 - Queensland Dairyfarmers' Organisation
 - Fleurieu Dairy Farmers Collective Bargaining Group

National Foods

- 4.17 National Foods supports the amended application for authorisation and submits that it will facilitate the continuation of the existing back to back milk supply arrangements offering greater certainty and reduced commercial disruption for dairy farmers, ACF/National Foods and DFMC.
- 4.18 National Foods also supports the grant of interim authorisation. National Foods notes that prior to the completion of the sale of ACF, it is commercially essential that ACF and DFMC offer their farmer members the Revised Farmer Supply Contracts. National Foods submits that interim will allow:
- affected farmers to make an informed decision on the proposed ACF transaction. These dairy farmers will need to understand the contract terms and conditions that are intended to apply after the acquisition occurs and
 - National Foods will obtain comfort regarding milk supply security, which is a critical element of the ACF business that it wishes to acquire.

Queensland Dairyfarmers' Organisation

- 4.19 The Queensland Dairyfarmers' Organisation (QDO) supports the continuation of the pricing and purchasing policies.
- 4.20 QDO submits that authorisation is necessary to ensure a smooth transition and sale process. QDO also submits that authorisation will allow minimal disruption to producers' confidence to continue with milk supply, and at the same time have no impact on the consuming public.

Fleurieu

- 4.21 Fleurieu asked a number of questions regarding the Revised Farmer Supply Contracts in order to determine that they will be fair and not pose barriers to trade. Fleurieu submits that DFMC's desire to secure milk supply is understandable and it could be in the best interests of milk suppliers to have a secure market for farm milk, but some of the contractual conditions of supply may be detrimental to the suppliers of raw milk.

DFMC/ACF's response to Fleurieu submission

- 4.22 In response to the Fleurieu's submission, the applicants submit that the Revised Farmer Supply Contracts do not pose any barriers to trade and are not detrimental to the suppliers of raw milk.
- 4.23 The applicants note that:
- when a Revised Farmer Supply Contract is offered to a farmer, the farmer will be provided with details of the pricing which, subject to authorisation, will be paid pursuant to the contract
 - the Revised Farmer Supply Contracts will be for defined volumes of milk. The volumes of milk which will be the subject of individual farmer contracts will be a matter between DFMC and each farmer and
 - participation in any capital distribution by DFMC from the sale of ACF will be governed by DFMC's rules.
- 4.24 The views of the applicants and interested parties are also discussed in the ACCC's evaluation of the arrangements in Chapter 6 of this determination. Copies of public submissions are available from the ACCC website (www.accc.gov.au) by following the 'Public Registers' and 'Authorisations Public Registers' links.

Submissions following the draft determination

- 4.25 On 25 September 2008 the ACCC issued a draft determination proposing to grant authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended MSA to apply to various contracts between ACF, DFMC and dairy farmers. The ACCC proposed to grant authorisation for a period of five years.
- 4.26 A conference was not requested in relation to the draft determination. The ACCC received no submissions following the release of the draft determination.

5. The net public benefit test

- 5.1 The ACCC may only grant authorisation where the relevant test in section 90 of the Act is satisfied.

Application A91089

- 5.2 The applicants lodged application for authorisation A91089 under section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act. The relevant tests for this application are found in sections 90(6) and 90(7) of the Act.
- 5.3 In respect of the making of and giving effect to the arrangements, sections 90(6) and 90(7) of the Act state that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:
- the provision of the proposed contract, arrangement or understanding would result, or be likely to result, in a benefit to the public and
 - this benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision concerned was given effect to.
- 5.4 The applicants seek authorisation for inclusion in the amended MSA prior to the completion of any sale of ACF, and to make and give effect to the amended MSA in order for ACF and DFMC to continue with the back to back pricing and back to back purchasing policies under clauses 4.4, 4.6.2 and 5.6 of the amended MSA.
- 5.5 The applicants also seek authorisation to make and give effect to the agreement of prices (which are to be subject of back to back pricing) in DFMC's Revised Farmer Supply Contracts. Similarly, authorisation is sought to make and give effect to the agreement of prices which ACF will pay farmers under Revised Farmer Supply Contracts which ACF obtains the benefit of.

Application of the tests

- 5.6 The Australian Competition Tribunal (Tribunal) has stated that the test under section 90(6) is limited to a consideration of those detriments arising from a lessening of competition.²¹
- 5.7 However, the Tribunal has previously stated that regarding the test under section 90(6):
- [the] fact that the only public detriment to be taken into account is lessening of competition does not mean that other detriments are not to be weighed in the balance when a judgment is being made. Something relied upon as a benefit may have a beneficial, and also a detrimental, effect on society.

²¹ *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004. This view was supported in *VFF Chicken Meat Growers' Boycott Authorisation* [2006] ACompT9 at paragraph 67.

Such detrimental effect as it has must be considered in order to determine the extent of its beneficial effect.²²

- 5.8 Consequently, given the similarity of wording between section 90(6) and (90(7), when applying these tests the ACCC can take most, if not all, detriments likely to result from the relevant conduct into account either by looking at the detriment side of the equation or when assessing the extent of the benefits.

Definition of public benefit and public detriment

- 5.9 Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.²³

- 5.10 Public detriment is also not defined in the Act but the Tribunal has given the concept a wide ambit, including:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.²⁴

Future with-and-without test

- 5.11 The ACCC applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and public detriment generated by arrangements for which authorisation has been sought.²⁵
- 5.12 Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the 'counterfactual'.

Length of authorisation

- 5.13 The ACCC can grant authorisation for a limited period of time.²⁶

²² Re Association of Consulting Engineers, Australia (1981) ATPR 40-2-2 at 42788. See also: *Media Council case* (1978) ATPR 40-058 at 17606; and *Application of Southern Cross Beverages Pty. Ltd., Cadbury Schweppes Pty Ltd and Amatil Ltd for review* (1981) ATPR 40-200 at 42,763, 42766.

²³ Re 7-Eleven Stores (1994) ATPR 41-357 at 42,677. See also Queensland Co-operative Milling Association Ltd (1976) ATPR 40-012 at 17,242.

²⁴ Re 7-Eleven Stores (1994) ATPR 41-357 at 42,683.

²⁵ Australian Performing Rights Association (1999) ATPR 41-701 at 42,936. See also for example: Australian Association of Pathology Practices Incorporated (2004) ATPR 41-985 at 48,556; Re Media Council of Australia (No.2) (1987) ATPR 40-774 at 48,419.

²⁶ Section 91(1).

Conditions

5.14 The Act also allows the ACCC to grant authorisation subject to conditions.²⁷

Future and other parties

5.15 Application to make or give effect to contracts, arrangements or understandings that might substantially lessen competition or constitute exclusionary provisions may be expressed to extend to:

- persons who become party to the contract, arrangement or understanding at some time in the future²⁸
- persons named in the authorisation as being a party or a proposed party to the contract, arrangement or understanding.²⁹

²⁷ Section 91(3).

²⁸ Section 88(10).

²⁹ Section 88(6).

6. ACCC evaluation

- 6.1 The ACCC's evaluation of the agreement to make and give effect to the back to back pricing and back to back purchasing policies is in accordance with the net public benefit test outlined in Chapter 5 of this determination. As required by the test, it is necessary for the ACCC to assess the likely public benefits and detriments flowing from the inclusion of the back to back pricing and back to back purchasing policies in certain agreements between ACF, DFMC and farmers.

The market

- 6.2 The first step in assessing the effect of the conduct for which authorisation is sought is to consider the relevant market(s) affected by that conduct.
- 6.3 Defining the markets affected by arrangements proposed for authorisation assists in assessing the public detriment from any lessening of competition from the arrangements. However, depending on the circumstances, the ACCC may not need to comprehensively define the relevant markets, as it may be apparent that a net public benefit will or will not arise regardless of this definition.
- 6.4 The applicants submit that the relevant markets for this application for authorisation are the regional markets for the acquisition of raw milk in far north Queensland; Eastern Australia (south east Queensland, New South Wales and some parts of Victoria); and Southern Australia (Victoria and South Australia).
- 6.5 The applicants also submit that downstream markets may be affected by competition in the regional markets for the acquisition of raw milk. The applicants submit these are the:
- New South Wales, Queensland, South Australia and Victorian markets for the manufacture and wholesale supply of fresh milk
 - New South Wales, Queensland, South Australia and Victorian markets for the manufacture and wholesale supply of flavoured milk
 - national market for the manufacture and wholesale supply of cheese
 - national market for the manufacture and wholesale supply of cream and
 - national market for the manufacture and wholesale supply of dairy foods, yoghurts and dairy desserts.
- 6.6 The ACCC accepts that there are regional markets for the acquisition of raw milk. In this regard the ACCC notes that DFMC members are located in the following regions (see also Table 2.1):
- Far Northern (North Queensland)
 - Northern (South East Queensland and Northern NSW)
 - Central (NSW excluding Northern NSW and Riverina)
 - Riverina/Northern Victoria (and Gippsland)

- Western Victoria/South Australia.

- 6.7 The ACCC notes that each DFMC member within a specified region is paid the same amount for the supply of raw milk, subject to quality bonuses and penalties.
- 6.8 For the purpose of assessing this application for authorisation the ACCC considers that the relevant areas of competition are the regional markets for the acquisition of raw milk according to the regions identified in paragraph 6.6.
- 6.9 The ACCC also considers that there may be some competition effects in downstream markets such as those submitted by the applicants and outlined at paragraph 6.5.

Dairy industry participants

- 6.10 The applicants submit that ACF has major competitors for the acquisition of raw milk in every regional market except the Far Northern region.

Fonterra

- 6.11 Fonterra is a co-operative owned by approximately 11 000 New Zealand dairy farmers. In Australia, Fonterra operates through several subsidiaries including Fonterra Brands (Australia) Pty Ltd and Fonterra Australia Pty Ltd.
- 6.12 Fonterra is involved in the manufacture and distribution in Australia of butter, cheese, cream, ice cream, milk, yoghurt and dairy desserts.
- 6.13 Fonterra's brand names include Bega, Anlene, Brownes, Mainland, Perfect Italiano, Connoisseur and Western Star.

Parmalat

- 6.14 Parmalat is a wholly owned subsidiary of the Italian based global dairy company Parmalat SpA. The company entered the Australian dairy industry as a result of an on-market takeover of Pauls Limited in 1998. Parmalat supplies dairy products in Queensland, New South Wales, the Northern Territory, South Australia and Victoria.
- 6.15 Parmalat produces:
- a range of dairy products including yoghurt, custards and creams under brands such as Vaalia Yoghurt, Paul's Custard and Parmalat children's products
 - a range of full cream, skim and organic white milks under brands such as Rev, Slim Milk and PhysiCAL, and soy milk under the brand Soy Life and
 - a range of other beverages including flavoured milk and iced coffee under brands such as Rush, Breaka Flavoured Milk and Ice Break.

Murray Goulburn

- 6.16 Murray Goulburn was formed in 1950 and supplies products in all supermarket chains within Australia.

- 6.17 Murray Goulburn provides products under the brand Devondale and is involved in the manufacture and distribution of butter, milk (UHT and reduced fat UHT) and cheese (tasty, mild and reduced fat) to domestic and export markets.

Warrnambool Cheese & Butter

- 6.18 Warrnambool was established in 1888 and listed on the Australian Securities Exchange in May 2004. The company focuses on producing bulk dairy products for corporate customers.
- 6.19 Its brands include Sungold and Great Ocean Road, and it produces cheese, milk powders, whey protein concentrate, fresh milk, butter and cream which are largely sold to export markets.

Norco

- 6.20 Norco is a diversified agricultural co-operative based in northern New South Wales. NORCO Foods, a division of Norco, produces dairy goods including fresh milk, flavoured milk, creams, custards, cheese and ice cream.

The counterfactual

- 6.21 As noted in Chapter 5 of this determination, in order to identify and measure the public benefit and public detriment generated by conduct, the ACCC applies the 'future with-and-without test'.
- 6.22 The applicants submit that the counterfactual (the future without authorisation) involves a future in which the current MSA will continue to be in place between ACF and DFMC until 2017 however ACF and DFMC will not be able to enforce the back to back pricing and the back to back milk purchasing policies in the current MSA.
- 6.23 The applicants submit that in the counterfactual, under the current MSA:
- DFMC is obliged to supply all of the milk it acquires from its farmer members. This includes milk acquired by DFMC from farmer members who have not entered into a supply contract. The applicants note that farmer members are only obliged to supply a minimum amount of milk in order to maintain their membership of DFMC
 - ACF is obliged to acquire all the milk DFMC has acquired from its members and
 - ACF is free to acquire milk directly from DFMC's members or any other person.
- 6.24 The applicants submit that in the counterfactual DFMC will be required to unilaterally determine the price at which it will acquire milk from its farmers. While the current MSA requires that ACF continues to pay DFMC a commercial market price for milk, ACF will not be obliged to pay DFMC the amount that DFMC decides to pay to farmers as the contracted base price and volume incentive.
- 6.25 The applicants also submit that the counterfactual will:
- expose DFMC to significant commercial risk as the prices it has agreed and will agree to pay its farmer members for milk may exceed the price it is able to negotiate

with ACF for such milk while it is nonetheless obliged to sell all of such milk to ACF and

- create uncertainty as to the enforceability of the existing supply contracts with farmer members.
- 6.26 The ACCC considers that given the applicants have sought authorisation for conduct that would otherwise breach the Act – arrangements that may substantially lessen competition including price fixing agreements – the ACCC considers the applicants would be unlikely to give effect to the pricing and purchasing policies in the absence of authorisation.
- 6.27 Ultimately, the ACCC accepts the future without the authorisation would be a situation as submitted by the applicants whereby DFMC will set a price for the acquisition of milk from its farmer members independently from the price it negotiates with ACF for the on-sale of milk. The ACCC notes that the completion of the sale of ACF to National Foods is dependant on a number of conditions, including a shareholder vote. The sale may be affected if any one of the conditions not be satisfied.
- 6.28 The ACCC considers that an alternate counterfactual may be that dairy farmers may choose to collectively bargain with ACF under the terms of authorisation A90966 granted to the Australian Dairy Farmers Limited in April 2006. However, conditions of this authorisation require that collective bargaining groups can only be formed by dairy farmers who have a ‘shared community interest’. This is where farmers in the group each have a reasonable expectation of supplying the same plant of a dairy processor and are within the economic delivery zone of that plant. To be part of the same bargaining group farmers must demonstrate that they have similar supply patterns or supply a specialty raw milk product.

Public detriment

- 6.29 There are two broad outcomes following the sale of ACF and the removal of the restraint clause in the current MSA (on ACF from purchasing raw milk directly from DFMC farmers or from parties other than DFMC), namely:
- ACF will be free to purchase milk directly from farmer members of DFMC and others. ACF and DFMC can therefore be regarded as potential competitors in the purchase of raw milk from farmer members of DFMC and
 - DFMC and each of its farmer members can be regarded as potential competitors for the supply of raw milk to ACF.
- 6.30 The applicants have sought authorisation to include the back to back pricing and back to back milk purchasing policies (including price structure) as outlined in clauses 4.4, 4.6.2 and 5.6 of the amended MSA. Essentially, this requires both DFMC and ACF to adopt the same milk price in relation to the purchase of raw milk by DFMC from its farmer members, which is on-sold to ACF. The applicants have sought authorisation to agree to, and implement, this price at both stages.
- 6.31 The ACCC’s assessment of the public detriments likely to result from the arrangements follows.

Price effect

Submissions

- 6.32 The applicants submit that the existence of the back to back pricing is merely the mechanism for applying prices which have been achieved through commercial negotiations. The applicants submit that the prices paid by DFMC to its farmer members have historically been in line with prevailing market prices.
- 6.33 The applicants note that clause 5.1.1 of the amended MSA specifically obliges ACF to pay a commercial price for milk. However, in respect of the period after 30 June 2010 and for milk which exceeds the Anticipated Full Demand level for a region, ACF is only obliged to pay DFMC 'a commercially reasonable price having regard to the best end use (subject to logistical and administrative costs) to which that milk is likely to be put'.³⁰
- 6.34 The applicants submit that when determining the commercial price of milk, the parties have regard to the following factors to ensure that the price of milk reflects market prices:
- quality
 - quantity
 - geographic variations
 - transportation and
 - handling costs.
- 6.35 The applicants submit that world market prices and the price which New Zealand commodity products can be imported into Australia constrain the prices which Australian dairy farmers and processors can achieve.
- 6.36 The applicants submit that prices differ by reason of the differing value of milk to ACF in each of the regional milk pools. The value of milk as reflected in the prices ACF is willing to pay are determined by the product mix for each individual ACF processing facility and ACF's strategic imperatives. For example, the applicants submit that in 2007 ACF asked DFMC to supply greater volumes of milk from the Southern Victorian region and indicated it was prepared to pay in excess of prevailing market prices for such milk. ACF had assessed a need for further milk to meet its business plans and it was concerned about a decline in milk supply in various areas due to the drought. DFMC subsequently entered into supply contracts with approximately 100 dairy farmers from the region.
- 6.37 The applicants also submit that individual farmers are weak sellers and have limited capacity to influence prices received for their milk especially given the fixed nature of production systems. The applicants submit that dairy farmers have limited capacity to vary milk supply in response to short term changes in price.

³⁰ Addisons, *Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Cooperative Foods Limited (ACF) dated 22 May 2008 (Authorisation Application): Attachment A – Summary of amendments made to the MSA and Revised Farmer Supply Contracts*, 2 September 2008, p. 7.

6.38 The Fleurieu dairy farmers collective bargaining group (Fleurieu) notes that DFMC and ACF have, over the years, paid the commercial price for milk that applies in the region. However, Fleurieu submits that DFMC has little or no bargaining power because they can only negotiate to sell milk purchased from members to ACF and can not negotiate with other processors to get a better deal.

ACCC's view

6.39 As noted, following the sale of ACF, National Foods and DFMC may be regarded as potential competitors for the acquisition of raw milk from DFMC members, and as a result of the non-exclusive nature of the amended MSA, ACF has the opportunity to acquire milk from any other third party which means that DFMC members may be potential competitors with DFMC for the supply of raw milk to ACF. As such the proposal to continue to give effect to the back to back pricing policy may amount to a price agreement between competitors.

6.40 Agreements between competitors which influence the pricing decisions of market participants have the potential to result in allocative inefficiencies. That is, they can move prices away from levels that would be set in a competitive market. Public detriment may arise from such a price agreement if the price negotiated between ACF and DFMC was artificially higher or lower than would otherwise be in the absence of the price agreement.

6.41 Under the terms of the amended MSA, the price for the supply of raw milk by DFMC to ACF, including the price which DFMC pays to its farmer members, is commercially negotiated. In determining the price regard is had to such factors as quality, quantity, geographic variations, and transportation and handling costs.

6.42 Confidential pricing information provided by the applicants and supported by the submission by Fleurieu suggests that this price has been consistent with prevailing market prices.

6.43 The ACCC does not consider that authorisation of the arrangements would remove the commercial incentives that currently apply in price negotiations between the parties. In particular the ACCC notes that there are a number of features which are likely to limit the ability of the parties to set the price for raw milk too high or too low relative to the counterfactual of no authorisation, namely:

- the prices which DFMC can achieve are constrained by world market prices
- prices are set according to regional variations and authorisation is not likely to result in an industry wide price for milk
- the amended MSA provides for a commercial price for milk between the parties
- membership of DFMC is voluntary and, following the expiry of any supply contracts, farmer members can supply ACF and other processors directly. Supply contracts are generally for two or three years.
- ACF is able to acquire from other suppliers and
- the countervailing power on the part of the major supermarket chains.

World market prices

- 6.44 As Australia exports around 50% of its annual milk production (after processing), international prices for manufactured dairy products influence the domestic price for raw milk. With the growing importance of the exporting of dairy products such as cheese, milk powders and butters, processors have an incentive to purchase greater amounts of raw milk from farmers. In times of high demand, processors (who export) tend to negotiate up the price of raw milk to ensure they have the necessary supply to service export markets, subsequently increasing the price of raw milk. The price effect is regardless of the intended use of the raw milk but is strongest in the southeast of Australia. Prices in other regions are influenced primarily by local supply and demand conditions. Although the ACCC notes that even in Queensland, Victorian farm gate prices plus freight costs tend to set a maximum price above which it would not be economical to source raw milk locally.
- 6.45 Further, domestic prices for manufactured products, for example cheese from New Zealand, are influenced by imports. There are no barriers to trade with New Zealand and the applicants submit that cheese imported from New Zealand constitutes about 15% of the national market.
- 6.46 As such the ACCC understands that world prices operate as a significant influence in the pricing of raw milk in Australia. ACF and DFMC will continue to negotiate prices for the acquisition of raw milk in this context with or without authorisation.

Regional price variations

- 6.47 The ACCC notes the claim by the applicants that the value of milk to dairy processing companies varies according to different regions and the best use it can make from the milk it collects. These regional variations will continue to apply and the ACCC does not consider that authorisation will result in a standard price being paid to all DFMC farmers across regions.

MSA requires a commercial price to be paid for raw milk

- 6.48 Under the amended MSA the price agreed between ACF and DFMC is set commercially according to relevant factors including the effective competitive price for milk paid to farmers in a region by other similar processors in that region and the cost of transporting and handling the milk.
- 6.49 The amended MSA obliges ACF to pay DFMC a commercial price for milk, being the market value or price. In respect of the period after 30 June 2010 and for milk which exceeds the Anticipated Full Demand level for a region, ACF is obliged to pay DFMC 'a commercially reasonable price having regard to the best end use (subject to logistical and administrative costs) to which that milk is likely to be put'. ACF will consider the next best use for the milk and pay a price according to that use, taking into account any additional costs.
- 6.50 The ACCC notes there are parameters in the amended MSA to ensure that for a period after the sale, farmers will not receive less than the fixed and minimum farm gate milk prices as agreed between ACF and DFMC. This ensures that contracts and planning decisions made by farmers before the sale of ACF can still apply.

- 6.51 If ACF and DFMC are unable to agree on a commercial price the amended MSA provides that the issue may be resolved by mediation and then expert determination. Access to a dispute resolution process may help to ensure that prices for raw milk as agreed between the parties reflect the market price for milk in each region.

Membership of DFMC is voluntary and, subject to any supply contracts, DFMC members can negotiate with other processors including ACF directly

- 6.52 The applicants advise that DFMC membership is voluntary and members regularly leave and join. DFMC members are free to choose whether to enter into a supply contract, or supply DFMC without a contract, however membership to DFMC relies on members supplying a certain minimum amount of milk to DFMC.
- 6.53 Farmers who do not enter into contracts, or whose contracts expire, remain free to seek to negotiate directly with ACF for the acquisition of their milk (in competition with DFMC) or other processors.
- 6.54 The ACCC notes, however, that the majority of farmer members do enter into a supply contract in order obtain the benefits of higher milk prices and certainty of supply. Farmers on a contract with DFMC are not able to supply alternate processors.
- 6.55 The ACCC also notes that ACF and DFMC must use reasonable endeavours to secure the entry by DFMC farmer members into Revised Farmer Supply Contracts prior to the completion of the sale. The ACCC understands ACF and DFMC are obliged to enter into Revised Farmer Supply Contracts for a specified volume of raw milk which is equivalent to a certain proportion of the milk supply by ACF to DFMC during the 2007-08 financial year.
- 6.56 Further, under the amended MSA, DFMC agrees to use its reasonable endeavours to supply ACF with a 'Minimum Volume' for each region during each quarter of the term of the agreement. Initially, the Minimum Volume is a proportion of the total volumes supplied by DFMC to ACF previously during the 2007-08 financial years, and commencing in 2010-11 will be determined in accordance with the provision of the amended MSA
- 6.57 The ACCC notes that the terms of supply contracts are for 1, 2 or 3 years, and at any one time a material proportion of farmer members' contracts are due to expire (see paragraphs 2.35 – 2.49 for the types of supply contracts DFMC has with its farmers and paragraphs 6.78 – 6.83 for further discussion). The applicants submit that this will ensure that the price for raw milk will not become artificially low following the sale of ACF.

ACF is able to acquire raw milk from other suppliers

- 6.58 The ACCC considers that the non-exclusive nature of the amended MSA further increases the likelihood that the prices negotiated between the parties will reflect market prices. The ACCC notes that while the amended MSA places an obligation on ACF to purchase all qualifying milk supplied by DFMC members (clause 3.3(a)), it will be free to acquire additional milk directly from persons other than DFMC, including DFMC's members who are not subject to a supply contract.

- 6.59 Clause 3.3 in the amended MSA requires ACF to acquire ‘all of the qualifying farmer member’s milk’ purchased by DFMC from its members. The definition of qualifying farmer member’s milk is contained in clause 1.1 of the MSA as:
- milk which is produced by a member of DFMC at a farm from which ACF collected milk at any time in the 8 weeks prior to the completion date of the amended MSA or
 - milk which is deemed to be qualifying farmer member’s milk pursuant to clause 3.7(b) of the MSA.³¹
- 6.60 Clause 3.7 deals with new farmer members. ACF is not obliged to purchase milk from DFMC if the milk was produced at a farm from which ACF did not collect milk at any time in the 8 weeks prior to the completion date of the amended MSA. ACF can also refuse to acquire milk from new farmer members provided that the milk to be supplied is excess to ACF’s Anticipated Full Demand.³² If ACF decides not to acquire the new farmers milk DFMC is free to sell that milk to another processor (clause 3.7(c)).
- 6.61 The ACCC considers that if ACF can acquire raw milk more cheaply from sources other than from DFMC, this will influence the price ACF will negotiate with DFMC which will help to ensure the price for raw milk will not become artificially high following the completion of the sale of ACF.

Countervailing power of grocery retailers

- 6.62 The applicants submit that the countervailing power of the major supermarket chains imposes a significant constraint on retail pricing of dairy products.
- 6.63 The ACCC has previously considered the countervailing power of the major supermarket chains in the context of assessing applications for authorisation of collective bargaining arrangements by dairy farmers. In particular, the ACCC considered that even where dairy farmers are able to negotiate increases in prices paid to them as a result of bargaining collectively, the competitive nature of the downstream market and the size and relative bargaining power of the major supermarket chains would mean that such increases are unlikely to be significant and the extent to which such increases are passed on to consumers is likely to be limited.
- 6.64 This has recently been confirmed by the ACCC in its report into the competitiveness of retail prices for standard groceries. The ACCC found that the bargaining power of the major supermarket chains in negotiating terms of supply for private label products is being reflected in retail prices. The ACCC noted that raw milk and processor costs of production have increased significantly and are subsequently reflected in wholesale prices for branded milk. However, processors contractual obligations and the bargaining power of supermarkets, has meant these increases in production costs are

³¹ Addisons, *Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Cooperative Foods Limited (ACF)*, 14 July 2008, p. 2.

³² Addisons, *Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Cooperative Foods limited (ACF) dated 22 May 2008 (Authorisation Application): Attachment A – Summary of amendments made to the MSA and Revised Farmer Supply Contracts*, 2 September 2008, p. 7.

not being fully reflected to the same extent in wholesale or retail prices for private label milk.³³

ACCC conclusion on pricing arrangements

- 6.65 The ACCC notes the applicants' submission that negotiations are carried out in a competitive environment and that to date the prices negotiated between ACF and DFMC have reflected the market price for milk. The ACCC notes that commercial negotiations take into account world prices, global demand, and regional and seasonal factors. The ACCC does not have any evidence before it which suggests that this will not continue following the sale of ACF.
- 6.66 The ACCC considers it unlikely that the pricing arrangements would result in any inflation or deflation of the price of raw milk. In particular the ACCC notes the requirement in the amended MSA for ACF to pay a commercial price for milk, being the market price or value (by virtue of clause 5.1.1) and this is supported by a dispute resolution procedure if the parties fail to reach agreement.
- 6.67 The ACCC also considers that the fact that prices are negotiated and set for DFMC members across particular regions as opposed to all DFMC members reduces any anti-competitive effect the arrangements may have and more accurately reflects the commercial prices for milk from each region.
- 6.68 The ACCC notes that upon the expiry of any supply contracts, there is an opportunity for individual farmers to negotiate directly with ACF, or to negotiate with other processors in order to receive the best commercial price for their milk. While many farmers will be subject to a supply contract and be required to supply all their milk to DFMC, upon expiry of their contract farmers are able to choose whether to enter or renew a supply contract, or to negotiate directly with an alternate processor.
- 6.69 The ACCC considers that while the current market has strong demand for milk the bargaining positions of farmers is stronger and the incentive for processors (including ACF) to pay a commercial price for milk is increased. This exists with or without the authorisation.

Supply effect

Submissions

- 6.70 The applicants submit that the non-exclusive nature of the amended MSA reduces any anti-competitive detriment the authorisation may have because ACF will be free to acquire milk from sources other than DFMC. Further, subject to the terms of membership of DFMC and any supply contracts they may be party to, farmer members of DFMC will be free to supply ACF directly, or supply other processors.
- 6.71 Fleurieu submits that the supply contracts between farmers and DFMC act as a barrier to the movement of supply of raw milk from DFMC to another processor. Fleurieu

³³ Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, July 2008, p. 296.

submits that farmers feel pressured to sign supply contracts with DFMC in order to receive financial benefits, even though the prices announced by DFMC at the beginning of the year are indicative only, and may be varied during the term of the contract.

6.72 Fleurieu is concerned that the requirement to provide 180 days notice in order to terminate a supply contract is unreasonably long. Fleurieu claims that even at the end of the term of the contract, the farmer is still required to give 180 days notice to terminate.

6.73 The Revised Farmer Supply Contracts may be terminated in the following circumstances:

- farmers will only be required to provide 90 days' notice in order to bring their supply contract to an end at the completion of the contract period and
- farmers may terminate the Revised Farmer Supply Contracts during the contract period provided that they provide DFMC with 90 days' written notice and obtain DFMC's prior written consent. DFMC can only withhold its consent if termination of the supply contract will be reasonably likely to result in the estimated milk supply to DFMC under Revised Farmer Supply Contracts in the relevant region for 3 quarters following the termination, to fall below the minimum regional contract level for those 3 quarters in that region. The minimum regional contract level is defined to be a volume which is 10% above the Minimum Volume DFMC is required to supply to ACF for that region under the amended MSA.

6.74 Further, the applicants advise that under the current supply contracts, farmers can terminate their contract during the contract period on 14 days' notice, with DFMC's consent, if they decide to permanently leave the dairy industry. In addition, farmers can terminate their contract on 30 days' notice if they sell their farm. Under the Revised Farmer Supply Contracts, farmers can still terminate their supply contract during the contract period on 90 days' notice, if they decide to sell their farm or cease operating a dairy business. However, before doing so, they must ensure that the farm or the farmers' dairy herd is sold to a person who agrees to continue to supply the Minimum Volume specified in the revised farmer supply contract to DFMC during the term of the contract period.

ACCC's views

6.75 The ACCC notes that public detriment may arise if the effect of the arrangements was to lock up a significant section of the farmer base thereby raising barriers to entry or expansion for other processors.

6.76 The ACCC notes that in general, access to a reliable supply of raw milk is essential for processors to be able to meet current demand and plan for future growth. This is particularly so in times where demand exceeds supply as in the current environment. If all dairy farmers in a region are tied to long term contracts with a particular processor barriers to entry and expansion for new milk processors seeking to enter that market are high.

6.77 Security of milk off-take is also important to farmers which means that committing to a supply contract may be attractive to many farmers. Under the DFMC arrangements farmers may choose to enter into supply contracts with DFMC in order to supply ACF with raw milk (see paragraphs 2.35 to 2.49). Farmer members have a choice of two

contracts to enter into, each with varying financial incentives, or may choose to supply milk without a supply contract.

- 6.78 The ACCC notes that over 95% of DFMC farmer members are currently contracted to supply milk to DFMC with terms of either 12 months, 2 years or 3 years depending on the type of contract. The applicants advise that farmers value the certainty provided by guaranteed minimum prices for the duration of fixed term contracts and of the farmers that enter the Defined Volume Fixed Term Contract, 35% elect to enter into a 3 year contract. The ACCC notes that by virtue of the Tripartite Deed between ACF, National Foods and DFMC, DFMC must use all reasonable endeavours to secure a proportion of milk supply in each region by entering into Revised Farmer Supply Contracts with farmer members.
- 6.79 Should DFMC members wish to cease to supply DFMC in order to deal directly with another processor or with ACF directly they would need to give notice terminating the contract. The ACCC notes that termination of the Revised Farmer Supply Contract requires 90 days notice prior to the end of the contract period, existing Defined Volume Fixed Term Contracts requires 180 days notice, and the Volume Incentive Contracts require 120 days notice.
- 6.80 Fleurieu submits that this length of time is excessive and acts as a barrier to farmers who wish to change processors, particularly as farmers must give the appropriate notice at the end of the current contract term.
- 6.81 In response the applicants have clarified that farmers on an existing two or three year Defined Fixed Term Contract may give notice to terminate the contract at any time, including before the end of the contract period. Although the contract does not expire until the end of the contract term. For farmers on a 12 month Supply Agreement 120 days notice period applies unless the farmer wishes to terminate the contract after the 12 month contract period has expired. In this case the farmer only has to give 28 days notice and does not need to wait until expiry of the contract term before giving notice.
- 6.82 The ACCC also notes that at any one time there are a number of supply contracts being renewed or negotiated. For example the applicants advise that of the 736 existing Defined Value contracts, 14% are due to expire by the end of 2008.
- 6.83 Further, farmers are not required to enter into a contract with DFMC to supply milk to DFMC and DFMC members appear to join and leave regularly.
- 6.84 It is also relevant to note that the issue of whether there would be a substantial lessening of competition in the acquisition of raw milk was considered by the ACCC as part of its informal clearance process.
- 6.85 The ACCC considered that the divestitures required as part of the undertaking offered by National Foods will create a viable fresh milk processor in competition with ACF in New South Wales and South Australia where the ACCC identified competition concerns. It was considered that the presence of an alternative fresh milk processor or processors who would act as a significant acquirer of raw milk in central New South Wales and South Australia will act as a constraint on ACF pricing decisions. As part of the undertakings, National Foods will supply the purchaser with a specified amount of raw milk over the 12 months following the divestiture date.

- 6.86 Overall, while the locking in of raw milk supplies through long term supply contracts may create barriers for processors who wish to enter or expand into particular regions the ACCC is satisfied that the arrangements do not increase any barriers that otherwise exist with or without the authorisation.
- 6.87 In general the ACCC notes that the capacity for dairy farmers to switch between processors does exist, even though the incidence of switching actually occurring may not be high.

ACCC conclusion on supply arrangements

- 6.88 The ACCC considers there will be limited anti-competitive detriment generated by the supply arrangements resulting from authorisation. In particular the ACCC notes that:
- the term of supply contracts are for a maximum of 3 years and are entered into at the discretion of the farmer. Further, there is no penalty for giving notice to terminate a supply contract once the minimum contract term has been carried out and the relevant notice to terminate a contract can be given prior to the expiry of the contract
 - where a farmer is not subject to a supply contract or a farmer's supply contract has expired, that farmer is able to supply other processors or seek to supply ACF directly should they wish and
 - while ACF is obliged to acquire all of DFMC's qualifying milk, ACF will be able to acquire additional milk directly from persons other than DFMC including DFMC's members.

ACCC conclusion on public detriments

- 6.89 The ACCC considers authorisation of the back to back pricing and back to back milk purchasing policies will not enable the parties to set prices at a level that is too high or too low relative to the market price. Prices will continue to be negotiated in an environment where world prices have a significant impact on domestic prices for raw milk.
- 6.90 Further the non-exclusive nature of the amended MSA enables ACF to acquire milk from parties in addition to DFMC. Similarly, following the expiry of any contractual obligations, DFMC members can negotiate to supply raw milk to other processors or to ACF directly.
- 6.91 The ACCC considers that any barriers for processors who wish to enter or expand into particular regions are not increased by the proposed arrangements for which authorisation are sought.

Public benefit

- 6.92 The applicants submit the proposed conduct will deliver significant public benefits through, broadly:
- providing certainty for existing and future supply contracts thereby providing security of milk supply

- encouraging farmers to remain in or enter the industry and
- facilitating the growth of exports by ACF.

6.93 The ACCC's assessment of the public benefits likely to result from the conduct follows.

Certainty of supply through continuation of existing milk supply arrangements or entering Revised Farmer Supply Contracts

Submissions

- 6.94 The applicants submit that authorisation will ensure that the terms of existing supply contracts and Revised Farmer Supply Contracts will be enforceable, therefore providing certainty to farmers and DFMC who are party to the contracts. Authorisation will ensure the ongoing ability for farmers to plan for matters affecting future production and growth.
- 6.95 With respect to Revised Farmer Supply Contracts, authorisation is sought for the offering of, and inclusion of, prices prior to the completion of the sale of ACF, and post sale the payment of such prices to farmers.
- 6.96 The applicants submit that authorisation of the pricing and purchasing policies to be included in such contracts ensures that DFMC, ACF and farmers can continue to rely on and enforce the prices already agreed upon and inserted into the supply contracts for the duration of those existing contracts, and for the period of authorisation for future supply contracts, following the completion of the sale of ACF.
- 6.97 The effect is that farmers will be able to continue to plan their production including growing their herds to meet current high demand, especially given the demand for exports. The applicants submit that this is particularly important during a period of extended drought and high feed, fertilizer, fuel and other input costs, to provide the necessary basis for farmers to invest in growing their milk production capacity.
- 6.98 Further, the applicants submit that ACF and consumers will benefit as ACF will have security of milk supply across regions which means it will be able to competitively tender for the supply of milk products to major grocery retailers and potentially grow the export market.
- 6.99 National Foods supports authorisation claiming it will allow for the continuation of existing milk supply arrangements which will provide greater certainty and reduced commercial disruption for all relevant parties.

ACCC's views

- 6.100 The ACCC accepts that the inclusion of the pricing and purchasing policies in the amended MSA and Revised Farmer Supply Contracts will provide certainty for existing supply contracts arrangements. This is particularly beneficial for farmer members of DFMC, where in light of the sale of ACF, it will help ensure there will not be a disruption in the supply of their milk for the agreed price. National Foods has

committed to specific prices for raw milk not less than those already offered by ACF to DFMC.³⁴

- 6.101 The ACCC also accepts that continuation of the purchasing and pricing policies as set out in the amended MSA will provide National Foods with some certainty and enable them to plan and meet the demands for supply of fresh milk and other dairy products at least in the short to medium term.
- 6.102 Whether the arrangements allow for longer term certainty largely depend on future price and contract negotiations as existing contracts expire and market conditions change. It is difficult therefore to determine to what extent the arrangements for which authorisation is sought will assist National Foods in tendering to major supermarket chains or increasing the value of exports as claimed.
- 6.103 Further, the ACCC notes that while farmers on supply contracts are obliged to supply all their milk to DFMC, following the expiration of these contracts they will have the option to negotiate with processors or ACF directly. The non-exclusive nature of the amended MSA means that ACF is no longer restricted from only acquiring raw milk from DFMC and may acquire additional milk from other suppliers, subject to ACF meeting its obligation under the amended MSA to acquire all qualifying farmers' milk. As a result some degree of change in the way raw milk is supplied in the future by DFMC members is possible and may be beneficial to both farmers and ACF.
- 6.104 The ACCC accepts there is some public benefit in the short to medium term from ensuring certainty of milk off-take and providing the opportunity for farmers and the future buyer of ACF to plan for future production.

Transaction cost savings and input into contracts

Submissions

- 6.105 The applicants submit that the arrangements significantly reduce transaction costs to farmers who do not have to have price negotiations with DFMC or ACF. As a result of the back to back pricing, negotiations will only take place between DFMC and ACF. The applicants submit, however, that farmers have input into the terms of the contracts through their membership of DFMC.
- 6.106 The applicants note that prior to entering negotiations with ACF, DFMC engages consultants to advise on world market prices, trends and other factors influencing export prices for Australian manufactured product, Australian and regional factors which may influence market price, and publicly available information regarding competitor pricing and other activities. DFMC also gathers information from its farmer members which may be relevant to the market price.
- 6.107 The applicants submit that this avoids information asymmetries arising from the disparity in bargaining positions and resources of the parties. The applicants submit that this will be particularly important for small to mid sized and individual farmers who do

³⁴ Addisons, *Authorisation Application lodged by Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Cooperative Foods Limited (ACF) dated 22 may 2008 (Authorisation Application): Attachment A – Summary of amendments made to the MSA and Revised Farmer Supply Contracts*, 2 September 2008, p. 7.

not have the time or expertise to gather such information or it would be expensive to for them to do so individually.

- 6.108 The applicants also submit that dairy farmers will continue to have direct access to ACF through the provision of field advisory services which ACF is obliged to provide under the amended MSA (clause 8). These services are directed at ensuring that farmers are both efficient and competitive by assisting them to produce high quality milk and high volumes. Through the provision of these services farmers are directly made aware of ACF's strategic issues and imperatives and can work towards them.

ACCC's views

- 6.109 The ACCC accepts there may be cost savings and efficiency gains experienced by individual farmers from the continuation of the pricing and purchasing policies by relying on DFMC to gather information and negotiate on their behalf with ACF for the commercial price of milk. The ACCC notes that DFMC performs a series of roles on behalf of its farmer members, by gathering information, consulting with experts on market prices, and negotiating with ACF for the supply of raw milk. In this way negotiations regarding pricing, production costs and other specific regional concerns can continue to be given appropriate weight and communicated to ACF when the price for raw milk is determined.
- 6.110 To the extent that DFMC members continue to supply DFMC with milk, ACF will also experience cost savings by negotiating with one party as opposed to numerous individual farmers. That being said, the ACCC notes there can also be benefits resulting from the flow and exchange of information where individual negotiations do take place.

ACCC conclusion on public benefits

- 6.111 The ACCC accepts that the continuation of the back to back pricing and back to back milk purchasing policies are likely to result in the following public benefits:
- certainty of supply in the short to medium term through the continuation of existing supply arrangements and
 - transaction cost savings and efficiency gains for farmers and ACF.

Balance of public benefit and detriment

- 6.112 The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, that the back to back pricing and back to back milk purchasing policies, are likely to result in a public benefit that will outweigh any public detriment.
- 6.113 In the context of applying the net public benefit test at section 90(8)³⁵ of the Act, the Tribunal commented that:

... something more than a negligible benefit is required before the power to grant authorisation can be exercised.³⁶

³⁵ The test at 90(8) of the Act is in essence that conduct is likely to result in such a benefit to the public that it should be allowed to take place.

- 6.114 The ACCC considers it unlikely that the pricing arrangements would result in any inflation or deflation of the price of raw milk. The ACCC considers that supply negotiations, including for price, are carried out in an environment that necessarily reflects world prices, global demand and regional and seasonal factors. The ACCC does not have any evidence before it which suggests that this will not continue following the sale of ACF.
- 6.115 Further, the non-exclusive nature of the amended MSA enables ACF to acquire milk from parties in addition to DFMC subject to the requirement that ACF acquire all qualifying farmer's milk.
- 6.116 Similarly, at the expiry of any supply contracts, DFMC members are able to negotiate to supply raw milk to other processors or to ACF directly. The ACCC notes, however, that farmers subject to a supply contract are required to supply all their milk to DFMC who in turn supplies all the milk it acquires to ACF. The ACCC considers this may result in some anti-competitive detriment by locking in supply of raw milk, however notes that supply contracts are for relatively short periods of time and farmer members may terminate their contracts subject to certain conditions.
- 6.117 The ACCC considers that any barriers for processors who wish to enter or expand into particular regions are not increased by the arrangements.
- 6.118 The ACCC considers public benefits, particularly in the short to medium term, are likely to result. In particular there is benefit from ensuring certainty of supply following the sale of ACF. There are also likely to be some transaction cost savings and benefits from ensuring effective input into contracts.
- 6.119 On balance, the ACCC considers the public benefits will outweigh the public detriment.

Length of authorisation

- 6.120 The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.
- 6.121 Authorisation is sought with respect to the making and giving effect to the agreement in respect of the prices to be offered to farmers, the offering of and inclusion of such prices, as well as the payment of such prices in Revised Farmer Supply Contracts, for a period of five years.
- 6.122 The applicants submit that authorisation for a period of five years would not bring about any substantial lessening of competition because the price negotiated by DFMC and ACF reflects the commercial price for raw milk.
- 6.123 As such, the ACCC grants authorisation to the back to back pricing and back to back purchasing policies as outlined in clause 4.4, 4.6.2 and 5.6 of the amended MSA to be

³⁶ Re Application by Michael Jools, President of the NSW Taxi Drivers Association [2006] ACompT 5 at paragraph 22.

reflected in existing supply contracts, Revised Farmer Supply Contracts and future supply contracts for a period of five years.

7. Determination

The application

- 7.1 On 22 May 2008 Dairy Farmers Milk Co-operative Limited (DFMC) and Australian Co-operative Foods Limited (ACF) (together ‘the applicants’) lodged application for authorisation A91089 with the Australian Competition and Consumer Commission (the ACCC). On 29 August 2008, the applicants amended their application for authorisation to account for amendments arising from agreements being entered into for the sale of ACF to National Foods Limited.
- 7.2 Application A91089 was made under subsection 88(1) of the *Trade Practices Act 1974* (Cth) to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.
- 7.3 Broadly, the applicants have sought authorisation for the inclusion of the back to back milk purchasing policies and back to back pricing arrangements contained in clauses 4.4, 4.6.2 and 5.6 of the amended Milk Supply Agreement which will take effect as and from the Scheme Implementation Date (amended MSA). The back to back pricing and back to back purchasing policies are to apply to several agreements between ACF, DFMC and farmer members.
- 7.4 Authorisation is sought for the back to back pricing and back to back purchasing policies to apply to existing and future supply contracts, as well as Revised Farmer Supply Contracts. The applicants have requested that authorisation be granted for the inclusion and giving effect to the pricing and purchasing policies for a period of five years.
- 7.5 The key effect of these clauses is as follows:
- DFMC must adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members, as ACF applies to its purchase of milk from DFMC (clause 4.4)
 - DFMC must adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk, as DFMC received from ACF for the milk it sells to ACF (clause 5.6) and
 - DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts (clause 4.6.2).

The net public benefit test

- 7.6 For the reasons outlined in Chapter 6 of this determination the ACCC considers that in all the circumstances the arrangements for which authorisation is sought are likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the arrangements.

7.7 The ACCC therefore **grants** authorisation to application A91089 for a period of five years.

Conduct for which the ACCC grants authorisation

7.8 The ACCC grants authorisation for:

1. the inclusion in the amended MSA of amended clauses 4.4 and 5.6 which provide for the continuation of the agreement in respect of back to back milk purchasing policies and back to back pricing arrangements upon completion of the sale of ACF
2. the inclusion in the amended MSA of new clause 4.6.2 which provides, among other things, that DFMC will sell to ACF milk it acquires from farmer members on the same terms and conditions relating to payment, pricing, collection and quality as contained in its farmer contracts.
3. the implementation of the back to back pricing and back to back milk purchasing policies by DFMC in its dealings with farmers for the supply of milk to ACF, following completion of the sale of ACF to National Foods
4. the making and giving effect to the agreement in respect of the policies and prices which are to be the subject of back to back pricing in DFMC's Revised Farmer Supply Contracts following completion of the sale and
5. the making and giving effect to the agreement in respect of the prices ACF will pay farmers whose Revised Farmer Supply Contracts are assigned to ACF, or which contracts ACF obtains the benefit of, in accordance with the transaction agreements.

7.9 This determination is made on 22 October 2008.

Conduct not authorised

7.10 Authorisation was not sought for, and does not extend to, any other provisions of the amended MSA.

Interim authorisation

7.11 At the time of lodging the application, DFMC and ACF requested interim authorisation to continue to engage in the conduct while the authorisation application is considered by the ACCC should the ACCC not have made a final determination by the time any sale of ACF is completed. The ACCC considered the initial request for interim authorisation on 18 July 2008 and decided that the protection afforded by interim authorisation was not required until DFMC and ACF cease to be related bodies.

7.12 At the time of amending the application for authorisation, the applicants also requested interim authorisation for the offering of, and entering into, Revised Farmer Supply Contracts and any future supply contracts which include agreed prices. The applicants note that interim authorisation is not being sought to pay the prices set out in the Revised Farmer Supply Contracts, because such payment will not occur unless authorisation for implementation of back to back pricing is granted by the ACCC.

- 7.13 The ACCC considered the request for interim authorisation at the time of the draft determination and decided to grant interim authorisation to allow the applicants to offer, and enter into, Revised Farmer Supply Contracts which include agreed prices consistent with the back to back pricing policies.
- 7.14 Interim authorisation will remain in place until the date that this final determination comes into effect or until the ACCC decides to revoke interim authorisation.

Date authorisation comes into effect

- 7.15 This determination is made on 22 October 2008. If no application for review of the determination is made to the Australian Competition Tribunal, it will come into force on 13 November 2008.

Appendix 4 – ACCC Authorisation 2013



Australian
Competition &
Consumer
Commission

Determination

Application for revocation and substitution of authorisation

lodged by

Dairy Farmers Milk Co-operative Limited (DFMC)

in respect of

**Milk supply arrangements between DFMC and Dairy Farmers Pty
Ltd**

Date: 3 July 2013

Authorisation number: A91364

**Commissioners: Sims
 Rickard
 Schaper
 Cifuentes
 Court
 Dimasi
 Walker**

Summary

The Australian Competition and Consumer Commission (ACCC) has decided to re-authorise milk supply arrangements between Dairy Farmers Milk Co-operative Limited, its members, and Dairy Farmers Pty Ltd.

The ACCC grants authorisation for ten years, until 25 July 2023.

Introduction

1. On 8 March 2013, the Dairy Farmers Milk Co-operative Limited (DFMC), lodged an application for the revocation of authorisation A91089 and the substitution of a new authorisation A91364 with the ACCC under section 91C (1) of the *Competition and Consumer Act 2010* (the Act) (re-authorisation).
2. DFMC seeks re-authorisation to make and give effect to back to back milk purchasing policies and milk pricing arrangements between DFMC, DFMC members and Dairy Farmers Pty Ltd (Lion)¹ by virtue of a Milk Supply Agreement (MSA)² between DFMC and Lion. The MSA sets out the terms whereby DFMC's acquisition of milk from its approximate 600 members is on the same terms as Lion's acquisition of milk from DFMC.
3. The clauses of the MSA are given further effect to by virtue of the agreements DFMC has entered into, and will enter into in the future, with its members to obtain milk supply.
4. The relevant clauses of the MSA between DFMC and Lion are identical to those considered by the ACCC in 2008³ except that the term of the MSA is extended to 2019. The key effects of the clauses are:
 - Clause 4.4 - DFMC must adopt the same milk purchasing policy (including price structure) in relation to its acquisition of milk from its members as Lion applies to its purchase of milk from DFMC
 - Clause 4.6.2 - DFMC must sell milk it acquires from members to Lion on the same terms and conditions relating to payment, pricing collection and quality as contained in its farmer contracts, and
 - Clause 5.6 - DFMC must adopt the same milk price in relation to the purchase by DFMC from its farmer suppliers of milk as DFMC received from Lion for the milk it sells to Lion.
5. DFMC seeks re-authorisation to make and give effect to the MSA which may be regarded as conduct:
 - a. fixing, controlling or maintaining the price for goods and the terms of supply of goods by DFMC members, DFMC and Lion, in contravention of the cartel conduct provisions of the Act, or

¹ Formerly known as Australian Co-operative Foods Limited (ACF) and now a wholly owned subsidiary of Lion Pty Ltd.

² A copy of the Milk Supply Agreement has been provided to the ACCC on a confidential basis.

³ On 22 October 2008, the ACCC granted Authorisation A91089 until 13 November 2013, to make and give effect to the back to back arrangements between DFMC, DFMC members and Australian Co-operative Foods Limited ((ACF) now Lion)³ (2008 Authorisation)

<http://transition.accc.gov.au/content/index.phtml/itemId/829411/fromItemId/401858>.

- b. in contravention of sections 45 (2)(a)(ii) and 45 (2)(b)(ii) of the Act.
6. DFMC seeks re-authorisation for ten years, however if the ACCC is not minded to grant authorisation for this length of time, DFMC seeks authorisation until the expiry of the MSA on 30 June 2019.
 7. The ACCC can authorise anti-competitive conduct such as cartel conduct if it is satisfied that the likely public benefits of the conduct will outweigh the likely public detriment constituted by any lessening of competition.⁴ Further details regarding DFMC's application for re-authorisation can be found on the ACCC's Public Register.⁵
 8. On 5 June 2013, the ACCC issued a draft determination⁶ proposing to grant authorisation for DFMC to make and give effect to back to back milk purchasing policies and milk pricing arrangements between DFMC, DFMC members and Lion by virtue of the MSA between DFMC and Lion for a period of ten years. No further submissions were received, nor a conference requested in relation to the draft determination.

DFMC

9. DFMC is a trading co-operative and commenced trading following a restructure of Australian Co-operative Foods Ltd (ACF) on 29 June 2004. DFMC's principal activity is the acquisition of milk from members (pursuant to supply contracts with its members) and the sale of all such milk to Lion (pursuant to the MSA). DFMC is the owner of the milk it sells to Lion. It does not have any infrastructure for milk collection and storage and is dependent on Lion for the collection and storage of the milk which DFMC acquires from its members and on sells to Lion.
10. DFMC submits that membership of DFMC is voluntary and members join and leave regularly. DFMC submits that as at 30 June 2012 there were approximately 600 DFMC members across Australia, located in the relevant dairy regions, see paragraph 15(d) below.⁷
11. DFMC submits that the following changes have occurred since 2008:
 - a. entry of Parmalat Australia Limited (Parmalat) in Central New South Wales
 - b. a reduction in the number of, and volumes of milk supplied by, DFMC members
 - c. the introduction of contracts between DFMC and farmer suppliers with shorter terms and shorter notice periods to exit
 - d. heightened countervailing power of retailers as opposed to milk processors, and
 - e. factory consolidation by milk processors.⁸

⁴ The ACCC's *Guide to Authorisation* (available from the ACCC website) has more details regarding the ACCC's authorisation process.

⁵ <http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039>.

⁶ Subsection 90A(1) requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

⁷ This is compared to 800 members as at 30 June 2008.

⁸ The complete submission can be viewed on the ACCC Public Register at:

<http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039/display/application>.

12. DFMC submits that these factors, when combined, mean that the impact of the milk supply arrangements on the sale of end dairy products is arguably even less significant than it was when the 2008 Authorisation was granted.

Public Consultation

Prior to draft determination

13. On 18 March 2013, the ACCC invited submissions on the application for re-authorisation from 33 potentially interested parties, including competitors such as Parmalat, industry representative bodies and dairy associations, and various state Government departments.

14. The ACCC received submissions from the three parties listed below. All submissions were supportive of the application:⁹

- a. Australian Dairy Farmers Ltd
- b. Queensland Dairy Farmers' Organisation, and
- c. Queensland Department of Agriculture, Fisheries and Forestry.

15. The views of DFMC and interested parties are outlined in the ACCC's evaluation chapter of this determination. Copies of public submissions may be obtained from the ACCC's website www.accc.gov.au/authorisationsregister.

Following the draft determination

16. The ACCC did not receive further submissions in response to the draft determination.

ACCC evaluation

17. The ACCC's evaluation of the milk supply arrangements is in accordance with the relevant net public benefit tests¹⁰ contained in the Act. In broad terms, under the relevant tests the ACCC shall not grant authorisation unless it is satisfied that the likely benefit to the public would outweigh the detriment to the public, including the detriment constituted by any lessening of competition that would be likely to result.

18. In its evaluation of this application, the ACCC has taken into account:

- a. Information received from DFMC and interested party submissions. In particular, the ACCC notes that there were no objections to the re-authorisation.
- b. Information available to the ACCC regarding the 2008 Authorisation.
- c. The likely alternative future without the conduct the subject of the authorisation. The ACCC accepts that the future without the conduct would be that DFMC unilaterally negotiates milk supply prices with dairy

⁹ All submissions can be viewed on the ACCC's Public Register, including a list of parties consulted - <http://transition.accc.gov.au/content/index.phtml/itemId/1105941/fromItemId/278039>.

¹⁰ Subsections 90(5A), 90(5B), 90(6), 90(7) and 91C(7) of the Act. The relevant tests are set out in Attachment A.

- farmers and Lion, creating greater uncertainty and increasing transaction and administrative costs. Alternatively, DFMC farmers may consider entering into collective bargaining arrangements consistent with those already operating in the dairy industry under an ACCC authorisation.¹¹
- d. The relevant areas of competition likely to be affected by the milk supply arrangements. The ACCC agrees with DFMC that the milk supply arrangements will directly impact the acquisition of raw milk by milk processors in the following areas:
 - North Queensland
 - South East Queensland and Northern New South Wales
 - New South Wales
 - Riverina/Northern Victoria (Gippsland), and
 - Western Victoria/South Australia.
 - e. The ACCC considers some downstream markets may also be relevant such as the markets for the wholesale supply of fresh and flavoured milk and the markets for the wholesale supply of other manufactured dairy products.
 - f. These areas of competition were considered relevant in the 2008 Authorisation and are supported by DFMC.
 - g. The ten year authorisation period requested.

Public Benefits

19. In line with the 2008 Authorisation, DFMC submits that the milk supply arrangements have led, and will continue to lead to the following public benefits:
- a. certainty of supply for DFMC, Lion and DFMC members through continuation of existing milk supply arrangements
 - b. transaction cost savings and greater input into supply contracts for DFMC members and Lion, and
 - c. greater farmer input into milk pricing and milk policies.

Certainty of supply

20. DFMC submits that the concurrent ability of individual members to freely select the duration of their supply contract, and the guarantee that all of a member's milk will be acquired for the period of their supply contract, has resulted in increased farmer efficiency.
21. For example, DFMC notes that it has received member feedback that the ability to select a 3 year supply contract in the knowledge that all their milk will be acquired has provided them with increased certainty to make the necessary significant capital and other investments to improve their production processes and increase their long-term efficiency, contributing to

¹¹ In 2011, the ACCC granted authorisation A91263 for ten years, with conditions, to allow dairy farmers to collectively bargain the terms and conditions of their supply contacts with milk processors.

dynamic efficiency. Meanwhile, for other members, the ability to select a relatively short-term contract (e.g. 1 year) knowing that all their milk will be acquired, has enabled them to maximise their production of milk whilst maintaining the flexibility to switch to supplying an alternate processor, should the alternate processor offer more attractive commercial terms.

Transaction cost savings

22. DFMC submits that the 2008 Authorisation has reduced the need for individual farmers to gather their own information on milk prices and has reduced total administrative costs that would be incurred by hundreds of farmers individually seeking legal and business advice on the merits of entering into a supply contract with Lion. Lion too, is able to negotiate and determine pricing and supply terms with a single party.

Greater farmer input

23. DFMC submits that since the 2008 Authorisation, it has provided numerous services to its members that have led to greater farmer input in contract negotiations with Lion, as well as higher levels of farmer engagement and understanding of milk pricing, milk standards and supply terms. For example, DFMC notes that it holds multiple member meetings each year in every region. During member meetings, DFMC both provides information to members, and garners feedback from members on numerous topics including desired amendments to standard supply terms as well as milk pricing.

24. DFMC submits that increased input into contracts has led to more efficient outcomes including better farm practices, greater compliance with milk standards and pricing that is likely to more closely correspond to efficient raw milk prices.

ACCC view on public benefits

25. The ACCC accepts that the milk supply arrangements have, and are likely to continue, to provide substantial transaction cost savings for DFMC members, DFMC and Lion. The ACCC is of the view that transaction cost savings in undertaking a single negotiation process, rather than a series of individual contractual negotiations between the parties, would not be captured without the proposed milk supply arrangements. The ACCC notes that as of June 2012, there were approximately 600 DFMC members across Australia.

26. The ACCC also accepts DFMC's submission that its role in representing DFMC farmers extends beyond negotiating milk supply arrangements and extends to the comprehensive gathering of information on trends and pricing for dairy products both in the Australian market and the world market. The ACCC is of the view that DFMC members are likely to benefit from DFMC undertaking this information gathering and market research in preparation for negotiations on their behalf with Lion. This is also likely to further improve the transparency and reduce information asymmetry for DFMC farmers regarding market conditions.

27. Further, the ACCC is of the view that negotiations between DFMC and Lion, on behalf of DFMC farmers, are likely to improve the level of input DFMC farmers have in contractual negotiations by addressing common contractual issues, such as pricing, terms and conditions, timing and delivery, in a more efficient and effective manner.
28. The ACCC considers that the milk supply arrangements are likely to continue to result in public benefit through providing certainty for DFMC, DFMC farmers and Lion in terms of their rights and obligations in respect to the supply chain. This in turn allows all parties to make better informed decisions and provides certainty over the life of the supply agreements entered into.

Public Detriments

29. DFMC submits that the milk supply arrangements result in no significant public detriments. In relation to the potential effect on competition, DFMC submits:
- a. Factors identified in the 2008 Authorisation¹² continue to constrain the prices negotiated for milk.
 - a. DFMC's pricing has been in line with prevailing market prices since the 2008 Authorisation was granted.
 - b. Although exports as a proportion of milk production have fallen from approximately 45% to 38%, exports continue to represent a significant proportion of milk production, and world milk prices have a significant impact on Australian milk prices, including those negotiated between Lion and DFMC.
 - c. Even with the milk supply arrangements in place between Lion and DFMC, DFMC farmer members continue to be in a position to move their supply freely, either to third party processors or directly to Lion. Therefore, DFMC is not in a position to lock up a significant section of the farmer base or raise barriers to entry by expansion to other processors.
 - d. DFMC represents fewer members and less milk volume than it did when applying for the 2008 Authorisation and DFMC covers a smaller proportion of the farmer base than it did when the 2008 Authorisation was granted.

ACCC view on public detriments

30. The ACCC considers that agreements between competitors which influence the pricing decisions of market participants have the potential to result in allocative inefficiencies. That is, they can move prices away from levels that would be set in a competitive market. In this case, public detriment may arise if the prices negotiated were artificially higher or lower than they otherwise would be in the absence of the milk supply arrangements.
31. Public detriments may also arise if a horizontal agreement creates or enhances the potential for coordinated (rather than competitive) conduct on

¹² Authorisation A91089 Final Determination paragraph 6.43.

other matters that are beyond the scope of the agreement, as well as across the market more generally.

32. However, in this instance, and consistent with the 2008 Authorisation, the ACCC considers that the milk supply arrangements, have resulted, and are likely to continue to result, in little public detriment.
33. The ACCC notes that even with the milk supply arrangements in place, Lion can still acquire additional milk from entities other than DFMC, and/or directly from DFMC members. Further, the ACCC accepts that due to changes to farmers' contracts since 2008, farmers can now more easily terminate their contracts with DFMC by giving at least three months written notice.¹³ Further, farmers coming off contract have had the option to enter into new farmer contracts with DFMC for 1, 2, or 3 years. Shorter farmer contracts and more flexible conditions make it easier for farmers to supply other processors, or to seek to supply Lion directly should they prefer. Finally, the ACCC notes that since 2008, the ACCC has not received any submissions raising competition concerns from industry participants or competitors of DFMC with respect to the 2008 Authorisation.

Balance of benefits and detriments

34. For the reasons outlined in this determination, the ACCC considers that in all the circumstances the conduct for which authorisation is sought is likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the conduct in accordance with tests found in sections 90(6), 90(7), 90(5A) and 90(5B) of the Act.

Length of authorisation

35. The ACCC considers it is appropriate to grant authorisation for the period requested, that is ten years.
36. Authorisation A91089 was due to expire on 13 November 2013, in line with the MSA. However following a letter of extension between DFMC and Lion the MSA now expires on 30 June 2019, and could potentially be extended further. The ACCC is of the view that granting authorisation for a period of ten years is consistent with similar authorisations granted recently in the dairy industry. Further, the ACCC notes that the milk supply arrangements have been operating since 2008 without concerns being raised with the ACCC.
37. The ACCC notes that it may review an authorisation prior to its expiry if, among other things, there has been a material change in circumstances since the authorisation was granted.

¹³ Previously 6 months notice in writing was required, except in limited circumstances.

Determination

The application

38. On 8 March 2013, the Dairy Farmers Milk Co-operative Limited (DFMC), lodged an application for the revocation of authorisation A91089 and the substitution of a new authorisation A91364 with the ACCC under section 91C (1) of the Act (re-authorisation).
39. In order for the ACCC to re-authorise the milk supply arrangements, the ACCC must consider the application for re-authorisation under the same statutory tests as if it was a new application for authorisation under section 88 of the Act. The relevant sections are:
- section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act.
 - section 88(1A) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

Determination

40. For the reasons set out in this determination, the ACCC is satisfied that the tests in sections 90(5A), 90(5B), 90(6), 90(7) and 91C(7) of the Act are met.¹⁴
41. Accordingly, the ACCC revokes authorisation A91089 and grants a new authorisation A91364 in substitution. The substitute authorisation is to Dairy Farmers Milk Co-operative Limited (DFMC) to make and give effect to back to back milk purchasing policies and back to back milk pricing arrangements, under the Milk Supply Agreement between DFMC, DFMC members and Dairy Farmers Pty Ltd (Lion). The ACCC grants the substitute authorisation, until 25 July 2023.

Date authorisation comes into effect

42. This determination is made on 3 July 2013. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 25 July 2013.

¹⁴ See Attachment A.

Attachment A

Competition and Consumer Act 2010

Section 90—Determination of applications for authorisations

Section 90 (5A) states that the Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a proposed contract, arrangement or understanding that would be, or might be, a cartel provision, unless the Commission is satisfied in all the circumstances:

- (a) that the provision would result, or be likely to result, in a benefit to the public; and
- (b) that the benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:
 - (i) the proposed contract or arrangement were made, or the proposed understanding were arrived at; and
 - (ii) the provision were given effect to.

Section 90 (5B) states that the Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a contract, arrangement or understanding that is or may be a cartel provision, unless the Commission is satisfied in all the circumstances:

- (a) that the provision has resulted, or is likely to result, in a benefit to the public; and
- (b) that the benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision.

Sections 90(6) and 90(7) state that the Commission shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:

- the provision of the proposed contract, arrangement or understanding in the case of section 90(6) would result, or be likely to result, or in the case of section 90(7) has resulted or is likely to result, in a benefit to the public; and
- that benefit, in the case of section 90(6) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision was given effect to, or in the case of section 90(7) has resulted or is likely to result from giving effect to the provision.

Section 91C(7) requires the Commission, in making a determination to revoke an authorisation and substitute another authorisation, to apply the tests in section 90(5A), (5B), (6), (7) (8), (8A), (8B), or (9) (as applicable) as if the authorisation were a new authorisation sought under section 88.