ACCC Perishable Agricultural Goods Inquiry Submission

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About NSW Farmers

The NSW Farmers' Association is Australia's largest state farming organisation representing the interests of its farmer members. NSW Farmers is Australia's only state-based farming organisation that represents the interests of farmers of all agricultural commodities. Our purpose is to build a profitable and sustainable New South Wales farming sector.

Our focus is not just on issues affecting particular crops or animals – it extends to the environment, biosecurity, water, economics, trade, and rural and regional affairs. Our industrial relations section provides highly specialised advice on labour and workplace matters.

Farmers across New South Wales produce more than $12 billion worth of food and fibre every year, including over $6 billion in exports, representing around one quarter of Australia's total agricultural output.

Our regional branch network ensures local voices guide and shape our positions on issues which affect real people in real communities. Our Branch members bring policy ideas to Annual Conference, our Advisory Committees provide specialist, practical advice to decision makers on issues affecting the sector, and our 60 member Executive Council is the final arbiter of the policies of the Association.

Executive summary

Farmers in NSW produce premium products that are valued domestically and internationally. Despite this, the profitability and sustainability of several domestic supply chains is threatened by pervasive power inequities. Whether there is a concentration of power at the retail or processor level, or both, farmers in these supply chains are exposed to risk through reduced bargaining power.

The dominance of a few major retailers in Australia has had a significant impact on farmers' profit margins. With only two retailers holding over 70 percent market share, there is a 'monopsony-like' (monopoly power of buyers) situation that allows these powerful players to dictate the value of fresh food items. The 'pricing wars' of these retailers on popular food items has largely resulted in these items receiving unrealistically low retail prices, hollowing out supply chain profits.

Equally, the processing stage of the supply chain has harmed farmers' profit margins. For some industries, the processor landscape is highly concentrated and the dominant players have significant control. This presents an immediate challenge to farmers' bargaining capacity, and results in adverse outcomes such as farmers entering contracts containing imbalanced terms.

Essentially, many of our farmers bear the brunt of uncompetitive markets. This situation directly threatens the profitability of farmers, but ultimately consumers will be negatively impacted through less product choice and innovation, volatility in pricing, and intermittent supply shortages.

There are endless examples of long-term value being destroyed in food supply chains owing to the undue power of supermarkets, processors and other intermediaries. As an example, because of the power asymmetry between poultry farmers and processors, processors have unfettered access to the cost structure of the farmer, setting their farm-gate price slightly above the cost of the farmer. Whilst at the same time issuing contracts with no provision for increased cost of production to be reflected in farm gate prices received.

This has meant farmers have not invested in productivity improvements as this pricing system makes investment unviable. Poultry farms are energy intensive, yet have been laggards in investing in cost reducing energy resources, as any reduction in their cost will reduce their farm-gate price. The result of the undue power in poultry supply chains means that the cost of production is being kept higher than what would be expected in a competitive market.

NSW Farmers has long advocated for supply chain competition failures to be remedied. The right policy settings could go a long way to achieving this. We support the strengthening of unconscionable conduct provisions in Australian Consumer Law, as well as the inclusion of the principle of fairness in the National Competition Policy.

Retailers and processors need to be held to higher account, and a future-focused solution needs to be found to the supply chain inequities plaguing many of our fresh food and dairy domestic supply chains.

Introduction

NSW Farmers welcomes the opportunity to provide feedback to the Australian Competition and Consumer Commission's (ACCC's) perishable agricultural goods inquiry.

Reforms to competition policy are a priority for the agriculture industry and NSW Farmers seeks action by the Australian Government to implement much needed change.

This submission provides analysis of the supply chains for several perishable commodities and then links these to shortcoming in current competition law along with improvements that can be made to expand the reach and effectiveness of the mandatory Dairy Code.

We do ask the ACCC to acknowledge the very brief consultation period provided for industry submissions, which has limited to some degree the information that could be gathered and the depth of consultation we have been able to undertake with our members and relevant stakeholders.

As such, we welcome the opportunity to engage in any further consultation process the ACCC may undertake through this inquiry.

Competition failures by industry

Power inequities exist across multiple fresh food and dairy supply chains. While particularly noticeable in the dairy, poultry meat and horticulture industries, there are also competition failures and imbalances in power across other perishable good supply chains, as per the scope of this review. The issues differ between the sectors, occurring to varying degrees and at different junctions along the supply chain, depending on the commodity in question. Below we have outlined the specific issues within each of the perishable good supply chains individually.

Dairy

There is a clear market power imbalance in the dairy supply chain. The market dynamics of the NSW dairy industry transformed with deregulation. Processors reset their businesses to an open competitive market model, and manufacturing had to adapt to higher costs of milk. Retailers also engaged in various strategies, initially with an increase in branded products and then the development of private label milk, which has since been discounted to drive market share. These changes have created pressure throughout the dairy supply chain as industry participants have had to compete for market share. The farmers who supply the market have also had to adapt and economies of scale have led to fewer and larger farms.

Relationships:

The Australian dairy supply chain has four distinct relationships: dairy farmer – processor; dairy farmer – retailer; processor – retailer; and, retailer – consumer. Each of these relationships is subject to power imbalances between participants. By virtue of their position at the beginning of the supply chain, farmers have limited opportunity to resist pressures and risk applied by the processor and retailer.

Farmer - processor

The competition in the processor sector plays a direct role in the bargaining position of farmers. In the dairy supply chain, competition between processors is limited as the market for the supply of raw milk is geographically restricted by the ability to viably transport milk for processing. The ACCC dairy inquiry found that geographic markets in Victoria and southern NSW have higher levels of processor competition for raw milk, with dairy farmers having up to eight processors competing for their supply. In contrast, farmers in the central milk pool, which encompasses most of NSW, typically have less competition for their milk. Farmers are at a serious disadvantage when it comes to negotiating contract terms or price particularly as in the fresh milk market.

Traditionally dairy farmers would not challenge the prices or terms offered by a processor, as any renegotiation or conflict would mean spoilage of their milk and loss of income. This situation has been improved with the introduction of the mandatory Dairy Code, with farmers now provided greater certainty and around pricing and terms. However farmers in NSW still operate in a more consolidated processor market, therefore limiting their negotiation power when dealing with processors and supply contracts. This differs from farmers in southern states, where there are far more processors, therefore more competition for supply, increasing the farmers options and leverage to negotiate.

Information disparity between farmers and processor continues to weaken farmers' bargaining position. Despite the implementation of the Dairy Code, many farmers are still faced with complex contracts that differ widely between each processor. This makes it difficult for a farmer to identify benefits in switching processors—if they even can—and increases the lack of transparency in the relationship. Steps to improve transparency and imbalance of bargaining power between farmers and processors, including the Mandatory Code, have been welcome however further steps are required by some processors in this regard.

Farmer - Retailer

The direct interaction between the dairy farmer and the retailer works similarly to the Farmer – Processor relationship. Both are marked by a clear market power imbalance and the difference in bargaining power enables risk to be passed onto farmers. The transfer of commercial risks means that farmers operate with a high degree of uncertainty. Although the current price paid by retailers is higher compared with that paid by processors, this pricing is underpinned by the drought levy which will be removed and direct retail contracts have only offered to a small number of farmers who are located close to markets.

Processor - Retailer

The Processor – Retailer relationship demonstrates that there is a strong link between the lack of competition in the processing sector and the end market of these products, being one controlled by only a few retailers. This correlation demonstrates the power and the ability of retailers to squeeze margins from the rest of the supply chain, particularly in establishing one-dollar a litre milk. As processors attempt to meet the fixed national price for dairy products set by retailers, their ability to pay farmers relative to their production costs becomes increasingly difficult.

The power of the supermarkets is reflected in the analysis below (*Figure 1*) by the ACCC in 2017. This work looked at farm-gate, processor and retail prices for fresh milk which highlights the strong bargaining position of the supermarkets, and demonstrates the lion's share of any increase in retail prices went to the retailer. The processor was able to access small increases in value while, regardless of price differentials in the retail price of private label and branded fresh milk, the revenue for the farmer remained unchanged due to them being in the weakest bargaining position. It ACCC also failed to compare this price / value distribution in current retail prices, to that prior to the introduction of $1/litre milk by the supermarkets.

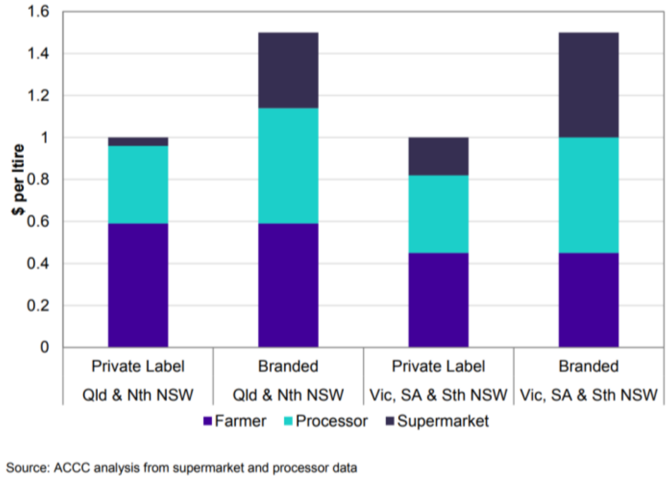

Figure 1: Distribution of Revenue from the sale of fresh drinking milk

Perversely, the ACCC used this data to conclude that 'dollar a litre' private label milk has no adverse impacts on dairy farmers, that the impacts were felt by the reductions in margins for the processor and retailer, and as such not a concern from a competition or market power perspective. This shows a lack of commercial understanding by the ACCC. Processors do not purchase milk from farmers for the specific purpose of supplying branded or private label milk. Any price pass-through to farmers will be determined by the average price obtained by the processor from the retailer. This means if the average retail price of milk falls, the average farm-gate price will also fall. This is why dollar a litre milk is viewed with such negativity by dairy farmers.

Retailer - Consumers

Australian consumers have a justified expectation that dairy products are safe and of high quality and retailers are able to meet this expectation. These products must also adhere to high standards of welfare, environmental management, and workplace relations. However, the desire for quality is accompanied by an expectation that the product will be low cost. The aggressive pricing of private label dairy products by supermarkets to the apparent benefit of the consumer highlights loss leading practices. These supermarket practices negatively impact the dairy supply chain, and many other perishable goods supply chains, by shifting profit margins to alternate products ultimately deceiving the consumer and triggering market failure.

Dairy farmers are highly concerned with the ability of the retailers to squeeze margins from the rest of the supply chain, particularly with $1 per litre milk. When the pricing campaigns for $1 per litre milk were introduced nationally in 2011 the retailers reduced their own brand milk by 25% over night. This had an immediate impact on processors who in turn had to reduce pricing on their branded products to remain competitive. Lost margins were pushed down to the farmer as the unreasonable discounting of milk continued. As NSW is largely a fresh milk market, there has been considerable loss of profitability and sustainability from the farm sector, forcing many dairy farmers to exit the industry.

In addition to domestic pressure applied by retailers, the importation of cheap dairy products from subsidised or lower cost of production countries devalues the dairy products across the entire chain. While free trade is important, the long term impact of heavily discounted overseas products is concerning. As processors look to markets with higher returns, Australian consumers may be left to purchase inferior imported products.

The recent drought has highlighted failures in the dairy supply chain and the inability for farmers to recover costs. A key risk for dairy farmers is the low margin business model where profitability has also been stifled by an inability to effectively negotiate pricing. Dairy farming input costs are significant, with considerable initial infrastructure costs to establish sheds, milk cooling facilities, quality herds and ongoing price pressures in relation to the core resources of energy, water, and adequate skilled labour.

Further, the impact of the drought on NSW dairy farmers has been significantly heightened in recent years, due to the reduced financial resilience of these farm businesses. The loss of profitability for the sector, the result of supermarket pricing strategies since 2011, has left dairy farmers with little financial reserves and therefore has reduced their ability to shoulder the financial impact of external influences to their business, such as drought. This in turn led to a greater need for government drought support for the sector.

Chicken (poultry) meat

Competition issues for farmers in the chicken meat supply chain are identical to those farmers in the turkey and duck meat supply chains. Poultry meat growers have almost no bargaining power with their processor as they now largely operate in monopsony environments where their processor controls their inputs, scale and turnover. Although many growing groups across Australia have authorisation for collective negotiation, it does not compensate for market failure. Processors have indicated that the terms of growing contracts are directly related to their inability to recover costs from their customers, including the major supermarket chains.

The concentration of the retail sector has hollowed out the chicken meat supply chain. Across Australia, 70% of the supply is controlled by two large processors, while just six processors control over 90% of the national poultry meat market.

In NSW it is a similar story. There are just two chicken meat processors who operate four regional plants, producing 35% of the national market. Just over ten years ago there were nine significant chicken meat processing plants in NSW owned by six different companies.

There are approximately 200 family owned contract poultry meat farmer businesses in NSW representing 60% of the NSW production. However recently a number of these farmers have been terminated or have not had their contracts renewed as the processors push toward corporate owned growing services. It is estimated that over 10% of family poultry meat farmer businesses operating across NSW in 2019 will exit the industry by the end of 2020.

Farmers are contracted to provide the land, sheds, equipment, utilities and labour necessary to grow the processor owned chickens (and turkeys or ducks). To be successful, farmers need long-term commercial relationship with a processor to meet financial obligations. Currently the contracts do not reflect these necessary long term timeframes.

The processor supplies the birds, feed, medication and pick up crews and remains in control or ownership of significant vital sections of the production system (Figure 1).

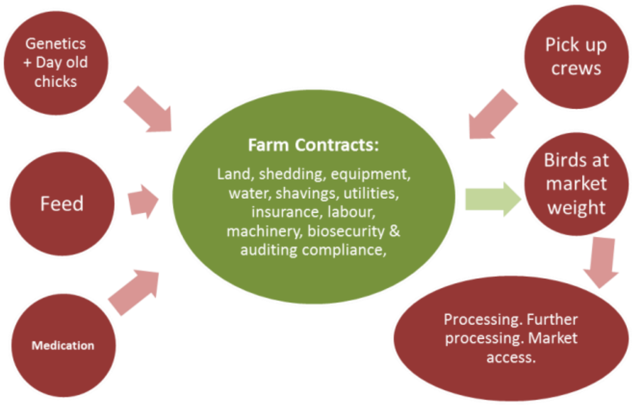

Figure 2: Contract poultry meat farming

Processors contract multiple farmers to raise their chickens and competition among processors for acquisition of chicken grower services has reduced in NSW due to the loss of processor competition.

Farmers are unable to switch between processors, even at the end of a contract term, due to their fixed geographic location and absence of any competitor processor. They are also unlikely to voluntarily leave the growing services sector due to the specific use of their farm infrastructure and the high expense of converting to alternative enterprises.

Growers have significantly less bargaining power during contract negotiations due to the regional monopsony environment that exists in the poultry meat industry. There is also significantly more financial risk for growers than there is for the processors in terms of holding and renewing contracts.

The market for chicken meat is national in contrast to the contract growing services which are geographically specific. Therefore, large processors have the ability to source and supply product on a national scale and vary their demand for individual growing services.

The poultry meat processors actively encourage investment in infrastructure across the country resulting in an oversupply of shedding. The processors take no responsibility for their growers, who are effectively employees, when the plant closes or reduces production. Family farmers are left with devalued or stranded assets, no viable alternatives and unfair contracts. As a current example, the group of 15 farms near Lismore in NSW have been left with no local processor, a significant reduction in farm values and complete loss of income. Farmers have no control over these types of business decisions made by processors and contracts offer little protection.

The farmers continue to highlight concerns around a lack competition and transparency in the poultry meat sector. Farm gate prices vary considerably, are not publicly available and are determined by the terms and conditions of individual contracts. Farmers are contractually obliged not to disclose the details of their contracts, including their payment terms. The lack of transparency and information deficit means farmers are unable to compare their contract price with others being offered, placing them at a distinct disadvantage when negotiating contracts with processors. Despite the growth in consumption of poultry meat and increasing contractual demands on farmers there is a negative trend in returns for contract growers. The retail price of chicken meat has remained stubbornly low in comparison to other meat products demonstrating the inability for cost recovery at that end of the supply chain also.

Horticultural produce

There is a significant value gap between returns to horticulture growers and the price at the supermarket checkout. In the past we have asserted that this gap indicates the major participants in the supermarket trade are obtaining disproportionate value. Supermarkets in particular continue to demand often unreasonable produce specifications that reduce growers' returns and create food waste issues.

While we acknowledge the development of the Grocery Code as a potential tool to remedy these problems, its capacity to motivate change is limited by it being voluntary. The refusal of key players to sign up to the Code means that it is generally ineffective, and the Code itself is seen to favour the retailers and not address the balance of power. NSW Farmers submits that wholesalers and retailers should operate under identical obligations when dealing with growers, particularly given that the majority of fresh horticultural produce is bought by supermarkets. Any entity that purchases horticultural produce from growers for on-sell should be bound by the same conditions.

Growers at markets still report issues with Horticulture Produce Agreements (HPAs), noting the lack of enforcement of HPA terms. A power imbalance between growers and wholesalers leaves growers feeling that they are vulnerable to retaliation when disputing HPA matters. The step towards alternative dispute resolution by embedding produce assessors in markets is positive, but more on-ground enforcement by the ACCC of non-compliant contracts and behaviour is required to change the culture within these marketplaces. Strong enforcement will send a message to wholesalers about the importance of the Horticulture Code. Many wholesalers are still operating without contracts, or are demanding that growers sign generic contracts that maintain the imbalance of power.

Organic producers have raised concerns about supermarket pricing structures for their produce. Continual downward pricing pressure reduces the cost of organic to be on par with conventional produce, and doesn't take into account the additional costs required to produce under strict organic conditions. This is leading some growers to walk away from their organic operations, but is also warping consumers' perception of the true price of organic produce.

Eggs

Egg farmers in NSW produce almost one third of Australia's eggs.[1] These farmers supply eggs into various markets, including the retail market, hospitality, fruit shops, wholesalers, food manufactures, food service, QSR's, local markets, corner stores and also direct to consumers.

The supply of eggs is highly competitive. The egg industry differs from the dairy and meat product supply chains as layer farmers do not deal with a processor. Layer producers have the ability to sell and market directly to buyers more easily because complex processing of their product is not

[1] Australian Eggs Annual Report 2018/2019

required. Unlike supply chains where large intermediaries are present, egg pricing can change rapidly in response to supply and demand.

The egg industry is also not entirely domestic. Australia imports egg products and finished products of which egg is an ingredient. Therefore, our producers are also competing with farmers from countries that have very different employment laws, wage structures and social structures.

Almost 45% of eggs[2] are sold to the major supermarket grocery chains. Producers who supply supermarkets directly are generally unwilling to speak up about any concerns regarding business dealings with the large retailers due to the high risk of reprisal. This fact alone demonstrates that there is an imbalance of bargaining power at this level of the supply chain.

The power imbalance of the retailers can be demonstrated by their ability to force systemic changes to the industry by imposing a customer policy of phasing out caged eggs. This move is not consumer led and cannot be justified on animal welfare grounds. Supermarkets have the power to manipulate the supply chain to push product with higher profit margin onto the consumer while limiting their choice. Further impacts on the supply chain would occur if the supermarkets enter the food supply services.

The move to more private labelled lines by the retailers also has an impact on the egg farmers within the supply chain. The focus on private labelled eggs not only reduces choice for consumers it enables supermarkets to minimise the number of suppliers they deal with, hollowing out the supply chain. This is evident with our big two retailers where the supermarket with less focus on their private brand has more suppliers.

The risks for egg farmers, which cannot be effectively priced into the product due to the influence of large retailers on the entire supply chain, include;

- uncertainty around the Standards and Guidelines for welfare. This process has been ongoing for 7 years and if finalised, would provide farmers with clarity and possibly a greater incentive to invest in their farming system.
- the Avian influenza outbreak in Victoria has highlighted the risk of disease outbreaks on egg producers. With increasing numbers of outdoor poultry systems and higher risk of these types of outbreaks, farmers need the ability to price risk into their product.
- increasing expense of, or inability to access, adequate insurance for both property and liability.
- access to finance/credit has become more difficult which will have an impact on re-investment.
- increasing cost of compliance for poultry producers. This is dependent on the market they supply and farmers may not be able to cost this into their product either.

Pork

The pork industry is different to other livestock industries in Australia. It is less export focused and has to compete with imported products for retail space.

Approximately two-thirds of processed pork products (which includes ham, bacon and smallgoods) are made from imported pork. All fresh pork is Australian, with only 13% of Australian pork being

[2] Australian Egg Farmers Annual Report 2018/2019

exported. The Australian pork industry's reliance on the domestic market exposes it to the dominance of Australia's supermarket duopoly. Generally supermarkets are the only purchaser of pork/pigs that will offer a long term contracts. Given the market share of the two major supermarkets, this in turn creates an unbalanced negotiation, were the retailers have the ability to dictate prices.

Pork marketing strategies of the major retailers also focus on the freshness and high animal welfare standards imposed on fresh Australian pork they sell. These standards are a positive position for the industry as a whole to take, but does drive up the cost of production. This in turn increases the competitiveness of imported pork into the Australian market, without these same standards imposed on producers in exporting countries. These marketing strategies also have the ability to mislead consumers who are unaware and unable to differentiate between what is classed fresh Australian pork, and what are processed pork products made from imported pork meat.

The pork sector is also an extremely concentrated industry with 72% of pork production in NSW delivered by only 2% of the state's pork producers. The remainder of the industry is made up of small-scale pig farms.

The pork processing sector is equally as concentrated. There are only five (5) abattoirs in NSW that process pigs. This means there are long freight journeys for many pigs from farm to abattoir. It is common for pigs produced in NSW to have journeys of more than 4 hours to an abattoir. As a result producers have a lack of choice as to where their pigs go. Any associated transport costs are borne by farmers – who have no way to recoup them.

It is also important to note that one of the state's largest processors, Rivalea, is a private abattoir that slaughters only Rivalea pigs. This means that NSW pig producers, excluding Rivalea, essentially only have access to four processors options. Given the lack of processors in NSW, many pigs from southern NSW are transported to Victoria for slaughter, where they are subject to the Victorian Compensation Levy, further increasing their costs.

Pork producers also have reduced access to abattoirs for halal certification reasons. An abattoir can only retain its halal certification if pigs are processed in a separate area to other animals. This is a compliance cost that only affects the pork industry.

The above demonstrates a number of competition issues within the pork industry. The industry's lack of export market makes it extremely reliant on domestic consumption and the major two supermarkets, who given their market share, benefit from the power imbalance in negotiations.

The pork processing sector is also very concentrated. It is small and lacks competition. Therefore smaller farmers have very few options for selling their pigs and the large integrated companies with both production and processing capability have been known to exploit this to their benefit.

The pork processing sector needs to be more competitive and pork producers need long-term certainty that processors will purchase their pigs. The retail sector also needs to improve its labelling so that local pork products are not competing with lost cost imports.

Beef

NSW is the second biggest beef producing state in Australia. At present there are 4.7 million cattle in NSW, produced by nearly 12,000 farming operations. Each year close to 2 million cattle are processed in NSW for human consumption with much of the meat produced exported overseas. Around 30% of the beef processed is for consumption in the domestic market.

In the cattle industry there are a range of different sales channels. The four basic sale methods in New South Wales are:

- Saleyard auction (approximately 60 per cent of sales);
- 'Over the hooks' (OTH), directly to the processor (up to 20 per cent of sales and increasing each year);
- In the paddock, directly to the processor (up to 20 per cent of sales); or
- Online (less than 5 per cent of sales

While beef producers have a range of sales channel available to them, none of the channels are overly transparent. A Senate Inquiry in 2015 found that there was some evidence of the major buyers colluding during saleyard auctions.

The same Senate report also found that processors' pricing information[3] was not publically available, nor when it was available was it presented in a standardised format. It found the lack of transparency around OTH pricing made it difficult for producers to make informed sales decisions.

The 2015 Inquiry also raised the following concerns with the current system of grading meat, finding that it lacks transparency and accountability, with grading undertaken by individuals (generally employed by processors) by way of visual assessments. It concluded that grading is inherently subjective and often inaccurate. It was hoped that new objective carcase measurements (OCM) technology would remove these issues with grading, however it hasn't. The current uptake of OCM amongst processors remaining low.

Another supply-chain issue the cattle industry faces is the consolidation of the NSW processing sector, which has led to a decrease in the number of abattoirs in NSW. As a result farmers can be forced to transport their cattle for longer distances than was required in the past. This has an impact on the cost of the transaction and the final price that a farmer will received for their produce.

Additionally, any NSW cattle traded through the Victorian system attract a Victoria state based duty, adding an unnecessary transaction cost for cattle or dairy producers. Whilst possible, the lengthy administrative process in place makes it difficult and time consuming for NSW producers to reclaim this duty.

In summary, the absence of a competitive processing sector means that abattoirs have significant influence over cattle prices. They also link farmer payments to a subjective grading method which could be misused, i.e. by downgrading meat, to reduce the payment made to beef producers. To

[3] In the form of OTH pricing grids.

counter the undue influence of processors, and their ability to distort cattle prices, the ACCC must implement all 13 recommendations from the 2015 inquiry.

Lamb

NSW produces about one third of Australian lamb support but slaughters only 23.6% per cent of the nation's total. Victoria slaughters over 43% of Australia's lamb as most of the major lamb processors are based there. This can cause supply-chain issues in the lamb industry that were recently exposed by COVID-19 and the Victorian restrictions.

When Victorian processors were required to reduce their staff capacity to meet the Victorian Governments COVID restrictions, prices for lambs fell in NSW. In some NSW saleyards, such as Wagga Wagga in the south of the state, the price for lambs fell nearly 50%, demonstrating the influence of Victorian lamb processors on NSW lamb prices.

The supply-chain issues identified in the cattle industry such as collusion of buyers at saleyards and visual assessments, are also prevalent in the lamb industry.

Shellfish

The NSW oyster industry has reached a point of relative equilibrium, whereby growers are generally obtaining healthy profit margins. However, only three to five years ago when the majority of oyster businesses sold directly to processors, growers had very little market power. They would typically make unsustainably low profit margins and were not receiving price increases aligning with the Consumer Price Index.

With no NSW standardised grading model, there was little to prevent processors from buying as a certain grade but selling on at a higher grade. Many growers had intergenerational relationships with processors and wholesalers and were extremely reluctant to do anything that might damage these relationships.

The ability of the oyster industry to regain some market power can in large part be attributed to many growers joining seafood 'marketing' companies such as Blue Harvest, Australia's Oyster Coast, Signature Oysters and East 33. While the models of these companies vary, they have all acted to generate collective bargaining power for oyster growers. The companies have been able to secure higher prices from processors and wholesalers, which then flow on to oyster growers.

Competition Challenges and Solutions

Australian farmers are not only exposed to highly distorted international markets, but highly concentrated domestic retail and processing markets. Having to deal with large organisations with significant market and bargaining power, has meant that the margins of farmers have been further squeezed, often below the cost of production. This will mean less money spent on capital investments and innovation, and will ultimately erode our food production capabilities.

The undue power of the supermarkets affects farmers in two ways:

- Producer surplus is appropriated by supermarkets from farmers who are direct suppliers; and
- Removing surplus from the food supply chain subsequently compels processors and manufacturers to squeeze the margins of farmers.

Australia has the most concentrated supermarket sector in the world, with a 70% market share for the largest two chains (Coles and Woolworths – 'the big two'), and 90% market share in the hands of just four supermarkets. It is also one of the most concentrated sectors in the Australian economy (Grattan Institute 2017).

Policy reform

Small business, particularly farmers, within food supply chains have been let down by competition policy in Australia. There has been a failure to address the significant and undue power of supermarkets, large intermediaries and processors. This is the result of gaps in the policy framework that unintentionally focus on short-term consumer benefit to the detriment of value creation, and gaps that fail to address monopsony-like power in supply chains.

Review of Unconscionable Conduct Provision

A possible way of holding dominant players in supply chains to account is through stronger unconscionable conduct provisions in Australian Consumer Law. These provisions are among the few avenues available to farmers in challenging the power of supermarkets and processors. Unconscionable conduct provisions in their current form are difficult and resource-intensive to prove. In order for allegations of unconscionable conduct to be successful, specific evidence around harm of a competitor is often needed, and an investigation is typically required to obtain this evidence. A review of unconscionable conduct provisions is needed to understand how they can be made more accessible to farmers in challenging supermarkets and intermediaries.

Adequate funding must be also be dedicated to the ACCC in progressing cases relating to unconscionable conduct. In *ACCC v Woolworths* (2016), it was noted in the judgment that the prosecution failed because the ACCC had not gathered specific evidence on harm of a competitor. Farmers cannot be failed at this step.

Unfair Contract Term Protections

A key area of the Australian Consumer Law (ACL) that must be addressed is the strengthening of the Unfair Contract Term (UCT) protections for small businesses.

The UCT protections were extended to cover business-to-business contracts in 2016.[4] The intent of this change was to protect small businesses from unfair contract terms in standard form contracts. This reform acknowledged that small businesses generally lack the bargaining power, time and expertise to negotiate or assess these contracts.

These reforms have been insufficient to properly protect many farm businesses from UCTs. Farmer businesses are still exposed to UCTs in standard form contracts across many perishable goods supply chains. NSW Farmers considers that a number of changes are required to help better protect our farmer small business operators against UCTs in standard form contracts.

First, there must be an effective deterrent to prevent issuing companies adopting UCTs. Currently, the inclusion of UCTs in standard form contracts is not a breach of the Australian Consumer Law. There is no pecuniary penalty for including UCTs in standard form contracts and compliance is proving very difficult without an incentive for contract-issuing businesses to remove the UCTs.[5] To be effective, the inclusion of UCT in standard form contracts must be a breach of the ACL and there must be significant penalties for contract-issuing businesses.

Second, the thresholds need to be lowered to recognise the impact on many small farming businesses. Amendments to the small business definition for UCT provisions are necessary to ensure that farm businesses are protected. The thresholds for the UCT provisions must be amended to acknowledge small businesses by expanding the current headcount and turnover thresholds, and removing the contract value requirement.

Finally, greater clarity is needed around what constitutes a standard form contract and the ability to effectively negotiate. It is not always clear if a contract is a standard form contract and throughout agricultural, particularly heavily consolidated fresh food supply chains, small farm businesses may not have a choice around accepting a contract.

Under the current regime contract-issuing businesses have the opportunity to circumvent the UCT provisions by making minor amendments to contracts and indicating that they are providing an opportunity to ‘negotiate’. UCT provisions must consider contracts containing ‘repeat usage’ clauses and further clarify the types of actions which do not constitute ‘an effective opportunity to negotiate’.

NSW Farmers’ considers the following must be considered:

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[4] Treasury Consultation Regulation Impact Statement, December 2019.
https://consult.treasury.gov.au/consumer-and-corporations-policy-division/enhancements-to-unfair-contract-term-protections/

[5] ACCC Submission, December 2018.
https://www.accc.gov.au/system/files/ACCC%20Submission%20to%20the%20Review%20of%20Unfair%20Contract%20Term%20Protections%20for%20Small%20Business.pdf

- Include in standard form contracts that UCTs must be identified as a breach of the ACL. Breaches must attract sufficient pecuniary penalties to deter businesses from including UCTs in their contracts with small businesses.
- The regulator of UCTs must have the ability to commence court proceedings on behalf of a class of small businesses.
- Expand the threshold of the UCT provisions to include contracts where at least one party to the contract is a business that employs less than 100 employees OR has an annual turnover less than $10 million.
- Remove the contract value threshold of the UCT provisions.
- Amend the UCTs to further clarify the types of actions which do not constitute an effective opportunity to negotiate and also to take into account ‘repeat usage’ of core contract terms.

Forced Divesture:

There is an inability for Australian competition laws to manage the power of the retailers, in particular the two largest supermarkets. This has been clearly demonstrated by the lack of prosecutions, including adequate fines, against supermarkets despite numerous complaints. Consideration to strengthen the ACL needs to include the option of forced divesture to ensure there is a maximum share a single business can have of any one market, such as 20%. This could be the key change that drives competition and ensures there are alternatives for both consumers and suppliers. The forced divesture of large supermarket chains and intermediaries may be the key to re-balance the supply chains for perishable goods and enable fair and equitable trade between suppliers and retailers.

Principle of fairness

NSW Farmers believes that the National Competition Policy needs to be adjusted to recognise the principle of fairness. Fairness is not an implicit or explicit principle in the ACL, and it only appears in the ACCC’s organisational mandate where it states “the ACCC promotes competition and fair trade in markets to benefit consumers, businesses, and the community”. Other jurisdictions, such as the European Union, have specific fairness provisions that look at bargaining power and ensuring viable supply chains. Similar provisions need to be introduced in Australia to ensure fairness is recognised in contractual arrangements between farmers and processors.

Fair Dealings Provision

Delay in settling invoices is an issue across all sectors of the economy. Maintaining a healthy cash flow situation is vital to business continuity, supplier certainty and business confidence. Small and medium enterprises often bear a disproportionately high burden from long delays in the settling of invoices. This practice is unfair.

The NSW Farmers believes that, if the commodity supply chain is competitive there is a strong relationship between farm-gate prices paid to farmers and the final retail price. In uncompetitive markets the relationship between farm-gate and retail prices break down. This is more to do with the ability of the processor or the retailer not to pass on the economic surplus of the transaction down the supply chain or to the consumer. Farmers, as price takers, tend have the weakest bargaining position in the supply chain.

Competitive retail markets are a necessary but insufficient measure to ensure a closer link between retail and farm-gate prices. The retail market for fresh food or groceries can be competitive, but if certain stakeholders within the supply chain have substantial market power, the economic surplus from the sale of fresh food and groceries will not find its way to the farmer. There does not have to be a contravention of market power regulatory provisions for the link between farm-gate and retail prices to break down. This has been demonstrated in the dairy supply chain, and by the recent ACCC report into the dairy industry. The subversion of price signals in the supply chain is a market failure that leads to poor economic and social outcomes.

Resourcing for compliance and enforcement

To reiterate an earlier point, the competition framework needs to be overseen by a well-resourced entity within the ACCC to ensure the functions of compliance, enforcement and investigation are adequately maintained. The cost of third party legal action is unfeasible for most farmers and small businesses, and the power imbalance between farmers and processors means that many farmers will be reluctant to provide evidence against processors out of fear of being locked out of supply chains. Therefore, the ACCC needs to ensure it is adequately equipped to carry out enforcement and compliance.

Enabling third party enforcement: Cost effective dispute resolution and access to justice

Access to justice for small businesses and farmers is essential for the functioning of Australia's competition law. The lack of enforcement and compliance activities with respect to competition law has been detrimental in establishing the behaviours and outcomes we expect from organisations governed by these laws. As previously mentioned, the ACCC's remit is broad and its resourcing is in all likelihood not commensurate with this broad scope. In the absence of a regulator equipped to relentlessly enforce the law, third party action can partially assist in ensuring adequate enforcement and compliance of competition provisions. Given the above, consideration must be given to introducing:

- A no cost order mode of litigation for small businesses and farmers where a prima facie review demonstrates that the litigation is not frivolous or vexatious; and
- Alternative low cost options for small business and farmers for competition related arbitration and dispute resolution processes.

Collective bargaining

Ideally, collective bargaining should provide farmers with an opportunity to redress the balance of power that large buyers have over the smaller farm businesses. Realistically though, the process of negotiating contracts in the perishable supply chains is rarely fair or balanced. In highly concentrated supply chains, such as poultry meat or dairy, the collective negotiation process can be undermined or completely ineffectual. Key reasons why collective negotiations may not succeed include the following.

Monopsony Environments
Many farmers are faced with a limited number of buyers for their goods and services, particularly within the perishable supply chains. Farmers may have no choice of which buyer they contract to due to their geographical location and unviable freight charges. There has been a loss of buyers from a number of perishable supply chains such as pork and poultry meat resulting in monopsony arrangements. Farmers lose leverage and the ability to effectively negotiate, even collectively, when there is no choice but to deal with a single buyer.

Staggering End Dates
Collective negotiations are undermined by staggering the end dates of contracts for individuals within the mutual group. These varied end dates effectively split up the group so those individuals or small groups whose contract is up for renewal are treated differently from the rest of the farmers for that period of time.

"Sweet-Heart" Deals
Individuals or smaller groups within a larger collective can be approached and offered better deals. These individuals may be less equipped to negotiate contracts, may have higher debt loads or may be offered incentives that are not provided to the rest of the group. Fragmentation can also be encouraged by grouping farmers together based on area or production system when contracts offered are largely standard form across all groups. Individuals or smaller group can then be leveraged against other collective groups.

Extending Collective Deals
Individuals who do not to participate in collective negotiations are often extended any enhancement to contract terms that the collective group have negotiated. This actively undermines the value of being in a group and, as there may be costs incurred for participating in collective groups, encourages farmers to act as individuals rather than part of a collective.

Targeting Group Representatives
Farmers report that they are concerned that they will be or have been targeted when acting as a group representatives or delegate. There is genuine fear amongst farmers if they speak out or act as a group representative there will be negative repercussions for their business in the future. This is a common concern across multiple supply chains where farmers feel powerless to speak up but one such example being poultry meat growers not being offered contracts renewals.

Transparency & Inconsistency
Farmers across multiple supply chains have no transparency over what deals are being offered to other farmers outside of their collective group. For some supply chains, payment systems vary so widely that there is an inability to make a direct comparison between the offerings. The inability to compare and contrast the deal being offered or to know what other groups/individuals have agreed to puts farmers at a distinct disadvantage.

Other shortfalls in Collective Negotiations
Authorisation to collectively negotiate is generally voluntary which enables large buyers to directly communicate with individuals involved in collective negotiations. This can happen when the larger

group may not agree to the terms and farmers are then individually approached to negotiate the terms of the agreement.

Farmers involved in negotiations with large buyers can be pressured using a number of other tactics including stalling negotiations, negotiating during uncertainty/market instability, not allowing time extensions to finalise negotiations, preventing the supply/receipt of product, directing communication to individuals rather than the group representatives. The use of authorised collective negotiations does not prevent the use of these tactics nor correct market failure where competition is inadequate.

Codes of conduct

Through industry codes of conduct, the Commonwealth Government (through the ACCC) can investigate unfair payment terms and can, where a breach of competition policy occurs, consider remedies at law. There are many industry codes of conduct which exist across the agriculture sector – recently, the ACCC recommended the adoption of a mandatory code of conduct for the dairy industry. The horticulture industry now has a mandatory code of conduct, with a voluntary code having first been put in place in 2007. At present, a review is taking place into the Food and Grocery Code of Conduct, a voluntary code which regulates trade between supermarkets and their suppliers.

NSW Farmers notes commentary on the food and grocery code by Graeme Samuel AC, the independent chair of the review into that code. Mr Samuel suggested that this code should be applied on a mandatory basis[6]. While codes of conduct assist in the regulation of trading arrangements, there remains an enormous power imbalance between small and medium tier suppliers and multi-billion dollar supermarkets, and their supply chains – all the 'good faith' negotiation provisions in the world cannot prevent the abuse of market power between a farmer with a time-sensitive crop or product seeking a buyer of those goods at a fair price.

Inefficient Supply Chains

Moving produce from paddock to plate in an efficient and timely manner is essential to product quality, freshness and food safety. New South Wales has some of the longest agricultural supply chains in the country, with Grain Growers Limited finding that transport costs can account for up to 40 per cent of farmers' post-gate costs.

Inefficient supply chains will exacerbate issues with the accessibility and affordability of fresh food in some communities within the Sydney catchment. The Institute of Sustainable Futures has forecast that the Sydney catchments ability to meet the region's food needs will decrease from 20% currently to 5% within the next twenty years. This will add to the cost of fresh food within the Sydney region through additional food miles. One solution is to improve the efficiency and reliability of the food supply chain.

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[6] Ex-ACCC boss Graeme Samuel recommends major changes to grocery code of conduct, Australian Financial Review, 23 May 2018 http://www.afr.com/business/manufacturing/exaccc-boss-graeme-samuel-recommends-major-changes-to-grocery-code-of-conduct-20180523-h10fms

Agricultural supply chains have changed. Historically, locally-grown produce was picked, packed and distributed at local distribution centres throughout regional areas. Increasingly, however, produce is picked locally and sent to more centralised packing and/or distribution centres, often located long distances from the place it was grown. These 'value added' products are then shipped back to the regional areas they were grown in and sold to consumers at a price significantly above the farm-gate price paid to the farmer.

NSW Farmers has identified, as part of our 2019 FOCUS agenda, and more recently our COVID Reform Plan released in September 2020, the need to increase regional capacity to value add food products. By value-adding in regional areas, new jobs are created and the ability to shift from growing food as a commodity toward niche production is enhanced. To support this shift, however, governments must invest in the infrastructure which enables regional communities to thrive – be it road and rail infrastructure through to investments in social infrastructure, tackling rural crime and ensuring the liveability and attractiveness of our regional centres.

There are efficiencies to be gained from co-located packing and distribution facilities, however they must be connected to efficient and reliable transportation opportunities for the produce. NSW Farmers has, therefore, championed a Fresh Food Precinct at Western Sydney Airport which includes dedicated freight pathways between the airport, distribution and value-adding centres and improved connectivity between Sydney and nearby agricultural areas.

Dairy Code

NSW Farmers welcomed the introduction of the mandatory Dairy Industry Code (the Code) on 1 January 2020 as an instrument to provide a fairer process for negotiating contractual arrangements between dairy farmers and dairy processors, however remain disappointed at the exclusion of the retail sector from the remit of the Code.

With the Code only enacted at the beginning of this year, there has been limited opportunity for the industry to fully review its effectiveness or impact on the sector, in particular prices received at the farm gate for dairy producers in NSW. Despite this, outlined below are some of the impacts acknowledged to date, both positive and negative.

Inclusion of the retail sector

The greatest weakness in the Code is the exclusion of the retail sector from its remit. There have been welcome developments in the dairy farmer – processor relationship under the Code, however the greatest impact on profitability of NSW dairy farmers remains the detrimental pricing behaviours of the retail sector.

The introduction of the $1/litre milk in 2011 reduced the price of private label milk by 25% overnight, and forced branded milk processors to do the same to remain competitive. Over eight consecutive years this has stripped the profitability out of the NSW dairy industry which predominantly supplies the fresh milk market. Dairy farmers have been most significantly impacted by this decline in profitability given their position at the end of the supply chain. This has in turn driven a decline in the number of dairy farm NSW and nationally, with many forced to leave the industry.

Retailers have continually ignored pleas from industry for an increase in price given the imbalance of market power and the lack of competition in the retail sector, as has been highlighted in previous sections of this submission. The deficiencies of commonwealth competition laws have allowed this imbalance of market power to occur, and the omission of the retail sector from the Dairy Code has made it an ineffective instrument to offer farmers the protection they need from the irrational pricing practices of the major supermarkets.

In addition to the competition law reform required and called for within this submission, the retail sector must be brought under the Dairy Code to ensure both farmers and processors protections within the dairy supply chain. This will be key to ensuring the long term sustainability of the Australian dairy industry, driving profitability back into all levels of the supply chain.

Retrospective pricing

One of the greatest impacts of the Code has been removing the prospect of retrospective price step downs in the future. This is a welcome protection for dairy farmers across NSW and nationally, following the devastating impact on farmers in 2016 when processors like Murray Goulburn instigated such a move.

Transparency in pricing

Under the Code, processors are now required to post their minimum price online by 1 June each year, one month prior to contracting. This development has been largely praised by dairy farmers as it affords them the opportunity to compare prices offered between the various processors.

The deficiency in the current Code is that processors are only required to post their minimum prices online, as was the experience in 2020. Inclusions and exclusions differ from one processor to the next, and given a range of quality parameters such as Bulk Milk Cell Count (BMCC), fat and protein that impact the final price, it remains difficult for farmers to accurately compare the prices on offer.

As such, NSW Farmers propose that the terms of the Code be amended to require processors to post their full pricing structure online on 1 June annually, to deliver full transparency and the ability to compare contract price terms between processors accurately.

Finally, the Code was intended to encourage non-exclusive contracts, allowing farmers to deliver to multiple processors. Unfortunately this outcome has not been delivered with processors offering exclusive and non-exclusive pricing structures, with a significant price penalty for entering into a non-exclusive supply contract.

Certainty in pricing

The introduction of longer term supply contracts and the timing of the minimum price release one month ahead of contracting have both been positive for NSW dairy farmers. The practical impact of this pricing certainty is the farmer's ability to plan and budget operations in advance, providing stability and certainty to their farm business for the season ahead.

There continues however, to be a reluctance to pay premiums for milk products when prevailing seasonal conditions such as drought drive up the cost of production. During these times the cost of inputs such as feed and water increase exponentially negatively impacting profitability.

The retail drought levy applied to private label milk by the major supermarkets has delivered limited impact to farm gate prices, with only some producers receiving any price benefit and of those who do, only a small margin of the retail levy amount. Further, it continues to ignore the longer term devaluation of milk and dairy products which have driven down farm gate prices and stripped the profitability out of NSW dairy farming.

Supply contracts with processors

The Code has delivered a positive impact on industry by highlighting the importance of contracts between producers and processors. Further, it has provided dairy farmers more certainty with the availability of longer term contracts.

The introduction of the Code however, has not seen processors deliver more simplified supply contracts across the board. Despite industries best efforts to develop standardised and simplified contracts templates, many processors have failed to adopt these, leading to unnecessary confusion for farmers trying to interpret the supply contract terms, and making comparison between processor contracts more difficult. This was one issue industry called for the Code to address and further enforcement of this is required.

Finally, an unintended consequence of every dairy farmers being locked into a supply contract is that it allows less flexibility to move to another processor mid-season should the opportunity for better pricing and conditions become available.