Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Senator Alan Eggleston
Chairman
Senate Economics References Committee
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

30th April 2011

Dear Senator Eggleston,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation (QDO) would like the opportunity to response to the additional information and answers to questions on notice that Coles Supermarkets Pty Ltd has responded to the Senate Economics References Committee on the 19th April 2010.

Firstly we appreciate that under your chairmanship the Committee has had to deal with a large amount of submissions and that understand that further time is required to analyse all of this information, in addition to the response from Coles Supermarkets Pty Ltd to questions on notice from the Committee being only provided to you on the 19th April, one day before you where due to provide a report on the inquiry.

We are extremely frustrated and angry that Coles Supermarkets Pty Ltd has continued to delay the progression of the inquiry in this manner, as this is delaying the implementation of a solution to the problem and the fact that dairy farmers in Queensland are already being affected with lower returns due to the cutthroat discounting on milk initiated by Coles.

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Luscombe comments – will not be first to change

- QLD impact

"There's no doubt we've been publicly critical [of the price drop], and it's not a sustainable position," he told ABC Radio National's Bush Telegraph.

"What we've seen since then, are reports - especially from south-east Queensland - that dairy farmers are seeing a reduction in income.

"Also, the two major processors have indicated they might not go ahead with much needed reinvestment in processing facilities."

Woolworths says the current price of milk isn't sustainable, something its competitor Coles' has long denied.

"Once one of the links breaks down, it becomes sustainable. You can see in the UK a lot of fresh milk comes from outside of the UK into the marketplace," he said.

"I'm not sure I want to see that happen in Australia."

Consumers have benefited from the price cuts by getting cheaper milk, but some wonder what they buy to help farmers.

"Buying branded rather than private label milk can have a better outcome [for farmers]," Mr Luscombe said.

That's because farmers get a bonus for selling branded milk.

Coles and Woolworths sales growth figures

Mr Tessmann added that comments from Woolworths CEO Michael Luscombe this week, stating that Woolworths would not be the first to move its milk prices upwards, highlighted the urgency for the Government to act.

“Clearly there is a major standoff occurring between the major retailers,” Mr Tessmann said. “And dairy farmers are the ones caught in crossfire. We need urgent action from the government to ensure the long-term viability of the industry and to ensure drinking milk States such as Queensland have fresh milk in the future.”

"We've said it's unsustainable for a lot of the dairy farming community, and clearly they've had a reduction in their income, and if that is sustained their businesses will be under threat," Mr Luscombe said.

"But whatever happens, Woolworths will make sure that our customers get the same price as the cheapest in the marketplace . . . we didn't take it down first, we're not going to take it up first."

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide to the Senate Standing Committee on Economics the following supplementary submission containing a set of recommendations for the Committee's consideration.

The QDO has been heavily involved with the development of recommendations as a member of the Australian Dairy Farmers (ADF) and as such many of the following recommendations directly reflect ADF's recommendations to the Senate Inquiry.

The QDO stands ready to, where possible, provide any further information Committee members may require and would welcome the opportunity to discuss any of the recommendations presented.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

Queensland Dairyfarmers' Organisation

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Supplementary Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

Recommendations

8 April 2011

Introduction

The Queensland Dairyfarmers' Organisation (QDO) presents and commends the following recommendations to the Senate Standing Committee on Economics Inquiry into the impacts of supermarket price decisions on the dairy industry.

The following should also be read in conjunction with QDO's submission and response to Questions on Notice to the Senate Inquiry.

A number of the following recommendations are also reflected in the recommendations being submitted by Australian Dairy Farmers.

Recommendation Summary

QDO Recommendation 1
That the relevant Federal Minister to give a direction to the ACCC to undertake an immediate investigation of Coles for a potential breach of section 46, of the Competition and Consumer Act 2010 in relation to predatory pricing.

QDO Recommendation 2
That the relevant Federal Minister to give a direction to the ACCC to;

1. investigate the pricing of all major retailers for potential breaches of the Competition and Consumer Act 2010 in relation to the sale of 'loss leaders' and;
2. undertake ongoing price, cost and marketing surveillance of the fresh milk supply chain.

QDO Recommendation 3
That the relevant Federal Minister to give a direction to the ACCC to investigate Coles' advertising of their discounted store brand milk for potential breaches of the Competition and Consumer Act 2010 in relation to false, deceptive and or misleading conduct.

QDO Recommendation 4
That the Senate Inquiry and the Government examine the United Kingdom Competition Act 1998 (section 18) with a view to implementing similar legislative provisions to strengthen the anti-competitive price discrimination provisions of the Act, in particular:

- Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom;
- Conduct may, in particular, constitute such an abuse if it consists of:
    - Directly or indirectly imposing unfair purchase or selling prices of other unfair trading conditions;
    - Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.
- That an 'effects test' for both competition and sustainability be reinstated within the Act.

QDO Recommendation 5
That the above definition or a similar definition with the same intent is inserted into the Act. A draft definition of unconscionable conduct is provided by Professor Zumbo in his submission and reads as follows: *'For the purposes of this section 'unconscionable conduct' includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.'*

QDO Recommendation 6
That a statutory duty of good faith be enacted as part of the Act to provide an appropriate and accepted benchmark of standards of ethical conduct.

QDO Recommendation 7
That the Australian Government commission an independent study of the economic impact of supermarket 'store brand' milk, procurement, marketing and pricing practices on;

- the sustainability of the fresh drinking milk supply chain,
- pricing, demand and competition between 'store' and proprietary milk brands in the fresh milk market,
- implications for consumer choice and cost in the longer term,
- implications for investment in product innovation, and
- whether placing limits of market shares of supermarket 'store brands' would derive long term benefits for consumers and the sustainability of the dairy industry fresh drinking milk supply chain.

QDO Recommendation 8
That a mandatory Australian Drinking Milk Code of Conduct be developed, under the Act, in consultation with industry, dealing with the relationship between dairy farmers, processors, distributors/vendors and retailers. That the Code have a Commissioner appointed with a head of power including the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, processors and retailers.

In addition the QDO supports the recommendations from Associate Professor Frank Zumbo that;

- civil monetary penalties for breaches of mandatory industry codes of conduct be imposed under the *Competition and Consumer Act*, and
- that the Australian Consumer Law framework dealing with unfair contract terms be extended to cover business to business agreements involving small businesses and farmers.

QDO Recommendation 9
That an Ombudsman / Commissioner and or a Supermarket Ombudsman be appointed, with appropriate heads of power, to head the Australian Drinking Milk Code of Conduct.

QDO Recommendation 10
Government to convene, and participate in, an Australian Government and or ACCC authorised forum of the dairy industry supply chain, from farmers to retailers, to constructively discuss solutions for ensuring a sustainable drinking milk market with fair and sustainable returns.

Background - Key Issues and Problems

As an unintended consequence of deregulation, since 2000, due to its unique characteristics, the major supermarket duopoly, with their dominant share and power in the domestic market, has utilised fresh drinking milk as a discount marketing agent to serve a range of purposes. This has led to the progressive unsustainable devaluation of fresh drinking milk products nationally and market failure within the Australian domestic fresh drinking milk market.

The current example of this market failure is clearly evident in southern Queensland where there is a shortage of milk, due to the impacts of natural disasters, and in order to service market needs milk is being transport long distances at much higher costs. However at the same time major supermarkets have reduced the price of their store brand milk, with supermarket using their store brand milk as a discount marketing agent. As the supermarkets are using milk to serve as a discount marketing agent for pursuing the growth in overall supermarket grocery sales, the value of drinking milk is being continually sacrificed for another purpose which does not reflect the true cost and market value of fresh drinking milk.

The consequences of this has been the creation of a situation whereby returns to the supply chain from supermarket store brand milk is not sustainable and are undermining the viability of the fresh milk supply chain, including returns to dairy farmers.

The latest, at near or below cost 'loss leader', discounting of fresh drinking milk, which was led by the Coles Supermarkets Australia Pty Ltd (Coles) on the 26th January, and then followed by other retailers, has furthered the devaluation of the fresh drinking milk in the market place and is undermining of the sustainability of the fresh drinking milk supply chain.

If the abuse and devaluation of fresh drinking milk by major supermarkets is not addressed it is feared that significant damage will be incurred by the supply chain, resulting in the further loss of dairy farmers, break down and loss of investment from the fresh milk supply chain, loss of choice and higher costs for consumers and potentially the loss of fresh milk supply for isolated regions.

Fresh Milk is Unique

Fresh drinking milk is a well defined market in Australia. Fresh drinking milk is unique in nature due to it being an every day, fresh, high quality nutritious, dietary staple of our community consumable. Due to this uniqueness fresh drinking milk as a product is also very inelastic in nature.

Fresh milk is a foundation staple of our population's daily dietary needs and expectations and the vast majority of Australian's take for granted that they are able to purchase milk from any shop in Australia with a refrigeration unit. Public disturbances due to the shortage of fresh milk during the floods in Queensland highlight that demand and expectation of consumers.

Australians drink some 102.4 litres of fresh milk per year and collectively this equates to the consumption of 2.33 billion litres per year, which makes up some 25 percent of the Australian dairy industry annual milk production (data source Dairy Australia, Australia Dairy Industry In Focus report 2009/2010). As such milk is one of the most frequently purchased items by consumers.

Due to all of these unique characteristics, fresh drinking milk serves as an ideal discount marketing agent for supermarkets and other retailers.

Challenges of Fresh Milk Production and Supply

The production, transport, processing, distribution and retailing of fresh milk entails a significant number of challenges and relative high level of investment and risks compared to other dietary staples and grocery products.

Unlike many other groceries, milk is highly perishable and as such requires a great deal of management and capital to ensure the product is made available to consumers in a fresh, high quality status. Compared to milk, other products such as water and soft drink do not require the same amount of supply chain investment as they are not perishable and or do not require refrigerated storage, as required for fresh milk.

In addition the production of milk comes from a live biological farming system and simply cannot be turned 'on or off' as other manufactured drink products can be.

To produce milk, dairy farmers carry the highest investment and risks per litre of milk and the most volatile returns of the whole fresh milk supply chain.

The huge amount of investment, effort, and risk required to produce, transport, process, distribute and deliver fresh milk on a daily basis is not reflected in the current discount price of milk by major retailers at $1 per litre, which was the price of whole milk back in 1992.

Retailing Tactics and Impacts

As fresh milk is unique in nature as a perishable every day inelastic dietary staple of our community major supermarkets continue to use fresh milk as a near or below cost 'loss leader' discount marketing agent, including as a;

1. 'door opener' to attract consumers away from their competitors to increase their own market share,
2. sales 'multiplier' to entice consumers to purchase other products while visiting the store to purchase milk being a every day staple,
3. 'locator' to make people walk through the store to be able to reach the milk cabinet and in so doing seeking to entice them to purchase other products while they are there,
4. means to grow their own supermarket brand market share at the expense of the market share held by processor proprietary brands, and
5. de-facto wholesaler to sell discounted milk to milk ingredient users such as coffee shops and or small retailers.

These marketing tactics in effect sacrifices the value of milk to serve an advertising function. The latest marketing tactics of Coles has seen the discounting taken to levels which simply are not sustainable for anyone in the fresh milk supply chain and are already causing significant negative impacts on the supply chain and dairy farmers.

The unique nature of milk provides retailers with an effective tool to grow their market share and power, however the consequences for the sustainability of the domestic fresh milk supply chain is significant to a point where if left unchecked it will result in undermining the viability of the whole fresh milk supply chain and effects the future supply, cost and choice to consumers.

The major two supermarkets in Australia effectively form a duopoly, benefiting from the unprecedented control of some 80 percent of the domestic grocery market and thereby collectively providing the largest avenue for the sale of grocery products to Australian consumers.

Through the above and other marketing tactics, including near or below cost discounting, the major supermarkets have effectively doubled their market share of their own supermarket milk brands over the last decade, to over 50 percent of all milk sold through supermarkets. The major supermarkets have also increased their share of the 'route' trade market for example through fuel stations to a point where some in the supply chain estimate that major supermarkets have around 65 percent of overall market share.

This increase in market share of discounted supermarket store brand milk has come at the expense of processor proprietary brands. This change in the market share between the two groups of brands has dramatically affected the returns to the dairy industry supply chain, including to milk processors and dairy farmers.

Under the last year of regulated domestic milk prices, the farm gate price was 54.9 cents per litre and the average retail price for whole white drinking milk was $1.26 per litre for supermarket brands and $1.33 per litre for processor proprietary brands.

Currently in Queensland the price for milk which is sold as fresh drinking milk at farm gate ranges from 47 cents per litre, up to 58 cents per litre for older contracts still in operation and the retail price is $1 per litre for supermarket brands and approximately $1.83 per litre for processor proprietary brands.

Last financial year the value difference of all milk sales during the year between the two groups of milk brands, being supermarket brands versus processor proprietary brands, was more than $414 million. This is the value which is now lost from the supply chain and is undermining its viability.

It is expected that if the current milk discount battles continue between major supermarkets the unsustainable reduction in supermarket 'store brand' price will have further flow on impacts including;

- further devaluation of all supermarket 'store brand' milk sales as major supermarkets compete with one another to protect market share and continue to use 'store brand' milk as a near or below cost 'loss leader' advertising agent;
- further devaluation and reductions in margins of processor proprietary brands of milk as processors either resort to discounting and or increasing advertising to try and mitigate market share losses across both supermarket and route trade market channels;
- reductions in the retail price of and margins from both processor proprietary and supermarket 'store brand' products will inevitably flow through to wholesale prices and processor profitability;
- increasing pressure on the viability of smaller retailers and the route trade operatives such as vendors;
- increasing downward pressure on farm gate prices and supply conditions;
- lower returns for the fresh milk resulting in impacts on investment and employment throughout the supply chain;
- divestment from the supply chain, threatening supply security in many regions, especially for more isolated regional areas;
- little or no investment in product innovation, less competition, choice and inevitably higher prices for consumers.

As major supermarket store brand sales increase, they obtain more market power to be able to dictate the price and supply conditions at which suppliers sell to them, across both supermarket and proprietary brands. The supermarkets also then get to dominate shelf space and as a result the choice to customers declines. This vicious cycle will in the long-term result in supermarket store brand domination of the market, less or no customer choice, little or no product innovation and worst of all for consumers, increases in the price, as has been the experience in the United Kingdom.

As presented in the QDO's submission to the Senate Inquiry, (refer to page 11 of QDO submission), across the whole domestic fresh milk market, including supermarket and route trade milk sales, if the current extreme, near or below cost, discounting by major supermarkets continues it could result in causing;

- overall milk value chain loss is estimated at $842 million per annum,
- each value chain sector, being retailers, processors and dairy farmers, would have to absorb a loss of approximately $281 million,
- an average dairy farmer seeing a reduction of 12.4 cents per litre or for an average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

The current further devaluation of fresh drinking milk will affect all sectors of the dairy industry including farmers, transport operators, service and supply businesses, processors, vendors, distributors etc and will lead to the loss of jobs throughout the supply chain.

In the interests of maintaining the sustainability of the domestic fresh drinking milk supply chain and all Australian consumers this situation needs to be addressed as a matter of urgency.

Recommendations

Major Supermarket Predatory Pricing

Coles' major competitor and other retailers have publically stated that the current discounting of fresh milk to $1 per litre is unsustainable. As such the question is asked why would a major retailer price fresh drinking milk at an unsustainable price?

It is evident from recent Senate Inquiry hearings and from other submissions presented to the Senate Inquiry that for the current discounting of milk to $1 per litre not to be a 'loss leader' defies logic, especially when taking into account the cost of distribution, refrigerated storage and retail in regional areas.

We also believe that from the recent actions of Coles and from evidence presented to the Senate Inquiry that there is a prima facie case of predatory pricing under section 46, including 46 (1AA), of the Competition and Consumer Act 2010, which the ACCC should be investigating as matter of urgency.

Market research comparing retail milk prices for southern Queensland compared to other states including New South Wales and Victoria presents that retail milk prices for Southern Queensland are on average less than that of New South Wales and Victoria, (refer to page 23 of the QDO submission to the Senate Inquiry, Sub. No. 94).

In contrast to this, prices paid to dairy farmers by milk processors in Southern Queensland are higher than that paid to dairy farmers in New South Wales and even more so in Victoria. Dairy Australia data presents that for the 2009/2010 financial year Victorian dairy farmers were paid 33.9 cents per litre and in NSW 48.7 cents per litre and Queensland 55.8 cents per litre. The difference between farm gate prices between the three states relates to different market mixes and production costs.

In Queensland, the dairy industry supplies the majority of milk consumed by the Queensland domestic market and to meet the market requirements, this milk needs to be produced every day of the year. The Queensland environment poses higher production costs for milk compared to Victoria where the majority of milk is processed for export products and produced seasonally with seasonal on farm fodder production and thus lower production costs. The higher cost of production in Queensland is due to the requirement for dairy farmers to supply of milk every day of the year, requiring the purchase of additional fodder, when on farm fodder production is not sufficient, and more intensive management systems, as well as constraints associated with tropical environments.

Within the dairy industry's domestic supply chain, milk processors compete in a national fresh milk retail market, whereas major supermarket chains now operate uniform pricing policies nationally. These policies do not take account of differential costs to producers and suppliers or different transport and storage costs to deliver products to more isolated markets from where the product is processed.

As such in the Queensland domestic market the cost of milk to processors is higher than NSW and Victoria, yet retailers such as Coles etc are applying a national discounted price of $1 per litre. When this is combined with evidence about margins presented by a Coles' representative to the Senate Economic References Committee's inquiry into the Australian dairy industry in February 2010, we believe there is a prima facie case of breaching the Competition and Consumer Act 2010. We believe this case is in relation to selling milk as a 'loss leader' in a predatory manner to gain market share from competitors.

From the market share figures presented on page 10 of QDO submission to the Senate Inquiry it is not difficult to conclude that the major objective of the Coles cutthroat discounting, in addition to using milk as a overall marketing agent to lure more costumers, is to target the next major market share growth opportunity being the reduced fat milk category

Coles has discounted the Coles brand reduced fat milk category by up to 33 percent to $1 per litre as that is the next main target for market share from processor proprietary brands. Over the last decade the major supermarkets have increased their market share of supermarket sales of milk of their own supermarket store brand for whole milk from 31 to 71 percent at the expense of processor proprietary brands, as well as growing their share of the route trade. This is similar to the market share penetration by supermarket store brands in the United Kingdom.

However the supermarkets' share of the reduced fat category of milk at the end of 2009/10 was still less then 50 percent of all supermarket sales of reduced fat milk. As such it is not difficult to conclude that Coles sees this as the next best market share growth target yield per promotional dollar spent. By targeting this category with near or below cost discounting over time could render some processor reduced fat propriety brands unviable, thus resulting in less choice for consumers.

It is our belief that Coles' actions have the specific purpose and likely effect of damaging their competitors, such as other major retailers, corner stores, independent petrol stations and other small retailers of milk, and over time will lead to substantially less competition in the market place.

This impact will also flow through to affect dairy farmers, service businesses, transport operators, processors, distributors and vendors and threaten the jobs of employees throughout the whole industry.

Furthermore, we believe this action by Coles impacts the viability of processor owned branded dairy products and thus will lead to the loss of consumer choice and competition, as has been the experience in other countries where these marketing tactics have been applied.

In addition, for local markets in a number of rural communities where a major retailer is the only major retailer of grocery products for the community and is the 'defined market' such discounting practices as currently practised by Coles would be anti-competitive as it is resulting in the undermining of competition within the store by undercutting proprietary brands yet consumers are left with no other option within the 'defined market' to purchase their groceries.

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to undertake an immediate investigation of Coles for a potential breach of section 46, of the Competition and Consumer Act 2010 in relation to predatory pricing.

Use of Loss Leaders

Given the high concentration of the retail and processing sectors and that following Coles discounting their store brand milk to $1 per litre on the 26th January 2011, Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres (96.33 cents per litre), the ACCC should investigate potential breaches of the Act and undertake an ongoing monitoring of the sector.

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to;

3. investigate the pricing of all major retailers for potential breaches of the Competition and Consumer Act 2010 in relation to the sale of 'loss leaders' and;
4. undertake ongoing price, cost and marketing surveillance of the fresh milk supply chain.

Misleading and Deceptive Conduct

Coles and Wesfarmers executives have publically stated that farm gate prices for dairy farmers have increased in the last year. However milk prices to many farmers have actually fallen by approximately 12 – 18 percent in Queensland and 10 percent in NSW and Victoria in the last 12 months, which includes the Tier One price dairy farmers are paid by National Foods that supply the milk for Coles supermarket branded milk.

In addition dairy farmers who have their farm gate price linked directly to processor branded sales have seen their milk cheque drop in early March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands. This impact on these farmers will continue to increase over the coming months as Coles and other supermarkets milk brands gain an increasing share of the milk sales and the share of proprietary milk branded sales declines.

Wesfarmers executive Richard Goyder has publically stated that the sales of the Coles brand milk has increased by some 15 to 20 percent since the products were discounted by some 33 percent on Australia Day 26th January 2011.

For Coles to publically promote that *"Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased."* (Coles media release 26th January 2011 and various public statements), is tantamount to deceptive and misleading advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers.

In addition there seems to be inconsistencies in the presentations of Coles print advertising compared to the Coles promotional press release of the 26th January, which may also be tantamount to misleading consumers and such should be investigated by the ACCC.

Further more, while Coles is saying in their submission that they ‘just’ reduced the Coles brand milk by 4.3% or 4.5 cents per litre, which is a reference to Coles reducing the price of its Coles supermarket brand from $2.09 to $2.00 for two litres, the full truth is that Coles stopped one line of Coles brand ‘Smart Buy’ effectively reducing the price of those sales from $2.47 to $2 per two litres or by 19% and reducing Coles litre milk from $2.99 to $2.00 for two litres or by 33%.

Coles promoted in its Press Release dated the 26th January 2011 stating that, “The price of Coles Brand fresh milk is being cut by as much as 33% from today……”

“Significantly the price cut also includes Coles Brand reduced fat milk which will be cut to the same low price of $2 for a two litre bottle, bringing it into line with full cream milk so customers will no longer have to pay a price premium for a lower fat milk option.

“By offering the same low price on Coles Brand reduced fat milk we are also enabling more customers to switch to the lower fat option at a price they can afford which is clearly a significant health benefit.” (We note that Coles has not made the same health claim with the discounting of alcohol, in relation to the converse health effects that would come from increased alcohol consumption vis-a-vis cheaper prices)

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to investigate Coles’ advertising of their discounted store brand milk for potential breaches of the Competition and Consumer Act 2010 in relation to false, deceptive and or misleading conduct.

Strengthening the Competition and Consumer Act 2010

Given the ongoing and worsening situation for the Australian domestic fresh drinking milk industry over the last eleven years, which has been amplified by the further discounting and devaluation of fresh milk by Coles, it is seen that the only long term solution to dealing with issues raised is to make further amendments to strengthen the Competition and Consumer Act 2010 (hereafter ‘the Act’) to ensure such abuse of market power is outlawed once and for all.

Misuse of Market Power (section 46 of the Act)

Section 46 of the Act is designed to prevent corporations with a substantial degree of market power from taking advantage of that power for the purposes of eliminating or substantially damaging a competitor, thereby preventing the entry of a person into that or any other market or deterring or preventing a person from engaging in competitive conduct in that or any other market.

Predatory Pricing (subsection 46 (1AA) of the Act)

Subsection 46(1AA) of the Act is designed to prohibit businesses with a substantial market share (having regard to the number and size of its competitors in the market) from selling goods or services for a sustained period at a price below their relevant cost of supply, for an anti-competitive purpose.

Coles’ current tactics in using its supermarket store brand milk as a near or below cost advertising agent, is designed to achieve a number of goals including:

1. seeking to promote a perception to consumers that Coles is a cheaper grocery provider then their competitors;

2. luring more consumers into their stores on a more regular basis, away from other retailers, in particular to take market share away from its main large retail competitor Woolworths. It should be noted that Woolworths has stated publicly that the milk price cuts are unsustainable.
3. increasing the sales and market share of Coles' store brand milk at the expense of the market share of other brands, particularly in the reduced fat milk category;
4. increasing the size and purchasing power of Coles' store brand milk tenders, as well as other dairy product tenders; and
5. to gain greater market share in the 'route trade' by taking business away from its smaller retailers such as corner stores and vendors, which could see many smaller operators become unviable.

As Coles' sales of its supermarket store brand milk increases, as a result of it's near or below cost 'loss leading' discounting, the following impacts are occurring;

- Devaluation of fresh drinking milk across the nation as other major retailers have reduced their retail prices as well, which is resulting in lower returns to the fresh milk supply chain;
- Processors financial returns are impacted due to the loss of market share of their own proprietary brands, which have sustainable margins compared to the unsustainable supermarket brand milk contracts. This will inevitably mean that further downward pressure will be place on farm gate prices when processors seek to renew contracts with dairy farmers;
- Dairy farmers which have farm gate price contracts that are linked with processor proprietary brand sales have already seen a drop in their milk cheques as processors proprietary branded milk lose market share to supermarket store branded milk;
- Smaller retailers are placed at a significant competitive disadvantage because of the higher wholesale prices they pay for branded milk;
- Milk vendors are placed at a significant competitive disadvantage as their regular customers, for example coffee shops, move to purchase milk at a lower price from supermarkets rather then from the vendor;
- The combined impact of lower returns to the fresh milk supply chain will have resulting impacts on investment and employment throughout the supply chain.

It is the contention that Coles is selling their supermarket store brand milk below their relevant cost of supply through to the supermarket 'check out', for an anti-competitive purpose through both misuse of market power and predatory pricing as outlined above, and in particular in the case of regional and remote areas of Australia.

In addition the QDO believes there is a prima facie case of price discrimination from supermarket store brands against processor proprietary brands, where the supermarket has specifically sought to target their supermarket store brand discounting against comparable processor proprietary brands.

The long term risk of continuing to allow major supermarkets to continue to use their market power to take control of more market share, as has been the experience in the United Kingdom, that once such an environment is allowed to result, particularly at the retail level where supermarket store brands dominate the market, it will result in;

- Devaluation of fresh milk as supermarkets use it as a loss leader marketing agent,
- Unsustainable returns to the supply chain,
- Less competition, choice and higher prices for consumers,
- Little or no investment in product innovation,
- Divestment from the supply chain, threatening supply security.

It is the contention that;

- Coles is currently selling their supermarket store brand milk below their relevant cost of supply and retail;
- The practice is anti-competitive, discriminatory and predatory in nature through the misuse of market power and pricing;
- The history of the removal of the anti-discrimination clause Section 49 in 1974 from the then Trade Practices Act, should not be forgotten;
- That subsection 46 of the Act was supposedly designed to do the task that section 49 was originally designed for, however in practice this has not been the case and as such anti-competitive behaviour continues to occur;
- That the Act needs to be strengthened to stop the current anti-competitive price discriminatory behaviour;
- Australia has been presented as having the 'weakest competition laws' of any OEDC country;
- That anti-price discrimination is prohibited in every OECD country except New Zealand, where New Zealand has more comprehensive provisions for the prohibition of the misuse market power;
- If the current situation of the growing market power of the supermarket duopoly is not addressed then the current imbalance in market power and function will increase to a point where significant damage to the supply chain will result and inevitably consumers will be left worse off;
- Even though there is prima facie evidence of anti-competitive price discrimination, the ACCC has not yet been seen to take action. As such the inclusion of more effective anti-competitive price discrimination legalisation to provide the necessary means for the ACCC to take action to stop and prevent further cases of anti-competitive price discrimination;
- The reintroduction of an anti-price discrimination clause into the Act is absolutely warranted and should be a foundation recommendation from the current Senate inquiry;
- That the Australian Government and the ACCC has not, in recent years, taken enough consideration of longer term issues and consequences of decisions and or inaction. As highlighted by the current 'milk price war' there is a critical need to not only assess the immediate impacts on the market and supply chain but also the potential future impacts and consequences, particularly in the case of the misuse of market power which can be disguised as creating competition in the short term. The former Section 49 included an 'effects' test to test if the conduct in question has the effect or the likely effect of bringing about a substantial lessening of competition. The reintroduction of an 'effects test' into the Act, for both competition and sustainability, would assist the ACCC in assess longer term potential consequences of issues requiring consideration.

Associate Professor Frank Zumbo, of the School of Business Law and Taxation at the University of New South Wales, in his submission to the Senate Economics References Committee Inquiry into the impacts of supermarket price decisions on the dairy industry outlined several practical international precedents that deal with anti-competitive price discrimination. These included the United States *Robinson-Patman Act of 1936* and the *United Kingdom Competition Act 1998 (section 18)*. The following recommendations to amend the Act are aimed at more effectively prohibiting predatory pricing, which is something that the current legislation has failed to demonstrate in action.

Recommendation: That the Senate Inquiry and the Government examine the United Kingdom Competition Act 1998 (section 18) with a view to implementing similar legislative provisions to strengthen the anti-competitive price discrimination provisions of the Act, in particular:

- Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom;
- Conduct may, in particular, constitute such an abuse if it consists of:
  - Directly or indirectly imposing unfair purchase or selling prices of other unfair trading conditions;
  - Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.
- That an 'effects test' for both competition and sustainability be reinstated within the Act.

Unconscionable Conduct (section 51 of the Act)

Unconscionable conduct is unfair or unreasonable conduct in business transactions that goes against good conscience. This can occur in transactions between businesses or in transactions between businesses and consumers.

The exact meaning of 'unconscionable conduct' is not defined in the Act. The Act lists several factors that the court considers when deciding if a party has acted unconscionably. However, the court is able to consider any other matters it believes are relevant.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry recommends inserting a definition of the word 'unconscionable' into Section 51AC of the Act. Section 51AC of the Act was introduced in 1998 to address the problem of small businesses facing power imbalances while dealing with larger commercial entities.

He believes this would be an 'obvious way to provide clear statutory guidance as to what is meant by the term as used in Section 51' and 'would send a clear parliamentary signal to the Courts that the concept is not only broader than the equitable concept, but that s51AC is intended to promote ethical business conduct.'

Associate Professor Frank Zumbo believes the courts are currently defining the term and 'are taking such an onerous view of what constitutes 'unconscionable' that there is a growing danger that s51AC will fall into disuse.'

It is contended that Coles' recent actions are unconscionable. This is particularly highlighted when Coles' promotional and advertising material is compared with impacts on the fresh drinking milk supply chain and other retailers, which are already occurring.

Recommendation: That the above definition or a similar definition with the same intent is inserted into the Act. A draft definition of unconscionable conduct is provided by Professor Zumbo in his submission and reads as follows: *'For the purposes of this section 'unconscionable conduct' includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.'*

Enacting a Statutory Duty of Good Faith

It is contended that Coles has not conducted its recent supermarket store brand milk discounting in good faith with either consumers or dairy farmers – even though Coles does not have direct contract relationship with dairy farmers.

There are several reasons for this contention including that:

- Coles has repeatedly presented misleading information in the media to present the perception to consumers that farmers are doing better financially than is the reality and that the Coles discounting will not harm dairy farmers. These misleading statements have included but are not limited to;
    - That farm gate prices went up last year, when the fact it that milk prices to farmers have dropped by some 10 percent in NSW and Victoria and more then 15 percent in Queensland in the last 12 months, which includes farmers that supply milk which goes into the Coles supermarket branded milk bottles, and
    - That their discount will not affect farm gate prices, when the fact is a significant number of Queensland dairy farmers which have their farm gate price linked directly to processor branded sales have seen their milk cheque drop already in March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands.
- Coles has refused to acknowledge the almost immediate impact of its actions on a significant number of dairy farmers in Queensland;
- Coles has repeatedly refused to rule out dropping prices for processors and farmers in future contracts; and
- Coles' strategy will ultimately lead to a fundamentally unsustainable devaluation of drinking milk across the whole domestic market.

It is contended that 'acting on good in faith' does not equate to situations where a dominant player in the retail market undertakes a near or below cost 'loss leader' discount marketing strategy and presents that it is about competition and presenting better outcomes for consumers and at the same time presenting that it is not having an affect on the supply chain, when in fact it is.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry highlights the fact that Courts are giving growing attention and support to an implied duty of good faith in commercial contracts.

Associate Professor Zumbo states that, 'Clearly the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.'

Recommendation: That a statutory duty of good faith be enacted as part of the Act to provide an appropriate and accepted benchmark of standards of ethical conduct.

Limitation of Supermarket Brand Market Share and Power

The current supermarket duopoly in Australia currently controls the majority of the grocery market.

These major supermarkets are able to use supermarket 'store brand' milk as a near or below cost discount price 'marketing agent' in a manner which is devaluing milk nationally and undermining the sustainability of the Australian domestic dairy industry supply chain.

Major supermarket chains, with their own 'store brand' are no longer just retailers, they are manufacturers and brand owners as well, with significant overall grocery sale and brand market share.

In 2009/2010 the total amount of milk sold through major supermarket chains accounted for 1.16 billion litres or 51% of total domestic milk sales.

It is estimated that when the major supermarket share of national milk sales through the supermarket channel is added to supermarket share of the 'route trade' for example sales through fuel stations, supermarkets now account for some 65% of all milk sales nationally.

Over the last decade major supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics, however primarily as a near or below cost discount price 'marketing agent'.

The major supermarket chains now provide the largest retail avenue to consumers in Australia for grocery sales, in addition to supermarket 'store brand' tenders now accounting for more then 25% of the national fresh drinking milk market.

Major supermarket discounting of milk from the 26th January 2011 has already seen sales growth of 'supermarket brand' milk of between 15 and 20 percent, as publically reported by Coles owner Wesfarmers.

In 2000/01 the difference in price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was, on average, $0.18 per litre and for whole milk the difference in price was, on average, $0.07 per litre. However in 2009/10 (p) the difference in price between proprietary 'branded' milk products and major supermarket chain 'store brand' products in 2009/10 (p) was, on average, $0.71 per litre and for whole milk the difference in price was also, on average, $0.71 per litre (data source Dairy Australia, Australia Dairy Industry In Focus reports).

If the major supermarkets continue to discount milk to $1 per litre then the price difference will increase, on average, to over $0.87, assuming no other price changes occur in milk processor proprietary 'branded' products.

In 1999/2000 the 'supermarket brand' label price for regular whole milk was, on average, $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent. By 2009/2010(p) the 'supermarket brand' label price for regular whole milk had dropped to, on average, $1.12 per litre or 11% and supermarket market share of whole milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent.

In contrast the price of proprietary 'branded' price whole milk has increased from, on average, $1.33 per litre in 1999/2000 to, on average, $1.83 per litre in 2009/2010(p) was up 38% compared to inflation rising approximately 36% during the same period.

When this value difference of milk sales is equated across the market share of major supermarket chain ‘supermarket brand’ sales for 2009/10 (p) compared to the value of proprietary brand sales through supermarkets the difference is $414 million nationally. In 1999/2000 the value difference amounted to some $44.5 million.

This is the amount the large retailers have taken out of the supply chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry supply chain.

As presented previously, it is expected that if the current milk discount battles continue between major supermarkets the unsustainable reduction in supermarket ‘store brand’ price will have further flow on impacts including;

- further devaluation of all supermarket ‘store brand’ milk sales as major supermarkets compete with one another to protect market share and continue to use ‘store brand’ milk as a near or below cost ‘loss leader’ advertising agent;
- further devaluation and reductions in margins of processor proprietary brands of milk as processors either resort to discounting and or increasing advertising to try and mitigate market share losses across both supermarket and route trade market channels;
- reductions in the retail price of and margins from both processor proprietary and supermarket ‘store brand’ products will inevitably flow through to wholesale prices and processor profitability;
- increasing pressure on the viability of smaller retailers and the route trade operatives such as vendors;
- increasing downward pressure on farm gate prices and supply conditions;
- lower returns for the fresh milk resulting in impacts on investment and employment throughout the supply chain;
- divestment from the supply chain, threatening supply security in many regions;
- little or no investment in product innovation, less competition, choice and inevitably higher prices for consumers.

As major supermarket store brand sales increase, they obtain more market power to be able to dictate the price and supply conditions at which suppliers sell to them. The supermarkets also then get to dominate shelf space and as a result the choice to customers declines. This vicious cycle will in the long-term result in supermarket store brand domination of the market, less or no customer choice, little or no product innovation and worst of all for consumers, increases in the price, as has been the experience in the United Kingdom.

As presented in the QDO’s submission to the Senate Inquiry, (refer to page 11 of QDO submission), across the whole domestic fresh milk market, including supermarket and route trade milk sales, if the current extreme, near or below cost, discounting by major supermarkets continues it could result in causing;

- overall milk value chain loss is estimated at $842 million per annum,
- each value chain sector, being retailers, processors and dairy farmers, would have to absorb a loss of approximately $281 million,
- an average dairy farmer seeing a reduction of 12.4 cents per litre or for an average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

As a comparison in the United Kingdom major supermarkets have virtually taken over milk retailing with their own supermarket store brands and as a result independent proprietary brands are now a rarity. A 2008 study by Oxford University estimated the big four accounted for 70% of the milk market in the UK.

In the United Kingdom processors have struggled to develop viable differentiated brands in this market. The effect of this supermarket 'store brand' dominance has been to stifle innovation, as evidenced by the lack of product differentiation in the UK milk market. The Oxford Study noted the shift in dominance in the dairy industry supply chain from processors to retailers, with only a small percentage of the supply chain profits attainable for farmers and processors.

A 2010 study by DairyCo on dairy supply chain margins noted the absence of any decline in retail prices for milk at a time of falling commodity and farmgate prices, concluding that processors and farmers absorbed the full impact of the decline in the dairy market.

Comparing 2009/10 with 1999/2000 indicated the retail price of milk increased 60% compared to a general food price increase of 36%. Over the same period the average farmgate price increased 34% and the estimated wholesale price increased 31%.

Recommendation: That the Australian Government commission an independent study of the economic impact of supermarket 'store brand' milk, procurement, marketing and pricing practices on;

- the sustainability of the fresh drinking milk supply chain,
- pricing, demand and competition between 'store' and proprietary milk brands in the fresh milk market,
- implications for consumer choice and cost in the longer term,
- implications for investment in product innovation, and

whether placing limits of market shares of supermarket 'store brands' would derive long term benefits for consumers and the sustainability of the dairy industry fresh drinking milk supply chain.

Code of Conduct for the Australian Fresh Drinking Milk Industry

Since the deregulation of the domestic fresh drinking milk price in the year 2000, major supermarkets have utilised their market position and power to their advantage resulting in;

- major supermarkets doubling their market share of discounted supermarket 'store brand' milk at prices equivalent to the early 1990s and also increasing their market share of overall domestic milk sales to significant levels;
- major decline in supply chain earnings from fresh milk sales as major supermarkets have increased their market share of discounted supermarket 'store brand' milk;
- major rationalisation of industry assets;
- significant decline in farm numbers;
- decline in milk production, especially in regions producing milk primarily for the domestic market.

The above situation has led to the progressive devaluation of the fresh drinking milk nationally and market failure within the Australian domestic fresh drinking milk market.

The current example of this market failure is clearly evident in southern Queensland where there is a shortage of milk, due to the impacts of natural disasters and in order to service market needs milk is being transport long distances at much higher costs. However at the same time major supermarkets have reduced the price of their store brand milk, with supermarket using their store brand milk as a discount marketing agent. As the supermarkets are using milk to serve as a discount marketing agent for pursuing the growth in overall supermarket grocery sales, the value of drinking milk is being continually sacrificed for another purpose which does not reflect the true cost and market value of fresh drinking milk.

The latest discounting of drinking milk by major retailers is seen as unsustainable by both industry operatives and some of the major retailers.
Over the last decade the major supermarket chains have procured significant market share and with that, market power.

This market power combined with the lack of transparency through the domestic dairy industry supply chain has created significant problems for the dairy farming sector which has been amplified by the latest discounting campaign instigated by Coles.

As previously presented processors are in 'catch 22' position with major supermarkets chains as they are the largest sales avenue to consumers for the sale of their own proprietary branded products, whilst also the supermarket 'store brand' milk tenders are now a major component of the overall domestic drinking milk market.

Between the sectors of the supply chain, being from farm to processor and then to retailer, there are major difficulties with the timing, time period of and complexity of supply contracting arrangements.

At the farm sector, dairy farmers currently carry the highest investment and risk and lowest returns in the supply chain per litre of milk and as such require higher returns and longer term contracts to be able to successfully manage the every increasing cost base and risk of farming.

However at the retail sector, major supermarkets offer one to two year contract to processors of different geographic sizes.

Dairy farming organisations accept that dairy farmers can not be expected to be paid a higher price for milk in excess of the drinking milk market demand. However, in the current environment a large number of dairy farmers are being paid some 10 % less than the regulated price of drinking milk back in 1999/2000 of 54.9 cents per litre, while over that period of time the costs of milk production has risen significantly.

With the current situation Coles has sought;

- to target blame at the processing sector for having excessive margins, which the processors have denied,
- blame processors for not paying enough to farmers,
- to deny having any impacts on returns to farmers, even though through their discounting the major supermarkets have devalued the whole fresh milk category nationally which is already seeing lower returns to the supply chain, including dairy farmers,
- to use misleading information to seek to create the perception that Coles discounting is not to blame for impacts on the supply chain.

While for dairy farmers, Collective Bargaining provisions have been made available under the Act, dairy farmers do not currently have the ability to directly address the issues created by the major supermarket chains in sacrificing the value of fresh drinking milk to use it as an advertising and sales leverage agent for other grocery product sales and growing market share.

To address this unsustainable situation, dairy farmers must have the ability enact a process to address any negative behaviour of retailers and or processors.

The current environment within the domestic dairy supply chain needs to be modified to;

- prevent the misuse of market power,
- provide greater transparency through the supply chain,
- provide dairy farmers with more effective collective bargaining provisions which allows dairy farmers to form collective groups to more closely align the market power of processors and retailers,
- provide dairy farmer collective bargaining groups with improved legal resources and training to strengthen their bargaining position in relation to processors and retailers;
- to ensure that supermarket brand milk tendering and contracts and proprietary brand supply arrangements do not undermine margins in a way that affects the sustainability and viability of the dairy industry supply chain,
- provide a more effective means of resolving disputes in a timely and cost effective manner,

The QDO believes that a dairy industry Code of Conduct could provide some distinct benefits for the industry and dairy farmers if it covered the entire value chain including dairy farmers, processors and retailers.

Benefits should include;

- provision of greater transparency through the industry supply chain;
- providing a better understanding amongst all industry value chain sectors of the issues and needs of each sector;
- providing much clearer information for dairy farmers to be able to make more informed business decisions;
- discouraging unconscionable and anti-competitive conduct;
- providing a timely and cost effective dispute resolution process, including both mediation and arbitration options;
- protection of the sustainability of the industry supply chain, whilst not hindering competition.

In relation to the issue of the need to ensure that undesirable practices do not undermine margins in a way that affects the sustainability and viability of the dairy industry supply chain, a supply chain sustainability index could be developed as a reference for the application of a sustainability test.

Over the last two years the Northern Dairy Industry has developed a Sustainable Milk Production Model to assess the requirements for sustainable dairy farming in the Northern Industry region covering Northern NSW and Queensland and to provide a long term planning and decision support tool for dairy farmers and industry stakeholders. This project is now being expanded as a national project.

There is the option to transform this model it into a regionally relevant sustainability index model which could provide accurate guidance on the key sustainability factors for milk production in key production regions for the domestic fresh milk market. Such an index system would help processors and retailers in their consideration of milk supply contracts, pricing and supply conditions, to assist in avoiding making decisions that would undermine the sustainability of milk production for the domestic fresh milk market. An independent body, acceptable to the supply chain stakeholders, could be appointed to maintain a regionally relevant fresh drinking milk supply sustainability index from which the sustainability test would be based.

The QDO believes that a similar approach to the sustainable return type model utilised in the United Kingdom has relevance if attached to a mandatory Whole of Supply Chain, Code of Conduct under the Competition and Consumer Act, with a Commissioner which has the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, or between processors and retailers.

In regard to the Produce and Grocery Industry Code (PAGIC) and the Produce and Grocery Ombudsman, dairy farmers cannot take action through the Ombudsman directly with retailers as they do not contract directly with them but rather with processors.

In regard to the Horticultural Code of Conduct it does not directly relate to the issues being faced by the domestic dairy industry, but has a number of elements which should be considered including;

- setting general terms and conditions of trade,
- minimum contractual standards,
- provision of a dispute resolution mechanism,

In addition further investigation needs to be undertaken of the potential initiatives which have been introduced by the United Kingdom by the Competition Commission including the Grocery Supply Code of Practice.

Recommendation: That a mandatory Australian Drinking Milk Code of Conduct be developed, under the Act, in consultation with industry, dealing with the relationship between dairy farmers, processors, distributors/vendors and retailers. That the Code have a Commissioner appointed with a head of power including the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, processors and retailers.

In addition the QDO supports the recommendations from Associate Professor Frank Zumbo that;

- civil monetary penalties for breaches of mandatory industry codes of conduct be imposed under the *Competition and Consumer Act*, and
- that the Australian Consumer Law framework dealing with unfair contract terms be extended to cover business to business agreements involving small businesses and farmers.

Code of Conduct Ombudsman / Commissioner

The QDO believes that for the proposed mandatory whole of supply chain Australian Drinking Milk Code of Conduct to be effective an Ombudsman or Commissioner with specific heads of power would need to head and oversee the operation of the Code and have a charter of improving the functionality and sustainability of the dairy industry supply chain for fresh drinking milk in Australia.

Any Ombudsman / Commissioner, be it a dairy specific role or an expanded Produce and Grocery role must be able to investigate complaints from across the whole of supply chain, from farm to retail.

The need for a whole of value chain Code of Conduct is highlighted by the current situation with Coles' implementing near or below cost 'loss leader' discount milk prices for their supermarket store brand milk leading to the devaluation of drinking milk nationally and the undermining of the sustainability of the fresh drinking milk supply chain.

Over the last decade major supermarket chains, especially the two major supermarket duopoly, in Australian have significantly increased their market share and power, which is a situation that has been allowed to develop by Government and the ACCC. As this has occurred, the processing sector been left with less market power and options and avenues to sell fresh milk and other dairy products to consumers.

With this development, major supermarkets chains have used their purchasing power to place considerable pressure on suppliers, especially for the supply of supermarket branded products. This increasing pressure on suppliers has over time led to downward price pressure on the supply chain and which inevitably flow through to lower returns to dairy farmers at the bottom of the supply chain.

Processors are understandably cautious about pushing back on large retailer pressure in relation to 'store brand' tenders as the major supermarket chains now provide the largest retail avenue to consumers in Australia for processor proprietary branded product sales, in addition to supermarket 'store brand' tenders now accounting for more then 25% of all fresh milk sales nationally. In addition the major supermarkets are also growing their 'store brand' market share and control across a range of other dairy products and food staples.

The discounting of milk by Coles and as followed by other retailers will inevitably force down farm gate prices for milk, which has been confirmed by public statements from Woolworths and other retailers stating that the reduction in price is unsustainable.

While for dairy farmers, Collective Bargaining provisions have been made available under the Act, dairy farmers do not currently have the ability to directly address the issues created by the major supermarket chains in sacrificing the value of fresh drinking milk, to use it at as an advertising and sales leverage agent for other grocery product sales.

To address this unsustainable situation, dairy farmers must have the ability enact a process to address the behaviour of retailers and equally processors.

The Ombudsman / Commissioner must be empowered to vet proposed contracts at any point in the supply chain, to apply a sustainability test and to direct mediation and or apply arbitration.

The Ombudsman / Commissioner must also be empowered to direct parties in dispute to behave in a way that promotes ethical business conduct.

It is noted that the consumer organisation Choice has recommended the establishment of an Australian Supermarket Ombudsman 'to tackle competition and fairness across the grocery sector.' Choice explains that the Supermarket Ombudsman would be dedicated to the task of promoting and protecting competition in the supermarket industry through the better enforcement of existing legislation. They advise that the UK Government is currently implementing a 'Groceries Code Adjudicator' under its Office of Fair Trading.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry recommends "the establishment of a new Federal Government agency to be called the Australian Small Business and Farming Commissioner would ensure that there was a suitably qualified and independent person with specific responsibility for;

1. researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and
2. assisting industry participants to resolve disputes."

Associate Professor Frank Zumbo further stated that, "While the ACCC should be concerned with identifying and prosecuting breaches of the *Competition and Consumer Act*, there will clearly be instances where the viability of industry participants is the central issue and resolution of that issue needs a business assessment by an independent party such as the proposed Commissioner rather than a legal assessment by the ACCC."

Recommendation: That an Ombudsman / Commissioner and or a Supermarket Ombudsman be appointed, with appropriate heads of power, to head the Australian Drinking Milk Code of Conduct.

Whole of Industry Forum ACCC Authorisation

It is presented that in order to effectively identify, develop, test and implement solutions to the current problems facing the domestic fresh milk market supply chain, the collective involvement of all major participants in the supply chain from production through to retail would be required.

In order for this to occur within the current boundaries of the Act we believe an Australian Government and or ACCC authorisation would be required.

The goal of the discussions would be to improve the sustainability of supply chain through an open dialogue with industry stakeholders about the true costs, margins and sustainability of production, processing, distribution and retailing through the supply chain and business practices within the industry, with the aim of addressing and improving the current unsustainable situation.

The terms of reference for such a forum could include:

- Examining the dairy industry supply chain from farmgate to retail outlet (including major retailers, route trade and small retailers of milk);
- Analysing the different markets, risks and returns across Australia, with a particular emphasis on regions where drinking milk production is the dominant section of the industry such as in Queensland, Western Australia, Northern New South Wales and then to a lesser extent South Australia and Victoria;
- Reviewing past farmgate, processor and retail prices and compare them to the current price of drinking milk including both processor proprietary and supermarket store brands; and

- Providing data and recommendations to the ACCC, Senate Economics References Committee, the Minister for Agriculture, Fisheries and Forestry and the Treasurer for actions to ensure a sustainable industry for all.

The QDO believes that the proposed Code of Conduct, Ombudsman / Commissioner and the whole of industry forum need to be directly linked to the National Food policy and planning process.

Recommendation: Government to convene, and participate in, an Australian Government and or ACCC authorised forum of the dairy industry supply chain, from farmers to retailers, to constructively discuss solutions for ensuring a sustainable drinking milk market with fair and sustainable returns.

The recommendations of the 2010 Economics References Committee report, Milking it for all it's worth – competition and pricing in the Australian dairy industry and how these have progressed

In relation to the recommendations presented from the last inquiry the QDO recommends that a strategic working group is established between Government and industry to further recommendations that provide an opportunity to derive positive outcomes for the dairy industry and the Australian community and economy.

Recommendation 5: "The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and publish its report by 30 April 2011."

The QDO supports this recommendation as there is circumstantial evidence that the objectives of the policy are not being met as retailers are using their significant market share to undermine competition in the market place, thereby lessening competition in the long run, which as experienced in some other countries such as the United Kingdom, has led to the loss of choice and higher prices for consumers.

Recommendation 3: "The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and publish the results of that review by 30 September 2010.

The QDO supports this recommendation as there is a real need for greater transparency through the supply chain of the dairy industry, particularly at the processor and retail sectors of the supply chain.

Recommendation 2: The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The QDO supports this recommendation as there is a real need for greater transparency and comparability for dairy farmers with regard to contracts offered by processors.

Recommendation 12: The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and report by 30 April 2011.

The QDO fully supports this recommendation.

Recommendation 13: In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- allowing collective bargaining groups to merge to address imbalances in bargaining power;
- the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and
- the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.

The QDO supports the recommendation and concepts of allowing Collective Bargaining Groups to merge, provision of a meditation process and a cooling off periods, however the QDO would like to further assess the specific elements of the recommendations.

Recommendation 11: The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

The QDO supports this recommendation.

Recommendation 1: The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and considers reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

The QDO supports the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 4: The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

The QDO supports this recommendation.

Recommendation 6: The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

The QDO would like to gain further information on the recommendation.

Recommendation 7: The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

The QDO supports the concept of the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 8: The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

The QDO supports this recommendation. As presented in the QDO submission the marketing, advertising and pricing tactics of major supermarkets with store branded milk is a major concern for the sustainability of the dairy industry particularly in regions which principally supply the Australian domestic market, such as Queensland.

Recommendation 9: The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

The QDO supports this recommendation. The QDO believes that the functions of the ACCC need to be reviewed given the nature of a number of recent decisions. The QDO would like to obtain further information on this recommendation to be able to provide a more informed response.

Recommendation 10: The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

The QDO supports this recommendation to ensure that appropriate transparency and issues of market power market manipulation are adequately addressed to enable the dairy industry to be sustainable into the future.

Recommendation 16: The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

The QDO supports labelling laws which accurately inform consumers on the provenance, manufacturer and contents of products.

Recommendation 14: The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

The QDO agrees with this recommendation and ADF is currently participating in the Primary Industries Ministerial Council review relevant to these matters including the review of research and development investment in agricultural industries. The QDO with other industry stakeholders have supported the development of a Sustainable Milk Production Model as a decision support tool which could provide a national reference tool for dairy farm sustainability.

Recommendation 15: In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

The QDO agrees with this recommendation as increases in production should be driven by market needs and opportunities. The QDO also encourages dairy farmers to seek professional independent advice when seeking to make business decisions.