ACCC Inquiry into the Australian Dairy Industry Issue Paper

9th December 2016

Issue 1 Competition for Milk

Loyalty Payments came into existence for Murray Goulburn in 2008 after competition for supply from Tatura Milk. Tatura Milk had loyalty payments that were conditional on the supplier supplying milk on a certain day after the end of the milk period for which the payment was obtained. In 2008 Murray Goulburn had a step down which made it "easy" for suppliers to leave the co-operative, with suppliers knowing they will be paid for their milk in step ups even if they leave. So Murray Goulburn changed the end of season step up to a loyalty payment to compete with Tatura Milk.

This form of competition has created a barrier to trade for suppliers as payment for a contracted period is conditional on supplying milk in another contracted period which may contain conditions or payments dissimilar to the original contract.

Productivity Incentive came into existence in the mid 90,s after Dairy Farmers (ACF) purchased Midlands Milk. Competition for supply was fierce and companies were chasing large suppliers to hurt companies that ventured into their region. I can recall the Chairman of Dairy Farmers explaining this new productivity incentive by saying, "we value all our suppliers large and small the same, however our competitors value our large suppliers more."

This form of payment is based on the volume of butterfat and protein supplied by a producer in a year and is incrementally based, so the more solids supplied the greater the incentive price paid per kg of butterfat and protein on the volume supplied.

In other legislation this form of incentive is non compliant, in particular, with rules set out in The Water Act 2007 for infrastructure operators. The Water Charge Infrastructure Rules prohibit infrastructure operators charging a customer different prices based on the volume their usage. The Rule only allows an infrastructure operator to charge the one charge per ML of water used regardless to how many ML's of water they use or the size of their operation. Also the Non Discrimination Rules determine irrigators being of the same class for charging of fees.

In this situation, if applying legislation from the Water Act, payments should be the same per kg of butterfat and protein regardless of the volume supplied. Each supplier is "of the same class" as the milk is the same and is distinguished only by the volume supplied.

This form of price incentive creates a barrier to trade based on the size of a suppliers operation and has created anti competitive environment for smaller producers to compete in the market based entirely on their volume of milk solids produced in a contracted year.

Issue 2 Contract Practices

Contracts have been set up in the past to attract new suppliers. In particular "new milk" contacts were implemented to include growth incentive for three years. These contracts were transparent in showing the incentive pricing however they did not show the supplier the price to be paid for their normal milk above the incentive milk for the term of the contract. For example if a supplier produced 2 million litres in the first year of new milk they received 100% payment at the new milk price for all milk. The second year they produced 2 million litres of milk and received new milk for 1 million litres and company price for the other 1 million litres. The third year of the contract the supplier would be paid 100% company price if they supplied 2 million litres of milk.

When contracts are drawn it should be clear what the term of the contract is, and the amount to be paid for all milk both company milk and growth incentive milk for the term of the contract. The company has an obligation to provide transparency in knowing it has a specific contract for a specific time for which the new milk is needed.

Minimum Price Paid Contracts are used by some processors to guarantee that a processor will pay at the minimum more than another processor. The processor is misleading in making this statement regarding a minimum price as some processors have used a general price as opposed to individual pricing so their supplier has not received exactly the same if they had supplied the other company. This minimum price payment can be remedied with the use of an opening price document so a supplier contracted to a company which advocates minimum pricing, can astutely determine that their company has paid the same as the processor they have nominated as the minimum price setter.

Issue 3 Transparency and Price Signals

5/ How the farmgate milkprices are communicated to producers

The source of communication of milk price is reflected in **income estimates**. The income estimate is a very complex document with prices generally quoted in three or four different methods on the one estimate. These methods are; c/per litre, $/kg of milk solids, $/kg of butter fat equivalent and $/ kg of butter fat and protein.

The income estimate prices are divided into fixed and variable pricing. The determinate for distinguishing fixed from variable pricing is in the **opening milk price document**. This opening milk price document should be treated in the same respect as the Schedule of Charges which apply to infrastructure operators and as so be compliant to the ACCC Rules.

This opening price document will determine how the milk price will be paid (what values will be used to determine the price paid eg paid per kg of butterfat plus price paid per kg of protein), for the following season with all deductions included. This opening milk price document should determine how prices are quoted on the income estimate throughout that year.

Recently, before the claw backs, I completed a farm business report for a farmer client who wished to purchase a property. The farmer provided an income estimate from a local processor which included three step ups to finish the year at $6.15/milk solid. The reporting of a canvassing price on an income estimate is having a perverse outcome on a farmers' decision to proceed in a business transaction to purchase a property and to supply a particular processor. The conflict is using income estimates for many purposes, these purposes include canvassing supply, bank loan requirement, communicating opening milk price with individual supplier milk quantities and quality to determine price, and consultant type production options.

An income estimate should be an income estimate based on averages of or actual previous production with the processor announced prices, this would mean that in providing an income estimate the provider is applying due diligence to the details provided much the same as is required in the finance industry. All what ifs and canvassing material should not be included on an income estimate but provided on a separate document tool called a company work sheet.

Many in the industry have called for price quoting to be the same for all processors so as to have a clear view of pricing compared to another processor. The example would be that all prices are quoted in dollars per kilogram of milk solids ($/kg of ms). By quoting $/kg of ms would mean a conversion from the opening milk price quotation in dollars per kg of butterfat plus dollars per kilogram of protein to $/kg of ms. This would have the effect of changing the fixed price quoted in the opening price document to a variable price quoted in $/kg of ms.

Processors quotes need only to contain fixed prices on their opening milk price document, any income estimate also should quote the fixed prices from the opening milk price document. However the processor should be able to provide actual prices paid both fixed and variable on their actual pay advice.

To be clear on fixed price quoting, it is the actual price paid for a litre of standardised milk or price paid for a kg of butterfat plus paid for a kg protein. The price $/kg of ms is a variable price as a formula is used to convert the butter fat and protein price to a milk solids price.

However if the processor quoted the opening milk price in $/kg of ms this would be the fixed price and the $/kg of butterfat plus price paid for a kg protein would then be variable.

Processors should not use averages to quote a fixed price to media. Fixed prices paid by processors vary from month to month, so to average this price has the effect of distorting prices. The simplest and most accurate way is to advertise the opening milk price in its entirety exactly the same as the Schedule of Charges under the Water Act with the prices paid in each month. However if the processor paid the same price each month of the year then a yearly average of the fixed price paid could be shown.

It should be also noted that the requirement to produce and communicate an opening price circular should not be mandatory, however if the processor elects not to provide a opening price circular then that processor should not be permitted to levy a volume charge or stop fee.

The opening milk price statement should include all the factory locations and other business's that the processor has included in their network for transparency in determining the volume charge price. If a processor fails to include a milk swap or sale to a business not listed as part of their network, no volume charge to the producers supplying this milk should be allowed. It can be reasonably argued that the producers providing milk to a business unlisted in the processors network on their opening milk price document are of a different class of producer from the network suppliers through location and/or milk quality or type and accumulative volume totals to fill a tanker.

The opening milk price document should be treated with the same rules as the Schedule of Charges under The Water Act (Water Charge Infrastructure Rules) document for infrastructure operators in only quoting fixed prices with deductions. Income estimates should feed directly from the opening milk price document with quoting of fixed prices only from actual production whether averaged or previous years. All other reporting of price should be on a company worksheet.

Issue 6 – Production costs and profitability

The average milk producer would feed grain at 1.8 tonnes per cow per lactation, and this could vary from zero to 3.5 tonnes per lactation. For most producers grain is the largest production cost to producing milk.

My concern has been the increase in on-farm storage of grain by grain growers since the abolition of The Single Desk Policy. Under this Single Desk Policy there was little incentive for growers to store grain on-farm as all grain was exported by a single trader and so growers binned and stored their grain with this export trader.

Now with on-farm storage many grain growers have been advertising binned grades of wheat for sale which have not been graded nor tested complete for binning.

To quote a wheat standard it must have been tested and variety checked then binned as that grade of wheat. Sales of wheat to dairy farmers are often quoted as ASW1 simply because the grain meets one of the criteria, i.e. meets test weight standard and looks good, yet fails on screenings and variety.

The advantage of quoting a binned grade of wheat (ASW1) is that it is transparent to see the price paid for that variety delivered to Port for export and then use this price to sell to a dairy farmer. The problem is the ASW1 wheat is exported or sold to local flour mills, and the grain that fails to be compliant with all requirements, yet having some characteristics of ASW1 is delivered to farm at the ASW1 export price.

The trend in the last eight years is for growers of wheat for domestic farm use to sell or market their wheat through a feed company. Often these feed companies are owned by the milk processor so through contract arrangements have access to the dairy farmers milk pay, so guaranteeing the grower of wheat a payment for their wheat with generous prompt payments.

This form of price control through advertising product not complicit with the standard quoted has created a barrier to trade in not allowing lesser product to meet the lower market price. Competition is less due to growers only selling feed quality grains to feed companies who then quote ASW1, dairy farmers cannot choose to turn away loads not complicit to the quoted standard as the dairy farmer has no option other then purchase because there is no avenue to purchase grain elsewhere.

I ask the ACCC to provide detail in legislation in advertising binned grain standards from growers and feed companies that have not been binned, yet advertised as a binned grade and then sold to dairy farmers often not meeting the binned grade standard that was advertised. The question is what steps are necessary for the advertiser of grain to ensure the grain advertised is compliant with the binned standards quoted?

Are growers and feed companies that on sell grain compliant with the Plant Breeders Act by advertising ASW1 wheat and not advocating the variety of wheat on the dairy farmers invoice and in so avoiding Plant Breeders payments?

Yours sincerely,

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