National Farmers' Federation

Submission to Australian Competition and Consumer Commission Price Inquiry - Perishable Agricultural Goods

Prepared by Mr Liam Watson

18 September 2020

NFF Member Organisations

National Farmers Federation

The National Farmers' Federation (NFF) is the voice of Australian farmers.

The NFF was established in 1979 as the national peak body representing farmers and more broadly, agriculture across Australia. The NFF's membership comprises all of Australia's major agricultural commodities.

Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations form the NFF.

The NFF represents Australian agriculture on national and foreign policy issues including workplace relations, trade and natural resource management. Our members complement this work through the delivery of direct 'grass roots' member services as well as state-based policy and commodity-specific interests.

Statistics on Australian Agriculture

Australian agriculture makes an important contribution to Australia's social, economic and environmental fabric.

Social >

There are approximately 85,000 farm businesses in Australia, 99 per cent of which are wholly Australian owned and operated.

Economic >

In 2018-19, the agricultural sector, at farm-gate, contributed 1.9 per cent to Australia's total Gross Domestic Product (GDP). The gross value of Australian farm production in 2018-19 is estimated to have reached $62.2 billion.

Workplace >

The agriculture, forestry and fishing sector employs approximately 318,600 people, including full time (239,100) and part time employees (79,500).

Seasonal conditions affect the sector's capacity to employ. Permanent employment is the main form of employment in the sector, but more than 26 per cent of the employed workforce is casual.

Environmental >

Australian farmers are environmental stewards, owning, managing and caring for 51 per cent of Australia's land mass. Farmers are at the frontline of delivering environmental outcomes on behalf of the Australian community, with 7.4 million hectares of agricultural land set aside by Australian farmers purely for conservation/protection purposes.

In 1989, the National Farmers' Federation together with the Australian Conservation Foundation was pivotal in ensuring that the emerging Landcare movement became a national programme with bipartisan support

Executive summary

Australia's current competition policy framework is not adequately protecting Australia's farmers. Behaviours by large buyers, such as wholesalers and retailers, are commonly unfair and anti-competitive in the common sense of the term yet are not prohibited.

The effect of these behaviours has been to diminish the profitability of farm businesses to a point where the viability of many industries is being called into question.

In order to properly safeguard Australian farmers from unfair trading practices and enhance the competitiveness of perishable food markets, thereby improving the outcomes for farm businesses and consumers, the NFF recommends:

1. Section 21 of the Australian Competition and Consumer Act 2010 be amended to specify characteristics which determine whether a behaviour is unconscionable.
2. The ACCC introduce a Mandatory Code of Conduct for all commodities examined in this inquiry.
3. Prohibitions on the use of unfair contract terms be strengthened, as per the National Farmers' Federation submission at Appendix A.
4. The ACCC consider instituting a regular review of perishable food supply chains.

Introduction

The National Farmers' Federation (NFF) 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 the NFF seeks action by the Australian Government to implement much needed changes. In recent decades, Australian farmers have increasingly been subjected to what we consider unfair and anti-competitive behaviour, eroding their margins and ultimately calling into question the viability of many commodity sectors.

Current competition law has proven ineffective at protecting farmers from harmful buyer (processors, supermarkets etc.) behaviour and forced them to accept commercial terms that transfer risks and responsibilities to the farmer that should be held elsewhere. In many cases this leaves them unable to operate profitable businesses.

The NFF does not consider it appropriate or justified in all cases to assign blame to the behaviour of processors or retailers. While in some cases this behaviour may be unethical or unfair, in many cases these businesses are meeting their fiduciary duties to shareholders and maximising their profits within the bounds of relevant legislation. It is this legislation and the behavioural bounds it sets which is the NFF's primary concern.

Commercial arrangements in perishable food supply chains hinder the long-term productivity growth of the industry by deterring productivity-enhancing investments made by farm businesses. Often these investments will not be made because the producer's supply arrangements leave the farm business too uncertain of its of future revenue, or simply provide the farm business with such a small portion of this revenue that investments are not viable.

Current competition provisions provide few protections to farmers from these flawed commercial arrangements. The primary goal of the competition policy framework is to promote consumer benefit rather than fair treatment of suppliers, such as farmers. Outside of poorly defined and impractical unconscionable conduct provisions, there is little protection for farmers from the exercise of undue power by large supply chain actors. Misuse of market power provisions have very little applicability for unwanted behaviours within perishable food supply chains.

The NFF acknowledges the importance of free and competitive markets, which serves the interests of consumers and businesses alike, and accepts that the law should not intrude excessively into this process. The recommendations put forward in this submission will promote the effective operation of free and competitive markets within our food supply chains.

To this end, the NFF makes the following recommendations:

Recommendation 1: Section 21 of the Australian Competition and Consumer Act 2010 should be amended to specify characteristics which determine whether a behaviour is unconscionable.

Recommendation 2: The ACCC should introduce a Mandatory Code of Conduct for all commodities examined in this inquiry.

Recommendation 3: Prohibitions on the use of unfair contract terms should be strengthened, as per the National Farmers' Federation submission at Appendix A.

Recommendation 4: The ACCC should consider instituting a regular review of perishable food supply chains.

This submission provides analysis of the supply chains for several perishable commodities and then links these analyses to shortcoming in current competition law. The names and details provided in the case studies have been changed to ensure anonymity.

The NFF would also like to note the extremely truncated timeframe in which this inquiry is being conducted - a timeframe which has given industry just 18 days to prepare submissions and the ACCC just 3 months to conduct its investigation and produce a report.

The NFF does not consider this timeframe adequate for industry to prepare submissions, given the significant amount of research, consultation and review that is entailed in this process. Nor does the NFF consider this timeframe sufficient for the ACCC to gain deep and meaningful insights into agricultural supply chains, compel and analyse evidence from industry participants and prepare a comprehensive report with considered recommendations.

Previous ACCC inquiries into agricultural supply chains have been completed in 12-18 months and focussed on just a single commodity, as opposed to the 9 commodities considered in this inquiry.

Should this inquiry not find any major issues with the level of competition or behaviour of participants in these supply chains, the NFF considers there to be strong grounds for rejecting these conclusions.

Chicken meat

The chicken meat supply chain

The chicken meat supply chain in Australia is highly consolidated. It also exhibits a high degree of vertical integration. Most stages of the supply chains are owned by the processor. Commonly, the processor:

- Operates the breeder farms, which produce fertile eggs for hatching into meat chickens;
- Operates the hatcheries, which incubate fertile eggs until they hatch; and
- Operates the processing plants, which slaughter birds and prepare them for sale[1].

The processor retains ownership of the chickens at all time. The grower (farmer) is contracted to care for the chickens for a period of 6-8 weeks and is paid a husbandry feed to do so. The grower provides management, shedding, equipment, gas, power and labour. The contracts between grower and processor specify the inputs which the grower must purchase and the methods which the grower must use when caring for the chickens.

Two processing companies - Ingham's and Baiada - produce approximately 70% of Australia's chicken meat[2]. The NFF considers that this level of concentration has diminished the bargaining power of growers. This diminishment of bargaining power has, in turn, contributed to the proliferation of contracts which exploit the weak bargaining position of growers.

Processor conduct in the chicken meat industry

Common examples of unfair contract terms and behaviour in the chicken meat industry include:

1. Contract terms (durations) which do not allow the farmer sufficient time to amortise capital expenditure or obtain returns on investment;
2. Clauses which require the farmer to make significant capital investments during the term of the contract;
3. Clauses which unreasonably transfer risk to the farmer and require him/her to pay indemnities under a broad range of circumstances;
4. Clauses which require the farmer to hold licensing, rights or insurance in excess of his/her usual requirements. This includes full-replacement insurance policies covering property that is held on the farmer's premises but owned by the contract-issuing party;
5. Clauses which require farmers to provide evidence of contractors complying with a wide range of laws;
6. Clauses which require the farmer to pay a financial penalty when certain misadventures occur, where the method for calculating the amount of these penalties is not disclosed to the farmer;

[1] AgriFutures 2020, Economic contribution of the Australian chicken meat industry
[2] AgriFutures 2020, Economic contribution of the Australian chicken meat industry

7. Asymmetrical clauses which restrict the farmer from assigning his/her contract without similar requirements placed on the contract-issuing party;
8. An absence of clauses which offer effective or affordable dispute resolution processes;
9. An absence of clauses which enable farmers, as unsecured creditors, to recoup losses should the processor become insolvent;
10. Clauses which set prices according to a farmer's performance relative to other growers, where that performance is often determined by the price of inputs over which the farmer has little control. 'Inefficient' performance – as judged by the criteria of the processor – is grounds for lowering the price payable or terminating the contract;
11. Asymmetrical termination clauses which allow the processor to terminate the contract with inadequate notice and for reasons such as legislative changes, general economic pressures, or closure of facilities owned by the contract-issuing party;
12. Clauses preventing the farmer, where that farmer has chosen to retire and terminate the contract early, from allowing any production of chicken on his/her property until the original term of the contract has ended;
13. Clauses which require the farmer to comply with internal standards designed by the processor or external standards designed by a non-government organisation. The standards may change during the term of the contract, and any breach may result in the contract being terminated; and
14. Complex pricing clauses which enable the contract-issuing party to change prices unilaterally and retrospectively.

One of the trends emerging from this industry is the obtaining and controlling of production data by the processor, often enabling them to set the prices paid to producers as a cost-plus margin. This practice eliminates the incentives for producers to invest in productivity improvements, since any cost savings resulting from these investments will cause a lowering of the output price.

We provide two case studies which illustrate the problems in the chicken meat industry.

<u>Case Study 1: Written and unwritten supply agreements in the chicken meat industry</u>

Joe and Jane invested approximately $4 million dollars in their farm after a verbal commitment from their processor that a long-term contract would be offered if they made this investment. After Joe and Jane Invested in their farm, no contract was offered, and their existing contract was terminated. They are now under pressure from their bank to sell the farm, which has lost most of its value due to the lack of a growing contract. Selling the farm would leave Joe and Jane in significant debt and without assets.

Case Study 2: Lack of dispute resolution processes for chicken growers

Roy purchased a farm and entered into a contract with a processor five-six years ago. During the initial negotiations with the processor, Roy was assured that the contract would be renewed so long as performance was satisfactory. Based on this assurance, Roy purchased the farm and invested $1 million in infrastructure upgrades. Despite operating as one of the processor's top-performing growers, Roy’s contract was not renewed.

This case study again highlights the inability of chicken growers in enforcing verbal agreements, and performance specifications being used by processors to bypass contractual agreements. Matters of performance within the chicken meat industry seem to be determined at the discretion of the chicken meat processor, with no avenue for the grower to dispute determinations made by the processors.

Case Study 3: Quasi-step down payments for chicken growers

A common practice within the chicken meat industry is the establishment of farmgate prices according to a farmer’s performance relative to other growers (the pooling system), where performance is often determined by the price of inputs, over which the farmer has little control.

‘Inefficient’ performance – as judged by the criteria of the processor – is grounds for lowering the price payable to the farmer, or grounds for terminating contracts. In addition, the price, source and type of farm inputs used by the farmer is often stipulated by the processor.

The ability of processors to change both the farmgate price and input costs effectively means that chicken growers do not have a specified minimum price under their supply agreement and have quasi-retrospective step-down payments as a result of the pooling system. The price determination in the pooling system is retrospective by definition, as price is determined after the grower's contractual obligations have been performed.

Dairy

The competition issues in the Australian dairy industry have been well documented and analysed, most recently and prominently by the ACCC. As the ACCC is acutely aware of these issues, the NFF will not discuss them at any length here.

However, we would draw attention to the dairy inquiry for two reasons. Firstly, we consider that many of the problematic market structures and practices identified in this inquiry are equally true of the markets for other perishable goods. Secondly, we consider the findings of this inquiry to be lacking in certain aspects and would not want those mistakes replicated in the current inquiry.

The NFF supports the following Dairy Inquiry findings and believes they can be instructive of issues within supply chains for perishable agricultural products:

- The generic and perishable nature of raw milk, and large number of farmers relative to processors, means that effective contract negotiations between farmers and processors are unlikely to occur;
- Farmers are significantly disadvantaged by a significant imbalance in the amount of pricing, market and product information available to them compared with processors;
- Supply contracts typically feature an indicative price only;
- Contracts provide processors with significant discretion to pass on risks to farmers; and
- Practices that make it harder for farmers to compare offers and switch purchasers are widespread[3].

The NFF is concerned with the Dairy Inquiry's claim that 'reliance on the CCA alone is unlikely to be sufficient to address the identified market failures'[4], yet beyond the Mandatory Code of Conduct for Dairy, provided little redress for dairy farmers. While the NFF is fully supportive of the Code, given the gravity of the findings, legislative reform within the *Competition and Consumer Act 2010* and outside of it would have been an appropriate first step, as per the recommendations in this submission.

While the analysis of the problems and challenges in the relationship between processor and farmer was well developed, the inquiry's findings as to the impacts of supermarket behaviour on dairy supply chains and farmers was more problematic. The ACCC failed to define the market it was purporting to examine and as such made any findings with respect to the supermarkets' relationship with the dairy supply chain extremely difficult.

The Dairy Inquiry at times treated the market under examination as a single market 'for the wholesale supply of dairy products in Australia'[5]. This market conception does not hold true from an end-user/customer perspective or supply chain perspective. From a consumer perspective, the markets for fresh milk, and

[3] Australian Competition and Consumer Commission 2018, Dairy Inquiry Final Report
[4] Australian Competition and Consumer Commission 2018, Dairy Inquiry Final Report
[5] Australian Competition and Consumer Commission 2018, Dairy Inquiry Final Report

processed dairy goods are distinct. Ice-cream and cheese are not substitutes for fresh milk. From a supply chain perspective, there are distinct markets for processed dairy goods and fresh milk, sharply distinguished by geographic region.

Had these markets been more accurately defined, there was likely to be more concerning findings around the bargaining power of supermarkets in the market for fresh milk, particularly with the use of fresh milk as a loss leader.

<u>Collective Bargaining</u>
Collective bargaining exemptions are an important tool for small farm businesses, allowing them to offset the imbalance in bargaining power which exists in negotiations with processors.

Australian Dairy Farmers - the peak industry group representing dairy farmers in Australia - has authorisation to registers and administer collective bargaining groups (CBGs). However, only 6.8% of dairy farms are currently members of CBGs.

The NFF asks that the ACCC consider the following reforms in order to improve the uptake of CBGs.

1. Dedicate resources to promotional, educational and facilitating services around CBGs.
2. Prohibiting processors from undermining a CBG by negotiating with individual members of that CBG.

<u>The Dairy Code</u>
Available evidence suggests that the Diary Code has been an effective intervention; processor contracts have been significantly reformed to ensure compliance with the Code. There has also been a shift away from informal, verbal contracts to formal, written contracts.

However, the NFF considers that the Dairy Code could be improved in several ways.

1. The Dairy Code should seek to incentivise longer-term supply contracts. The introduction of the Dairy Code has seen the duration of many supply contracts shortened, which has discouraged on-farm investment.
2. The Dairy Code should seek to address the perverse outcome created by its provisions that 'the milk supply agreement must not provide for both exclusive supply and maximum volume' and 'the milk supply agreement must not provide for both exclusive supply and tier pricing'. This has led to a situation where processors are offering a lower price for non-exclusive supply contracts, a practice which goes against the intent of these provisions.
3. Where an unwritten supply contract has been created and the processor has provided written notice of these arrangements within 30 days, the Dairy Code should require the farmer to acknowledge receipt of this notice. This would eliminate the risk for the farmer should a dispute arise.
4. The Dairy Code should be extended to retailers.

Horticulture

Horticulture supply chains are characterised by many sellers and few buyers. Produce quality can deteriorate significantly post farm-gate for a variety of reasons, including the application of post-harvest treatments and post-harvest management of the produce (for example, poor packaging or long periods of time without refrigeration).

The perishability of the produce, which is greater in horticulture than perhaps any other agricultural commodity except dairy, puts growers at a significant disadvantage when negotiating with wholesalers or retailers. Some growers feel that they have no choice but to accept the wholesaler's/retailer's price; if they refuse the offer, the produce will deteriorate before they find another buyer.

Informational asymmetry between the grower and the purchaser, often deliberately imposed, greatly diminishes the bargaining power of horticultural producers. This was one of the key features of the industry identified in the Australian Government's 2015 Independent Review of the Horticultural Code of Conduct[6].

This review identified two principles themes which remain problematic for the industry. These are:

1. Trading terms being often unwritten and left to trust; and
2. Inadequate disclosure of information regarding sales and calculation of price.

We provide two case studies which highlight these issues.

[6]Napper and Wein 2015, Independent Review of the Horticulture Code of Conduct: Final Report

Case Study 4: Lack of pricing transparency for horticulture

It is typical for fruit growers to enter into supply arrangement with wholesalers, who in turn sell the fruit to retailers. Supply contracts rarely specify pricing, and the price paid to growers will vary week-to-week.

There is little transparency in the price setting process. The wholesaler does not inform the grower what price is being paid by the retailer and does not allow the grower to discuss with other growers the price being paid by the wholesaler, or other wholesalers. The same situation exists for fruit growers selling directly to retailers.

The lack of price information prevents growers from gauging whether prices received are competitive market prices. This price opaqueness and the information asymmetries in favour of the wholesaler/retailer allow these entities to extract margins above and beyond what is expected of a competitive market and dampens price signals to fruit growers. The lack of price signals often means there is an under or over supply of fruit, as growers have little information to calibrate their investments in future supply capacity.

Case Study 5: Potential price manipulation of horticulture via quality specifications

This case study has been provided in confidence at Appendix B due to fears of identification.

Case Study 4 demonstrates, in our view, an informational asymmetry which is deliberately maintained by the grower for the purpose of extracting surplus margins from the grower. This echoes the findings of the ACCC dairy inquiry.

In Case Study 5, the retailer has drafted the supply contract so that an important aspect of each interaction between the grower and retailer - the accepting or rejecting of consignments - is left to the discretion of the retailer rather than the provisions of the contract. The contract has been designed leave the majority of interactions between the retailer and the grower uncaptured by its provisions.

The effect of this, if not the intent, is to allow the retailer to exercise its superior bargaining power to the detriment of the grower. This practice seems to be a common theme in perishable food supply chains, likely because bargaining powers are usually equalised in favour of the weaker party wherever interactions are captured by clear, written contractual provisions and their outcome determined by these provisions. It is therefore in the interest of the party with superior bargaining power to ensure these interactions are governed by contractual provisions as least often as possible.

This example highlights the shortcoming of unfair contract terms prohibitions, which, by their nature, are only able to regulate interactions which are captured by contractual provisions. So long as it is possible for interactions to remain uncaptured by contractual provisions - which seems inevitable - unfair contract terms prohibitions will offer insufficient protection to farm businesses.

The NFF views the Horticulture Code of Conduct as having several shortcomings. Firstly, the requirement that purchasers give 48 hours-notice when cancelling orders is insufficient, as many operations require 72 hours to pack each consignment. Secondly, the NFF has been made aware that many horticulturalists will not report breaches because they are fearful of retaliation by wholesalers and retailers.

We note that amendments to the Code are unlikely to overcome this second issue, which the NFF views as serious. We provide two further case studies on the horticulture sector.

<u>Case Study 6: Implicit exclusivity contracts forcing horticulturalists to sell at below market prices</u>

Simone is a fruit grower. She sells her fruit to a wholesaler who then sells it on to a retailer. The wholesaler and retailer meet on Monday each week to discuss prices for the week. Simone is not informed of the price until Friday, which is when she is required to pack her fruit for shipping. The price is often lower than the market price for that week, but the implicit threat of having the retailer cease buying her produce forces her to sell for the below-market price. Even if she wanted to sell into an alternate supply chain, she does not have the time to switch her produce into that supply chain.

More alarmingly, Simone often gets a call from her wholesaler on a Friday night or Saturday morning that the retailer no longer wants the order at the agreed price and quantity and will be cancelling the order and puts in a new order at a lower price. This cancellation and reordering practice usually coincides with a competing retailer releasing their catalogue of weekly specials.

<u>Case Study 7: Price fixing via supply controls</u>

Retailers stockpile semi-perishable horticultural products, which will remain ripe for significant periods of time if kept in cold storage. When the market price begins to rise, the retailer releases a portion of these stockpiles onto the market to depress prices. It is difficult not to compare this to the behaviour of the Organisation of Petroleum Exporting Countries (OPEC) in the global oil market.

Shortcomings of current competition provisions with respect to farmers

The current suite of competition provisions and protections provide very little substantive protection to farmers from supply chain abuses, including those highlighted in the above case studies. Misuse of market power provisions are of little practical relevance for a farmer challenging supply chain abuses. To prove misuse of market power by a powerful buyer, such as a processor, a farmer would need to demonstrate that the offending behaviour would lessen competition in the processing market – something that would be very hard for a farmer to prove.

While the NFF is fully supportive of the various industry codes of conduct, and measures such as unfair contract legislation, these frameworks only provide procedural fairness and do not address underlying issues with bargaining power imbalances.

Unconscionable conduct provisions within the competition regulatory framework are one of the only avenues for farmers to challenge the monopsony-like power of buyers. However, unconscionable conduct is notoriously difficult to prove, and there have been few successful prosecutions to date.

Reform options

<u>Reform of unconscionable conduct provisions</u>

The National Farmers' Federation considers that the most appropriate action to improve the bargaining power of farm businesses is a reform of the unconscionable conduct provisions in the CCA to more clearly specify business practices, contractual arrangements and principles that constitute 'unconscionable conduct'.

We consider that reform of unfair contract terms prohibitions is an important action that would signify progress towards fair and competitive supply chain interactions. However, unfair contract terms are limited in their applicability to the contents of a contract and therefore cannot capture those behaviours that fall outside of the contract, including behaviour during contractual negotiations and behaviour that occurs once the contract is in force.

The NFF's submissions to the Treasury inquiry 'Enhancements to Unfair Contract Term Protections' is attached at Appendix A. We are of the view that the recommendations in this submission (at Appendix A) are sensible reform options that would overcome many of the issues identified in this (current) submission and ask that they be given due consideration by the ACCC.

The NFF contends that unconscionable conduct is often a consequence of a lack of competition - unconscionable conduct tends to occur where a bargaining power imbalance exists, and the existence of a bargaining power imbalance is often symptomatic of a lack of competition in the market - and that unconscionable conduct is commonly anti-competitive in its effect. We consider this to be grounds for the strengthening of unconscionable conduct provisions. However, strengthening of these provisions should *not* be contingent on the extent to which the existing provisions encourage or discourage anti-competitive behaviour. A failure to demonstrate that unconscionable conduct is anti-competitive does not imply that the provisions against this conduct are adequate.

That unconscionable conduct provisions have not yet been reformed appears to be a result of the Harper Review, which found that 'the successful conclusion to a case of business-to-business unconscionable conduct [*ACCC v Coles Supermarkets Australia Pty Ltd]* indicates that the current unconscionable conduct provisions appear to be working as intended'[7].

This extract indicates to the NFF that had the Harper Review been undertaken after the 2016 Federal Court decision in favour of Woolworths, in which a case of business-to-business unconscionable conduct was not successful, it would likely have recommended reforms to unconscionable conduct provisions.

We provide an analysis of this case, which we believe demonstrates both the shortcomings of current unconscionable conduct provisions and provides guidance as to how they might be reformed.

[7] Harper et al 2015, Competition Policy Review Final Report

Case Study 6: ACCC vs Woolworths Limited

The 2016 Federal Court decision in *ACCC v Woolworths Limited* demonstrates the need for a strengthening of unconscionable conduct provisions and provides guidance as to what form this strengthening should take. Incidentally, it also demonstrates the shortcomings of unfair contract terms prohibitions, as the behavior in question lay outside the supply contract and was, therefore, not captured by unfair contract term prohibitions (in fact, that they lay outside of contractual arrangements was a key reason for considering them unconscionable).

The NFF considers that Woolworths' 'Mind the Gap' scheme (the Scheme) is the sort of behavior that should be captured by unconscionable conduct provisions. The conduct of Woolworths:

- Exerted undue pressure on suppliers;
- Placed financial responsibility on suppliers for events that were not the fault of those suppliers and not their responsibility to manage; and
- Was retrospective in its application.

The arguments in defense of Woolworths (ultimately successful), which formed the basis of the court's ruling, centered on claims that the Scheme fitted within Woolworths' usual patterns of behavior and was normal behavior as judged by the standards of the supermarket industry and that Woolworths' did not hold a superior bargaining position with respect to its suppliers.

The NFF considers the second of these claims to be self-evidently untrue. With respect to the first claim, the NFF does not see any rationale for judging behavior to be conscionable solely in virtue of the fact that it is typical of behavior in the industry in which it occurs. The corollary of this judgement is that unconscionable conduct could not occur in an industry where egregious treatment of suppliers, contravening all standards of social and commercial morality, is ubiquitous.

The other key reason for the failure of the ACCC's case - the reliance on analysis of the policies of Woolworth's and the systems through which these policies were carried out, rather than the reliance on the treatment of individual suppliers - is less obviously amenable to reform, since s21(4)(b) of the Australian Consumer Law is quite clear as to the applicability of unconscionable conduct provisions to a 'system of conduct or pattern of behavior, whether or not a particular individual is identified as having been disadvantaged by that conduct or behavior'.

The other issue which becomes apparent from this case is the need for greater legislative specificity in the legislation as to what standard of behavior is to be considered 'unconscionable'. The judgement that unconscionable behavior must involve a 'high level of moral obloquy' and not be merely unfair or unjust draws an arbitrary demarcation on a continuum of behavior, which ranges from charitable, good faith behavior on the one end to egregious behavior, outrageous to all sensibilities, on the other end.

The failure of the legislation to specify where this demarcation lies (i.e. its failure to identify practices and behaviors, or at least purposes and effects of behaviors) leaves market participants (both suppliers and purchasers) unable to know whether their conduct is legal until after its impacts have been experienced and a court has made ruling.

This case study demonstrates the need for amendments to unconscionable conduct provisions that:

1. Specify standards of unconscionable conduct that are objective and are unequivocally not tied to normal or typical standards of behaviour within an industry;
2. Stipulate, as precisely as possible, what characteristics a practice or behaviour must exhibit for it to be judged unconscionable; and
3. Recognise that, where supply chains feature numerous small-scale suppliers and few large-scale purchasers, requests made from the purchaser to the supplier will usually be accompanied by a perceived (if not real) threat of retaliation should the supplier not comply.

The ACCC or Treasury should undertake extensive consultation in identifying appropriate characteristics. It is crucial to ensure that the characteristics capture all possible instances of unconscionable conduct, since introducing these characteristics into the legislation will leave suppliers with no recourse should they experience unconscionable conduct which does not exhibit any of these characteristics. The NFF considers that the benefits of introducing greater precision to outweigh this risk.

The NFF does not, at this time, have a position on what these characteristics should be. However, we consider that that they should encompass (and therefore prohibit) the range of behaviours identified in this submission as problematic, where these behaviours are not prohibited by existing legislation.

We draw the ACCC's attention to the European Union Commission's green paper on 'Unfair Trading Practices in the Business-to-Business Food and Non-Food Supply Chain in Europe'[8]. This paper, which has been foundational for recently introduced prohibitions in the EU, has identified four characteristics which it considers captures most unconscionable conduct. These are:

1. One party unduly or unfairly shifting its own costs or entrepreneurial risks to the other party;
2. One party asking the other party for advantages or benefits of any kind without performing a service related to the advantage or benefit asked;
3. One party making unilateral and/or retroactive changes to a contract, unless the contract specifically allows for it under fair conditions; and
4. One party unfairly terminating a contractual relationship or issuing an unjustified threat of termination of a contractual relationship.

To be clear, the NFF does not endorse these principles and is merely suggesting that it is a good starting point for the development of Australian principles and practices that provide greater clarity as to what constitutes unconscionable conduct.

[8] European Commission 2013, Green Paper on Unfair Trading Practices in the Business-to-Business Food and Non-Food Supply Chain in Europe

We also draw attention to the 2019 EU directive on unfair trading practices in the agricultural and food supply chain, which explicitly prohibits 16 specific 'unfair trading practices'[9]. The NFF considers there to be merit in the two-tier approach taken by this directive in its categorisation of unfair trading practices as 'black' (prohibited outright) and 'grey' (allowed if the supplier and the buyer agree on them beforehand in a clear and unambiguous manner).

The ten black practices are:

1. Payments later than 30 days for perishables;
2. Payments later than 60 days for other agrifood products;
3. Short notice cancellations of perishable agrifood products;
4. Unilateral contract changes by the buyer;
5. Payments not related to a specific transaction;
6. Risk of loss and deterioration transferred to the supplier;
7. Refusal of a written confirmation of a supply agreement by the buyer, despite request of the supplier;
8. Misuse of trade secrets by the buyer;
9. Commercial retaliation by the buyer; and
10. Transferring the costs of examining customer complaints to the supplier.

The six grey practices are:

1. Return of unsold products;
2. Payment of the supplier for stocking, display and listing;
3. Payment of the supplier for promotion;
4. Payment of the supplier for marketing;
5. Payment of the supplier for advertising; and
6. Payment of the supplier for staff of the buyer, fitting out premises.

To be clear, the NFF Is not necessarily endorsing these prescriptions, but using them as example of what can be done to ensure greater fairness in food supply chains.

Should the ACCC find that the reformed unconscionable conduct provisions outlined here are not suitable for inclusion in the CCA, the NFF asks that provisions to the same effect be included in the a more suitable legislative framework.

<u>Mandatory code of conduct for perishable agricultural goods</u>
The NFF recommends that a mandatory code of conduct for perishable agricultural goods (the Code) be established.

The Code should capture all business-to-business dealings where at least one party is a producer of perishable agricultural goods. The Code should have the same legal status as the Dairy Code of Conduct and should apply to all commodities identified in the scope of this inquiry. Its provisions should, as far as

[9] Directive (EU) 2019/633 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain

possible, place the same obligations on all supply chains. Where supply chains are so dissimilar that provisions cannot be drafted in this way, the NFF supports the Code containing different provisions for different commodities.

Where the Code conflicts with other codes of conduct, such as the Food and Grocery Code of Conduct, the Horticulture Code of Conduct or the Dairy Code of Conduct, the code that provides the most stringent set of protections to the farmer should take precedent.

Should the ACCC take this path, the NFF strongly recommends that the ACCC publish a draft Code for industry feedback, to ensure the provisions in the Code are practical, of material benefit to producers, and are unlikely to have unintended adverse consequences.

The NFF considers that at a minimum, the following provisions should be included in the Perishable Agricultural Goods Code of Conduct:

1. An obligation on all parties to act in good faith;
2. A set of minimum disclosure requirements for every supply contract;
3. A right to certain dispute resolution processes;
4. A requirement that supply contracts specify a minimum price;
5. An obligation that contracts specify quality requirements which leave minimal room for the purchaser to apply discretion. Where a significant portion of consignments do not meet the quality requirements but are accepted by the purchaser regardless, the section of the contact which sets out these requirements should be redrafted to rectify this situation.

<u>ACCC monitoring of perishable food supply chains</u>
Given the high level of concentration in both the retail sector and, for many perishable commodities, the processing sector, the NFF recommends that the ACCC consider instituting a regular review of perishable food supply chains.

The rationale for instituting this review is the same rationale as that which underlies the ACCC's monitoring of regulated infrastructure: high levels of market concentration with the potential to harm consumers and businesses by allowing the largest players to accrue supernormal profits.

This review should occur every two years, and should monitor the supply chains against the following criteria:

1. The level of concentration which exists at retailer and processor level, with further examination triggered if the level of concentration is found to have increased since the last review;
2. The behaviour of purchasers towards their suppliers and whether this behaviour is suggestive of excessive market power. For example, the practice of imposing pseudo-regulations on farm businesses through contractual conditions which dictate standards on animal welfare and other activities; and
3. Analysis of the prices and margins paid to suppliers and whether these prices and margins are suggestive of competition in the supply chain.

Should you have any questions regarding this submission please contact Mr Liam Watson on 02 6269 5666 or at lwatson@nff.org.au.

Yours sincerely

TONY MAHAR
CEO

Appendix A: National Farmers' Federation Submission to the Enhancements to Unfair Contract Terms Protections Regulatory Impact Statement

Executive Summary

The National Farmers' Federation (NFF) recommends that:

- Unfair contract terms (UCTs) be made illegal and courts given the power to issue civil pecuniary penalties where terms are found to be unfair;
- Prior use of UCTs be made an offence under Australian Consumer Law;
- Courts be empowered to issue remedies other than declaring a contract term void;
- The creation of a rebuttal presumption provision - where similar terms have been previously ruled unfair - be considered;
- UCT protections be made applicable to all standard form contracts, regardless of business size;
- The definition of a standard form contract be expanded to capture repeat usage and cases where the contract cannot feasibly be negotiated by the small business party due to a fear of retribution should they seek amendments. It should exclude contracts where instances of consultation, negotiation or amendment have been one-off and/or very limited; and
- Australian Consumer Law be amended to specify a standard negotiation/agreement process that includes a fair and reasonable timeframe to consider the provisions and a more transparent fee structure.

Introduction

The NFF welcomes the opportunity to provide a submission to The Treasury's 'Enhancements to Unfair Contract Term Protections' Consultation Regulatory Impact Statement (consultation RIS).

As the peak body representing agriculture across Australia, access to, and the scope and effectiveness of, unfair contract terms (UCTs) protections has implications for the viability of many farming businesses.

This submission builds on most of the recommendations from our submission to the initial discussion paper[10]. These are:

1. That the headcount approach to determine eligibility of small businesses for UCT protections be abolished and replaced with a $10 million aggregated turnover definition in line with the Australian Tax Office's definition of a small business entity;
2. That the ACCC's ability to enforce unfair contract law be strengthened by amending the law to identify unfair contract terms as illegal, providing the ACCC with the power to impose a penalty on those who include unfair contract terms in their standard contracts, and empowering the ACCC to issue infringement notices for contract terms that are likely to be unfair.
3. That the definition of a 'standard form contract' should be expanded to include contracts that - while officially including clauses that allow for negotiation - cannot feasibly be negotiated by the small business party due to a fear of retribution should they seek amendments.
4. That the ACCC provides a clear definition of a fair standard contract that includes, *inter alia:*
   - minimum obligations for small businesses relating to supply agreements;
   - a requirement for all parties to act lawfully and in good faith;
   - a prohibition on businesses from threatening small businesses with business disruption or termination without reasonable grounds;
   - minimum standards of conduct such as payment terms, standards and specifications for services/goods; and
   - a dispute resolution mechanism.

These recommendations were made in consideration of the unique nature of agricultural supply chains, including the perishability of foodstuffs and the oligopolies which exist at the retailer level and, for many commodities, the processor level.

The following submission provides a general response to each topic and the options set out in the consultation RIS and then addresses the specific questions asked in the RIS that the NFF is able to respond to.

[10] National Farmers' Federation 2018, *Submission to Treasury: Review of Unfair Contract Term Protections for Small Business Discussion Paper*

Legality and penalties

The NFF agrees the current regulatory framework dealing with UCTs does not effectively deter businesses from using UCTs in small business contracts. As such, the framework does not achieve its intended purpose.

Additionally, the current provisions place a significant enforcement burden on the ACCC while providing little to no incentive for businesses to proactively assess their standard form contracts for fairness.

Of the four options proposed by Treasury for increasing the effectiveness of UCT protections, the NFF supports *Option 3 - making UCTs illegal and attaching penalties*. The NFF considers this option to be the most likely to promote proactive assessment of standard contracts and removal of unfair terms before contracts are issued.

The NFF seeks amendments to the current framework that materially reduce the instance of farmers being presented with contracts that include unfair terms.

1. Please provide any relevant information or data you have on the use of UCTs in contracts involving small businesses, including where possible, the types of UCTs (or potential UCTs) used and the characteristics of businesses affected by UCTs.

The NFF is aware of a number of farming sectors where small farming businesses have been presented with contracts that include unfair terms. The circumstances generally involve small farming operations that have access to only one processing facility due to the perishability of the product they produce and/or prior contractual arrangements that have bound the farm business to a particular processor.

The kinds of unfair terms used include requirements to invest in farm infrastructure without compensation, the removal of fee negotiation, mediation and review processes, and contract terms that allow for the contract to be voided on minimum notice and or evidence.

The absence of any minimum standards Included in these contracts has seen contract fees reduced, reduced contract periods, and reduced contracted volumes.

2. Please provide any relevant information or data you have on the impact of UCTs on small business, including where possible on costs, and any impacts on business practices or processes. Information and data can relate to individual small businesses or small business as a whole.

The NFF is aware of a number of small farming businesses that have closed because they were unable to secure fair contract terms or their contracts were terminated.

5. Do you have any suggestion as to how regulatory guidance and education campaigns could help reduce the use of UCTs? This includes any suggestions on improvements to current guidance or areas where further guidance is needed.

The NFF considers an important channel for reducing the use of UCTs is to increase the education and awareness of small businesses subject to UCTs. There is significant opportunity to increase the awareness and understanding of small farming enterprises of UCTs and the options available to them to address TCTs.

The NFF welcomes the ACCC's efforts, via the Agriculture Consultative Committee, to keep industry informed of developments and competition law as it relates to the agriculture sector. We would suggest that agricultural industry associations are well placed to assist the Government and ACCC increase access to information and to help tailor relevant Information to make it easier to understand. The NFF, working in conjunction with its members, would be pleased to disseminate information on UCTs via our formal networks as well as our social media networks.

The National Heavy Vehicle Regulator conducts a grants program that enables industry associations to run tailored programs to increase awareness of road safety and other NHVR-related issues. The ACCC could be funded to conduct a similar kind of program in relation to competition policy.

6. Do you consider making UCTs illegal and introducing financial penalties for breaches would strengthen the deterrence for businesses not to use UCTs in standard form contracts? Please provide reasons for your response.

The NFF considers making UCTs illegal and introducing financial penalties is the only realistic avenue for deterring businesses in dominant market positions from trying to impose UCTs on smaller businesses. The financial penalty is needed to counter the financial gain secured by transferring risk from the dominant firm to the smaller business.

8. What do you consider are the additional costs and benefits for each of the proposed options?

The NFF is aware of arguments against using courts to prosecute UCTs that are made illegal and come with a financial penalty. In place of courts, some have proposed tribunals be empowered to mediate UCTs because they are less costly, and administratively easier, for small businesses to access. The implication is small businesses are more likely to dispute UCTs If the vehicle for prosecuting cases Is easier to access and less expensive.

The NFF's preference for court action is based on the view that a court process that delivers a heavier penalty is likely to have a stronger deterrent effect. As such, this Is likely to encourage firms with dominant market positions self-assess contracts well before they are exchanged reducing the need for small firms to challenge contract terms in the first place. We are not aware of any farming business that has the time, energy or is keen to expend the resources to pursue contract issues either in a court or a tribunal. Our strong preference is for amendments to the law that are most likely to effectively deter UCTs.

Flexible Remedies

The NFF acknowledges that declaring unfair contract terms void may sometimes not be the best outcome for one or both parties. If the term in question is found to be unfair and therefore void but the contract still capable of operating, uncertainty may arise. Alternatively, if the entire contract is unable to operate when a particular term has been declared void, the impact on the small business (and possibly also the contract-issuer) may be detrimental; it may leave them in a worse position than if the contract had remained operational with the UCTs in place.

We note that the ACCC, in their submission to this inquiry, expressed that they have, in some cases, declined to take action against potential UCTs because the outcome would likely have put the small business in a worse-off position[11].

The NFF therefore accepts that the court should have the power to provide some remedy other than declaring a contract term void. We are supportive of Option 2 (5.4) - UCTs not automatically void. When a court declares a contract term to be unfair, that term should not be automatically void. The court should be given the power to determine an appropriate remedy, with one possible remedy being a declaration that the term is void. Careful consideration should be given to the process for deciding an appropriate remedy.

The NFF also provides tentative support for Option 4 (5.6) - UCTs used in similar circumstances. Creating a rebuttal presumption provision would have the positive consequence of encouraging businesses which issue standard form contracts to improve their awareness of court rulings on UCTs, thereby making them less likely to include UCTs in their standard form contracts. However, as the consultation RIS notes, this would require careful consideration of legal and practical implications.

[11] Australian Competition and Consumer Commission 2018, *Review of Unfair Contract Term Protections for Small Businesses: ACCC Submission*

10. If a court determines a term or terms in a standard form small business contract are unfair,
should it also be able to determine the appropriate remedy (rather than the term being
automatically void)? Please detail reasons for your position, including the possible impact this
might have on your business.

As noted earlier, the nature of primary production markets means small farm businesses can have few if any choices with regard to the processors or purchasers they must deal with. For this reason, courts should be provided with the discretion to determine the appropriate remedy to enable it to take Into consideration the particular circumstances of each case. Voiding a contract can deprive a primary producer from accessing the only viable purchaser of their product which, in effect, could close the business.

11. Do you consider a regulator should be able to commence court proceedings on behalf of a
class of small businesses on the basis that an unfair term has caused or is likely to cause the class
of small businesses to suffer loss or damage? Please detail reasons for your position, including the
possible impact this might have on your business.

The NFF considers regulators should be able to commence court proceedings on behalf of a class of small business. The NFF's preferred outcome from amendment to the law Is that small farming businesses do not need to carry the cost and administrative burden of prosecuting UCTs. If the regulator is empowered to prosecute the case this is likely to increase the deterrence of the measure as they are generally better placed to prosecute a case than a group of small farming businesses.

Similarly, and again reiterating the nature of many primary production markets, enabling the regulator to bring a class action is likely to dilute the negative impact on commercial relationships that many small farming businesses will continue to rely on after a case is concluded.

Definition of a small business contract

The NFF had proposed in its earlier submission that eligibility for UCT protections should depend on a business meeting at least two of the following three criteria:

1. Less than 20 employees;
2. Annual turnover less than $10 million; and/or

3. Value of contract less than $3 million per annum.

We took this view because each single criterion has deficiencies, but also merits. For example, while the employee head count is often a reasonable proxy for business size, horticultural producers will often employee more than 20 staff at harvest time. At all other times and in all other respects they have the characteristics of a small business.

Also, chicken growers often enter into contracts with an annual value in excess of $3 million. However, a single contract will often constitute their entire supply arrangement, and their annual turnover will be far below $10 million.

We also posed the more fundamental question of why it is necessary to distinguish a small business from other, larger businesses. The NFF would like to see a blanket ban on UCTs in all standard form contracts, regardless of business size. In its submission to this inquiry, the ACCC point out that 'where a business can impose a contract on a 'take it or leave it' basis [i.e. a standard form contract], it demonstrates that the other business lacks countervailing bargaining power or any ability to effectively negotiate, such that the UCT protections should apply to that contract.' The NFF concurs with this reasoning.

Should the Treasury consider there is a need to restrict access to UCT protections to small businesses only, then the NFF considers the small business definition should be consistent with that used by the Australian Taxation Office - an individual, partnership, company or trust that run a business with less than $10 million aggregated turnover.

Value threshold

Farming businesses tend to be capital intensive, with high revenue but low profit margins. The value of contracts for heavy farming equipment or supply of produce is normally higher than the current value threshold of $300 000. Additionally, many agricultural sectors operate with an oligopoly at the processor level. This means that, while a farmer may enter into a contract worth over $300 000 per annum, it is often the only supply agreement he or she will enter in to.

Contracts in agriculture often contain provisions whereby the price paid for produce can vary based on market conditions, or the supply volume can itself vary. This can create uncertainty as to the annual (or total) value of the contract and, for this reason, whether the contract is eligible for unfair contract terms provisions.

As the consultation RIS points out, the increased threshold would reduce uncertainty for many small business contracts that do not have an upfront price payable and which are likely to exceed the current threshold. Eliminating the value threshold would do away with the problem entirely.

Clarity on standard form contracts

The lack of clarity on what constitutes a 'standard form contract' is problematic. We are inclined to take the position that one-off and very limited instances of consultation, negotiation or amendment should not affect the overall character of a contract as 'standard form'. If the definition of 'standard form contract' was interpreted in this way, it would be easy for parties to circumvent the UTC provisions.

For this reason, we support Option 3 (8.5) - clarifying 'effective opportunity to negotiate'. Amending the law to further clarify the types of action which *do not* constitute an effective opportunity to negotiate would be of benefit to our industry. The examples provided in the consultation RIS of action which *would not* constitute an effective opportunity to negotiate, namely:

a. Opportunities for a small business to negotiate minor amendments to a contract, which are amendments that would not alter the intent and essence of the original term; and
b. Opportunities for a small business to select, from a pre-existing list of possible terms, which term they would prefer, rather than an opportunity to actually negotiate the substance of the term

Are a reasonable start. The law should also specify a standard negotiation/agreement process that includes a fair and reasonable timeframe to consider the provisions and a more transparent fee structure to provide growers with the confidence they need to remain in business and to plan production into the future.

We also believe there to be merit in Option 2 - repeat usage. Ensuring that courts, when considering whether a contract is standard form, take into account whether a business has issued a contract with the same terms and conditions, or same core terms and conditions, to multiple parties, would make these judgements more likely to capture those contracts that are intended to be captured.

There is one further change to the definition of a 'standard form contract' which we believe would improve the efficacy of UCT provision. The oligopolies which operate at the processor level for many agricultural commodities leave many producers with few potential buyers. In these industries, a decision from any single processor to refuse to purchase from a farmer can impact on the viability of their enterprise. In many cases, agricultural producers will not contest the terms of a contract as they are concerned it will impact on future dealings with a purchaser. In these cases, the fear of retributive action by the processor is an effective barrier to negotiations. The NFF is of the view that the definition of a 'standard form contract' should apply to contracts that - while officially including clauses that allow for negotiation - cannot feasibly be negotiated by the small business party due to a fear of retribution should they seek amendments.

22. What impact do you consider ‘repeat usage’ would have on clarity around standard form contracts? Please outline reasons for these views.

The NFF is concerned that requiring 'repeat usage' to identify a 'standard contract' may reduce the ability of small farm businesses that sign multiyear contracts from challenging UCTs in those contracts. Similarly, if a processor sources products from a small number of primary producers, and uses multiyear contracts, there might be limited evidence of 'repeat usage' if changed circumstances over time, or the unique offering of each small farm business, means different contracts are used but still include UCTs.

23. If the law were to be amended to set out the types of actions which do not constitute an 'effective opportunity to negotiate', what impact could this have on your business?

The NFF considers prescriptive guides on what actions constitute an 'effective opportunity to negotiate' would assist small primary producers with identifying UCTs. It Is also likely to reduce the incidence of contracts including terms to do *not* provide for an effective opportunity to negotiate.

25. Do you have any suggestion as to how regulators could better promote and enhance guidance on what constitutes a 'standard form contract'? Please provide details, including any suggestions around improvements to current guidance and areas where further guidance is needed.

Please see response to question 5 above.

Minimum standards

On the question of whether minimum standards, which are inserted into a standard form contract as prescribed by state or territory law, should be exempted from UCT provisions we would note the following points:

1. The Law Society of Queensland has expressed the view that minimum standards do not require exemption because they are, as mandatory provisions, already protected by the law[12];
2. The Law Council of Australia has expressed the view that there is a very low likelihood of minimum standards being ruled 'unfair' under UCT provisions[13]; and

[12] Law Council of Australia 2019, *Review of Unfair Contract Term Protections for Small Business: Supplementary Submission*
[13] Law Council of Australia 2018, *Review of Unfair Contract Term Protections for Small Business: Submission*

3. Good legislative practice should involve state legislators undertaking the checks necessary to ensure their minimum standards do not contradict Commonwealth law.

We consider these points make a sound case for excluding state and territory mandated minimum standards from UCT provisions. That said, there are no guarantees that these provisions will meet the definition of what an 'unfair' term Is and should be open to challenge regardless of the source of the terms.

Should you have any questions regarding this submission, please do not hesitate to contact Mr Liam Watson on 02 6269 5666 or at lwatson@nff.org.au.