Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

General Manager
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
Email: competition@treasury.gov.au

12th February 2016

Dear General Manager,

In Confidence
RE: Queensland Dairyfarmers' Organisation Submission to the Commonwealth Government Discussion Paper
'Options to strengthen the misuse of market power law'

The Queensland Dairyfarmers' Organisation (QDO) appreciates that the Federal Government has undertaken the review of the Competition and Consumer Act and welcomes the opportunity to respond again to the Competition Policy Review process and the Discussion Paper on 'Options to strengthen the misuse of market power law'.

The QDO is the peak industry organisation representing the interests of dairy farmers in Queensland. The QDO is a member of Australian Dairy Farmers (ADF) and fully supports ADF's submission, as well as presenting the following points.

The QDO has publicly welcomed the review of the Competition and Consumer Act (C&C Act) and has recommended, in previous submissions, a number of amendments to the Act and initiatives to strengthen the Act to address the significant impacts which have been incurred by our dairy farmers and the fresh milk supply chain, caused by predatory and unconscionable practices of major supermarkets and practices of large milk processors. These impacts have also been outlined in QDO's and ADF original submissions to the Harper Review Panel and submissions in response to the Draft and Final report.

The major supermarkets use their market power to implement a wide range of tactics to gain unfair advantage and to secure greater margins and market share for their own store brand or 'private label' products from supply chains and product manufacturers, such as rebates, marketing fees, shelve charges, shelf face manipulation, delivery charges, brand mimicking, bundling, margin cross subsidisation, waste charges and deceptive advertising to name just a few. We have observed over the last five years that the major supermarkets are continually adapting these tactics.

The QDO strongly advocates the need for the C&C Act to be strengthened, particularly in areas to outlaw predatory conduct, as outlined above, that has negative effects and implications on competition, value chain suppliers, particularly farmers, and ultimately consumers.

As stated in the Options Discussion paper, the objectives of the “C&C Act is to enhance the welfare of Australians through the promotion of competition and **fair trading**, and provision for consumer protection.” The QDO supports that objective, but as the QDO has presented to the Federal Government on repeated occasions, fair trading is not occurring and it is having impacts of competition and is now impacting consumer choice and in the future unless addressed will also impact consumer price.

As such it is critical that the ACCC has the ability to examine the effect of such tactics and strategies of major supermarkets, with particular emphasis on the impact on competition and fair trading (including small businesses), consumer choice, farmer viability, the supply chain and future prices.

QDO supports the conclusion of the Harper Review, and a long list of other competition law professionals, that change is needed to make our competition laws fit for purpose.

The proposed change to section 46 to include an ‘Effects Test’ would make our Australian competition laws more consistent with international best practice, which prohibits unilateral conduct by a dominant firm that has a harmful effect on competition.

The QDO has not responded to each of the questions in the Options Discussion Paper, but has focused on the issues we have repeatedly raised with the Federal Government prior to and throughout the review of the C&C Act.

The QDO sees that of the six options presented in the Options Discussion Paper, options A to D are absolutely untenable as we do not believe they would address the current abuse of market power currently occurring as they do not countenance including the most important and effective measure canvassed in the Options Discussion Paper - an Effects Test.

The QDO welcomes and supports the Harper Review Panel’s recommendation for the inclusion on an ‘effects test’ within Section 46 of the C&C Act.

A range of current tactics of major supermarkets have had major impacts on farmers, the supply chain and is now starting to affect consumer choice and service. The ACCC needs the ability to apply a longer term assessment of the potential implications of such procurement and retail practices of major supermarkets.

However the QDO is extremely concerned that the recommended amendments to Section 46 within the Harper Review final report and associated sections of the Act, will make the inclusion of an ‘effects test’ ineffective, including;

- that the conduct to be prohibited must be determined if it ‘substantially’ lessens competition,
- removal of the prohibition of predatory pricing and,
- removal of prohibition of price discrimination.

The latter two amendments have been proposed by the Harper Review Panel to be effectively covered by the recommended amendment to Section 46 of the Act to include an ‘effects test’.

The QDO sees that the Option E in the Options Discussion Paper is the closest preferred option. However the QDO does not support the inclusion of the 'purpose' criteria, due to the practical difficulties of proving this, which is currently the case with the purpose test in the C&C Act. The purpose test has failed to date to stop the current predatory conduct of the major supermarkets.

Proving the purpose of commercial conduct is very difficult practically due to the fact it involves a subjective enquiry; whereas, proving anti-competitive effect is less difficult because it involves an objective enquiry.

Australia's current C&C Act, focusing solely on the purpose of the dominant firm to establish a contravention of unilateral conduct prohibitions, are rarely used due to an anti-competitve purpose being almost impossible to prove. A company with dominant market power may have a multitude of purposes in a pre-meditated action in the market place but not disclose all purposes.

In any policy and law a key principle is consistency and as such the QDO supports consistency within the C&C Act and note that Option E provides an opportunity to make section 46 consistent with section 45 (anti-competitive arrangements) and section 47 (exclusive dealing) which apply if the purpose, effect or likely effect of the conduct is to substantially lessen competition and section 50 (mergers) which applies if the effect or likely effect of the conduct is to substantially lessen competition.

The QDO notes that the inclusion of an 'Effects Test' in section 46 of the C&C Act is in line with competition policy amongst developed nations around the world with the vast majority of developed nations having an Effects Test in their respective competition laws, with the exception of Australia and New Zealand.

The proposed change to section 46 to include an 'Effects Test', would move Australian law closer to international best practice, which prohibits unilateral conduct by a dominant firm that has a harmful effect on competition.

We also note the public support of competition experts for including an 'Effects Test' in Section 46 of the C&C Act, including the Harper Panel, the ACCC, former Chairman of the ACCC and small businesses and suppliers and their respective organisations across Australia.

While the QDO does not have expertise in the design or wording of competition law, we are extremely concerned that the removal of the prohibition of predatory pricing and price discrimination, which we see as two tactics used by major supermarkets which has damaged the fresh milk industry, combined with the current wording of the proposed new 'effects test' will not provide the ACCC with enough power to stop such practices of major supermarkets.

The QDO believes that if the proposed amendments to Section 46, as set out in the Report, do not outlaw the current tactics of major supermarkets, using their own store brand of fresh milk as a sacrificial, below cost, discriminatory marketing agent for an extended period of time and the impacts it has and is having on suppliers, the supply chain and consumers, then the proposed amendment is inadequate.

The QDO strongly recommends that the Federal Government seek to assess the legal adequacy of proposed amendments to Section 46 of the Act, to test if the proposed amendments would in application, outlaw such practices of major supermarkets, as described above, and if the proposed amendments need to be further refined to achieve that outcome.

Background to the Need for Change - Impacts of Major Supermarket Conduct

The Queensland dairy industry has been particularly hard hit in the past five years by the supermarket milk price wars leading to significant impacts on farm prices. In particularly, Queensland dairy farmers are required by the companies operating in the market for raw milk supply in the State to produce high quality milk every day of the year, something that is not required by dairy companies for a majority of dairy farmers in Southern Australia.

Production of milk all year round has substantial additional production costs and risks compared to seasonal milk production, as production of pasture out of optimum seasonal growth months requires significantly greater supplementation of purchased inputs such as grains, silage and hay. In addition milk production in tropical and sub-tropical regions will also incur some cost disadvantage because of the available feedbase no matter what production system is used compared to temperate regions.

As virtually all of Queensland milk produced is used as drinking milk, it makes Queensland farmers highly susceptible to impacts from manipulation of the national pricing of drinking milk by major supermarkets through the ongoing supermarket ‘milk price war’.

With the requirement to supply milk all year round it makes for a difficult operational environment for dairy farmers with limited or no alternative supply and production system options.

When the milk price war started on Australia Day 2011, fresh milk was discounted to the unsustainable level of $1 per litre, which was started by Coles and then followed by the other major supermarket chains.

This marketing gimmick has sacrificed the value of fresh milk right across the nation and this has had major knock on effects for the domestic fresh milk industry and the dairy farming families that supply fresh milk for Australian consumers.

The impacts of discounting supermarket branded fresh milk by up to 33 percent to $1 per litre have been wide spread, including;

- devaluing fresh milk at retail level nationally by an estimated $220 million per annum;
- forcing a large price difference between supermarket store brands and processor proprietary brands to an average differential of more than 90 cents per litre;
- causing the loss of market share of processor proprietary brand milk sales to discounted $1 per litre supermarket store brands and with that, the loss of processor profitability;
- forcing processors to discount their own proprietary brands to try and slow the loss of market share, with a further loss in processor profitability;
- use of bundling, margin cross subsidisation and long term set price contracts to elongate the ability to sacrificially discount products like fresh milk to a point where permanent damage is caused to the supply chain and competition,

- these market pressures on processors have been passed back to dairy farmers through the reduction and ongoing suppression of farm gate prices, along with the reduction in contract periods and tightening of contract conditions, quality penalties and addition of freight charges. This has been happening while farm operational costs have continued to go up, forcing farmers out of the industry.
- preventing the recovery of milk production following the severe flooding in Queensland in 2011 and 2013 and driving milk production lower, when Queensland has seen a major shortage of milk to meet its own needs since the start of 2011.
- small independent retailers and processors have been placed at a huge disadvantage on price, particularly in regional areas, where major supermarkets use national cost averaging and sell milk at a loss at $1 per litre in regional towns, including very isolated large and small centres like Mount Isa or Charleville. In fact processor representatives are telling the QDO they are losing money servicing some regional centres. If the processors withdrew from supplying loss-making centres then the consumers in those centres would only have a choice of supermarket own brand milk and that is only in those regional centres where the major supermarkets trade. This also impacts on independent retailers, corner stores and other outlets which normally supply milk to consumers in those centres. This implication was forewarned by the processing sector during the Senate Inquiry in 2011.

In 2007, Queensland milk supply was close to the regional market demand line, caused by many years of severe drought impacts combined with low farm gate prices. The processors responded to this tightening supply, by increasing the prices of their products in the market place, enabling them to then afford to pay farmers a much higher farm gate price as well as providing longer five year term contracts. This initiative allowed milk production to stabilise and recover. In the current market environment, if processors acted to increase prices they would lose further market share to the supermarket discounted $1 per litre store brand milk.

In 2011 and 2013 with severe flooding impacting many Queensland primary production areas, unlike the other industries such as the fruit and vegetable industry when the supply to the market was impacted the price, based on supply and demand, rose. The flooding also adversely impacted Queensland fresh milk supply, but prices did not rise. In fact, the farm gate price for milk fell during this period due to the market power interference by the Coles led supermarket milk price war, which has not allowed normal market supply and demand pressures to function properly in the Queensland market.

In Queensland alone, we have now lost more than 160 dairy farmers since Coles started the milk price war in 2011, and we arguably should not have lost any, as we have been short of milk in Queensland to meet the needs of Queensland consumers since the start of 2011.

This is not just a loss of generational expertise in dairy farming and upcoming young farmers, but equates to a loss of some $550 million to investment in milk production in Queensland and some 560 on-farm jobs, let alone the jobs lost from cut backs by the processors and job losses from regional Queensland as service work to the dairy industry is lost. This is a clear case of regional market failure.

At the same time farmers are leaving the dairy industry we are short of fresh milk to meet the daily needs of consumers.

This year we are forecast to be more than 30 percent or more than 170 million litres short. This figure will get worse unless the current market failure is addressed.

At the same time milk processors are freighting milk longer distances from NSW and Victoria, at a much higher landed cost, than they are paying Queensland dairy farmers, to fill this supply gap.

Sourcing milk from the southern Australian regions to fill the domestic market gap is effectively diverting milk away from being manufactured into dairy products for the export market and transferring income from the dairy industry to the transport sector. This is a net loss to the Australian economy as a whole and will have long-term ramifications.

The QDO and Australian Dairy Farmers (ADF) foresaw and presented these possible implications to the Senate Inquiry in 2011, however the growing impacts and their causes are still being ignored.

The forecast population growth in Queensland over the next ten years translates to the need for another 110 million litres of fresh milk to meet the needs of Queensland consumers. To achieve that goal, let alone take advantage of the opportunities in the growing Asian market, farmers and investment need to be attracted to our industry not driven out of it.

All of these are factors which should be having a positive influence on the Queensland farm gate milk price, but are not. If a truly free market operated, then farm gate prices should increase.

The impacts of market failure can be clearly seen in the results of a survey of Queensland dairy farmers carried out in August last year which achieved a response rate of 51%. The survey confirmed that farm confidence remains extremely low and fragile due to negative farmgate returns and low milk prices, which is now being exacerbated by rising input costs such as electricity.

The survey responses presented that;

- the majority of Queensland dairy farmers are not confident about or were uncertain of the future of their dairy farming business and the whole northern dairy industry,
- only 31% presented that they expect to still be dairy farming in 5 years' time,
- 74% of those people with an expectation of possibly leaving the industry listed "lack of profitability" as the major reason for considering leaving the industry,
- 52% of farmers could not pay all of their monthly bills with their monthly milk cheque, and that a similar percentage has had to increase their level of loan or overdraft debt over the past year and had been forced to postpone vital repairs.
- 71% have deferred or cancelled repairs and maintenance and capital expenditure.

What has happened in the United Kingdom (UK) over the last decade and half can be used as a forecast of what is in store for the Australian domestic market if the current supermarket tactics continue.

During this time in the UK, the supermarket brands have largely taken over the market place, supermarkets have taken control of the supply chain and from the data provided from the UK group DairyCo, from 1997 to 2009, or 12 years, the retail milk gross margins for;

- farmers increased by only some 4 percent,
- processors increased by some 20 percent, however
- retailers increased by over 600 percent.

At the same time, choice for consumers in the UK has declined and they are now paying a higher price. As this has unfolded more and more UK farmers have left their industry and now the UK imports dairy products from the Europe to meet its consumer's needs. Now in the UK the major supermarkets have started another 'milk price war'. The UK farmers are also seeking stronger Government intervention to bring about fairness in their market.

The QDO has welcomed the ACCC's decisions to take action against Coles in the Federal Court where Coles engaged in unconscionable conduct in dealings with suppliers. However this action has not addressed the predatory conduct which continues to occur.

The QDO has made a range of representations to the ACCC with regard to the dealings of the major supermarkets since the commencement of the milk price war in 2011.

The QDO has a concern with this process of investigation and ultimate action. We believe the Act needs to be strengthened in this and other areas as it can often take many years to collect the evidence and develop a case before the action in initiated. The case itself can often take many months, if not years, to complete and there is the option of an appeal for any aggrieved party.

During such time, not only can the conduct continue but it can cause such damage that a supplier may go out of business while the regulatory process is proceeding.

There needs to be a more timely approach to investigations and legal action by the ACCC, so that damage to a supplier stops. The QDO believes the ACCC should be given more resources to undertake its responsibilities of enforcing the C&C Act in a more effective manner.

However the QDO believes that that the proactive approach of strengthening the C&C Act to an extent that leads to significant improvements in corporate behavior and culture would the preferred approach.

In the interests of dairy farming families of Queensland, the QDO appeals to the Federal Government to strengthen the C&C Act by including an 'Effects Test' in section 46 without additional qualifications which could limit its enforceability and therefore effectiveness.

If you require further information please do not hesitate to contact me or QDO's Executive Officer, Adrian Peake.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd