

19 September 2014

Grocery Code Consultation Paper
Small Business, Competition and Consumer Division
The Treasury
Langton Crescent
PARKES ACT 2600

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To Whom It May Concern,

RE: Food and Grocery Code of Conduct Consultation Paper

Australian Dairy Farmers (ADF) appreciates the opportunity to provide a submission to the Grocery Code Consultation Paper as part of the Treasury's process of 'Improving Commercial Relationships in the Food and Grocery Sector.'

ADF believes that a rigorous consultation process is important in achieving a Code that is beneficial and viable for both suppliers and retailers. As dairy farmers have been profoundly affected by supermarkets' aggressive discounting of home brand milk, ADF is eager to see the realisation of a Code that allows retailers and suppliers to negotiate fair, honest, and reasonable commercial agreements.

ADF recognises that the proposed Code is a step forward and considers this to be a positive result of the significant media and political pressure generated by ADF, Queensland Dairyfarmers' Organisation (QDO) and other industry organisations.

However, while the Code is admittedly a step in the right direction, ADF believes that it lacks scope and is not sufficiently comprehensive. In this submission, ADF will bring attention to significant gaps in the Code including but not limited to the need for an Ombudsman, penalties, establishing a Code that is mandatory, and an Effects Test.

If you wish to discuss this submission or require further information on this matter, please do not hesitate to contact ADF Senior Policy Manager, David Losberg, on (03) 8621 4200.

Yours sincerely,



Noel Campbell
President

Introduction

Australian Dairy Farmers (ADF) is a not-for-profit organisation that represents the interests of dairy farmers nationally. As the collective voice to Government and the community on national issues affecting dairy farmers, ADF has a long history of successfully lobbying for the rights of dairy farmers on many fronts.

Australian dairy is a \$13 billion farm, manufacturing and export industry, with an extremely positive future given fair market circumstances. Dairy's value to the Australian economy, jobs on farms, manufacturing and service sectors, the towns and communities it supports, as well as the ongoing health and wellbeing of Australian families, are a compelling basis for Government attention and policy that levels the current playing field domestically.

Australia's 6,400 dairy farmers produce around 9.2 billion litres of milk a year, with the potential to grow substantially over the next decade to meet growing international demand, particularly in South East Asia, China and the Middle East.

The industry directly employs 43,000 Australians on farms and in dairy processing, and more than 100,000 are employed in dairy service sectors.

Background

On 26 January 2011, Coles dropped the price of its home brand milk to \$1 per litre. This was initially perceived to be a temporary marketing tactic. Unfortunately, this unsustainable pricing has now continued for 3 ½ years, negatively impacting the domestic dairy industry.

The considerable amount of work, investment, planning and risk required to produce, transport, process, distribute and deliver a perishable product, fresh milk, on a daily basis is not reflected in the current discount price of milk by major retailers at \$1 per litre and is distorting the market.

If left unchecked, the actions of the major retailers in squeezing the supply chain will ultimately lead to a substantial lessening of competition in the market place, a significant impact on the viability of branded dairy products, less product variety on supermarket shelves, less choice for customers and in the long term, higher prices for consumers.

The supermarket duopoly in Australia benefits from unprecedented market share and market power. The unique nature of milk provides retailers with an effective means to grow their market share and power. However, the consequences for the sustainability of the domestic fresh milk supply chain are significant.

Coles has continually tried to claim that farmers are not being impacted by the pricing of milk at an unsustainable \$1 per litre. This is simply not true. Dairy farmers in the key drinking milk markets are being affected.

A key claim of Coles' was that they were "fully absorbing the price cut", i.e., the cost of the discounting of milk to \$1 per litre.

Coles Video and Cartoon – contravention of Australian Competition Law

Recent Australian Competition and Consumer Commission (ACCC) findings that the ‘Our Coles Brand Milk Story’ video and cartoon are likely to have contravened Section 18 of the Australian Competition Law contradict Coles’ key claim of “fully absorbing the price cut.”

Section 18 prohibits misleading or deceptive conduct, and Coles has admitted it is likely to have contravened this part of the act.

The ‘Our Coles Brand Milk Story’ video and cartoon were a cynical exercise by Coles to convince consumers that farm gate prices had increased for dairy farmers when they had actually decreased.

The ACCC’s investigation followed complaints from dairy farmer organisations, including ADF and the Queensland Dairyfarmers’ Organisations (QDO), about the misleading nature of the video and cartoon; which was published on social media. Coles has also claimed that their own margins decreased on Coles-brand milk – something that the ACCC has said could not be substantiated.

The ACCC found that Coles had, in the video and cartoon, represented the farm-gate milk price increasing from 86 cents per two litre bottle of Coles-branded milk in 2010-11 to around 90 cents in 2011-12, when in fact this was an estimate with the final industry figures showing the 2011-12 farm-gate milk price actually decreasing to 84 cents.

The ACCC’s ruling is an indictment of Coles and their key claim that they have absorbed the cost of \$1 per litre milk. Pleasingly, the ACCC recognised this and compelled Coles to take action, including via social media, to correct the record and to avoid making misleading or deceptive claims around the retail price of milk in future.

As Coles themselves stated in their ‘Corrective Notice on our Milk Story – Coles’ video on YouTube: “We made representations about facts that were actually only estimates or opinions”. In the corrective notice Coles also admitted that it has now only funded the “majority of the price cuts”. ADF has, since January 2011, consistently said that milk priced at \$1 per litre is simply unsustainable and does not give a fair return for dairy farmers and others in the supply chain.

Another case of key interest is the recent announcement of ACCC Federal Court proceedings against Coles.

ACCC Federal Court proceedings against Coles

The ACCC announced in April that it will take Federal Court action against Coles for alleged unconscionable conduct towards 200 of its smaller suppliers. The commission will allege that Coles’ alleged behaviour towards suppliers includes providing misleading information and taking advantage of their superior bargaining position.

The ACCC’s decision to take this case to court is an important vindication of the concerns raised by ADF about the excessive market power of the major retailers and the ways in which they have exercised this power. ADF looks forward to the outcome of the court case given its strong advocacy to the ACCC on behalf of the industry since the introduction of \$1 per litre milk in 2011.

It is worth noting that a lack of complaints against the major retailers does not mean there is an absence of market failure but instead represents evidence of significant market failure as smaller suppliers are extremely reluctant to take action or give evidence.

ADF will continue to strongly lobby the Federal Government and advocate for a Mandatory Code of Conduct, including a Supermarket Ombudsman 'with teeth' to balance the extreme market power of the major retailers.

The ACCC's findings in relation to the Coles video and cartoon, the recent Federal Court proceedings, the excessive market power of the major retailers and their treatment of suppliers, both big and small, add up to a compelling case for a Mandatory Code of Conduct, including the establishment of an independent Supermarket Ombudsman with 'teeth', and changes to the Competition and Consumer Act to balance the excessive market power of the major retailers.

The United Kingdom situation

The United Kingdom has already experienced the sort of discounting Australian farmers have now endured for 3 ½ years along with the ensuing impacts on farmers and processors. This led them to develop measures to bring about more fairness and transparency in the market.

ADF believes these measures, particularly the UK Groceries Supply Code of Practice (the Groceries Code) provide a good starting point for the basis of Australian legislation establishing a mandatory code of practice and an ombudsman or commissioner.

The United Kingdom Competition Commission (CC) found that one of the features that adversely affected competition in the market was the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers – a situation ADF believes is being replicated in Australia.

The UK CC found that there was a detrimental effect on customers resulting from the adverse effect on competition and published its final report on 30 April 2008. In the report the CC considered that a package of remedies consisting of the following key elements would be effective and proportionate in remedying the various features of the market identified as having an adverse effect on competition:

- (a) the establishment of a Groceries Supply Code of Practice (GSCOP); and
- (b) the establishment of a GSCOP Ombudsman (or Adjudicator) to monitor and enforce compliance with the GSCOP.

A major issue the report raised was that some practices by big supermarkets were still having an anti-competitive effect, harming the long term interests of consumers. The new UK Code of Practice (the Groceries Code) was designed to improve the relationship between big retailers and their suppliers by preventing certain practices from occurring.

The Groceries Code came into force on 4 February 2010 and applied to all retailers with an annual turnover of more than £1 billion in groceries in the UK (there are ten such retailers in the UK). It must be incorporated into contracts with suppliers.

A key point here is the view that an Adjudicator or Ombudsman was felt necessary to enforce the Code and was legislated for.

Situation for Consumers

ADF's view that Coles is not absorbing the cost of this marketing tactic has been upheld by the result of the ACCC action against Coles over its video and cartoon claims, which were shown to be false and misleading.

It is clear that the major retailers are trying to take business and market share from corner stores, independent petrol stations and other small businesses. We believe when they have achieved their goal and cornered the market in the long-term, they will raise the prices on milk again as there will be little or no competition.

If left unchecked, Coles' actions will lead to a substantial lessening of competition in the market place, a substantial impact on the viability of branded dairy products and are likely to lead to less product variety on supermarket shelves.

As outlined above, this aggressive discounting has happened before in the UK and it is the ADF's belief that Coles' executives are intent on replicating that model here in Australia. It ultimately leads to less choice for consumers, higher prices on products that are not staples and unsustainable pressure on farmers and others in the supply chain. ADF believes that unless addressed this situation is inevitable in Australia.

Impact on processors

Coles and Woolworths between them have almost 80% of the market and this places processors in a 'catch-22' position. The major retailers are not only the largest sales avenue to consumers for the sale of processors own branded products but the supermarket 'home brand' milk tenders are now a major component of the overall domestic drinking milk market.

This means that processors are understandably cautious about pushing back on the major retailers due to their market power. It also means there are significant impacts down the supply chain with farmers bearing the brunt of reduced value in the supply chain and changes in contract supply requirements in different regions.

The value of branded products has fallen as processors have discounted their products to compete with the retailers' home brand products.

ADF Recommendations – Excessive Market Power of the Major Retailers

ADF's recommendations to the Code in relation to the excessive market power of the major retailers can be summarised as:

1. Mandatory Code of Conduct
2. Appointment of an Ombudsman to Enforce Compliance with the Code
3. Financial Penalties
4. Reintroduce an Effects Test
5. Investigate Predatory Pricing
6. Definition of Unconscionable Conduct
7. Statutory Duty of Good Faith
8. Unfair Contract Terms
9. Collective Bargaining Changes

- 10. Removal of Carve-Outs
- 11. Whole Supply Chain Approach

1. Mandatory Code of Conduct

Given the sheer size of the supermarket duopoly and the disproportionate power they wield in the Australian market place the majority of Australian suppliers, particularly of fresh food produce and drinking milk, must have some sort of ongoing commercial relationship with them. It is important therefore that there is full transparency along the supply chain and that processors and farmers have access to timely and cost effective dispute resolution processes in their dealings with major supermarkets.

The only effective way to ensure this is to establish a Mandatory Code of Conduct covering the whole supply chain to balance the market power of the major retailers and appoint an Ombudsman with teeth to ensure compliance.

The Code should apply to all retailers and it must be mandatory to ensure complete coverage across the industry and it must remove the ability of retailers to opt out of the Code; giving it the authority necessary to effect real changes.

2. Appointment of an Ombudsman to Enforce Compliance with the Code

Considering the market power of the major retailers and the reluctance of suppliers to take action or give evidence against them, an important aspect of the Code will be the ability of industry organisations, federations or associations to make complaints on behalf of their members. Appointment of an Ombudsman will be instrumental in facilitating correct compliance with the Code and improving the balance in the commercial relationship between retailers and suppliers.

An Ombudsman provides the added benefit of absolute focus on issues pertaining to the food and grocery space, allowing proactive monitoring of the Code, as has been the case in the UK, where the adjudicator does not have to wait for a unilateral complaint or failure of other mediation process in order to take necessary actions. Appointment of an Ombudsman encourages speedy resolution of disputes rather than escalation.

ADF recommends that the Ombudsman have the capacity to obtain information, documents and evidence, issue written public warnings regarding the conduct of a supermarket and apply substantial financial penalties for those who transgress.

The appointment of an independent arbiter by one of the major retailers to oversee an internal supplier charter and help resolve disputes is tacit acknowledgement of the need for an independent Ombudsman.

3. Financial Penalties

In order for the Ombudsman to enforce compliance with the Code, the Ombudsman must have the power to instigate significant financial penalties against those who transgress, as in the case of the UK Grocery Code, which allows maximum penalties of 1 percent of the retailer's turnover. The proposed Food and Grocery Code does not provide for any penalties and this is a glaring omission.

ADF believes that the absence of penalties and an Ombudsman to impose financial penalties severely undermines the authority of the Code's provisions.

4. Reintroduce an Effects Test into the Competition and Consumer Act

The clear intent of the major retailers' strategy is to extract as much value as possible from the supply chain with consequent pressure on those at the start of the chain, namely farmers. They are also seeking to increase their own market share to the detriment of competitors and to increase the share of home brand products in store. In Queensland, where almost 100 per cent of production goes to fresh drinking milk, over 100 dairy farmers have left the industry since the supermarkets aggressive discounting strategy began.

Given this, it is important that the ACCC has the ability to examine the impact of such strategies in the longer term, with particular emphasis on the impact on consumer choice, farmer viability, the supply chain and future prices. It should also be noted that ADF is of the firm opinion that the ACCC must take a longer term view of market issues than it currently does on all issues and in all its investigations; including those related to the proposed Food and Grocery Code.

The importance of the effects test has also been recognised and endorsed by the ACCC Chairman Rod Sims, who has stated that inclusion of such a test in the Competition and Consumer Act would assist the ACCC in its objective to maintain strong competition by curbing abuse of market power and discovering the true impact for consumers, farmers and others of strategies undertaken by those with significant market power.

5. Investigate Predatory Pricing

That the relevant Federal Minister give 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, particularly in regional and remote areas.

In regional and remote areas of Australia such as Darwin, Kununurra and Broome milk cannot be sold at \$1 per litre on an ongoing basis without making a loss. ADF believes it is impossible to buy, transport, store and sell milk in these areas for \$1 per litre without selling below cost. In these same regional market areas processor proprietary brands have lost significant market share to discounted supermarket home brand milk.

6. Definition of Unconscionable Conduct

Greater certainty in the form of a legislative definition could assist farmers' access relief from unconscionable conduct. 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 2010 inquiry into Competition and Pricing in the Australian Dairy Industry recommended 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.

Associate Professor Zumbo 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.' This is particularly important in a country where two dominant players have almost 80% of the market.

Such a definition would not interfere with the driving of a 'hard' bargain, but rather would provide clear statutory guidance as to what is considered unethical, set out a non-exhaustive benchmark for assessing conduct to determine whether or not it goes beyond what is reasonably necessary to protect the legitimate interests of the parties involved.

ADF believes that Coles' recent actions are certainly unconscionable, particularly when the intent of the actions is taken as a whole. Coles clearly means to damage other competitors and also put pressure on the dairy (and other commodity sectors) value chain.

ADF is of the view that anything that provides clarity for the courts and reduces the limitations of the current Act is worth pursuing. A possible definition as outlined by Associate Professor Zumbo is below:

'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.'

7. Statutory Duty of Good Faith

It is important in any commercial relationship that acceptable and ethical business be promoted and undertaken. It is ADF's belief that enacting a statutory duty of good faith in the Food and Grocery Code will assist in ensuring this takes place.

ADF understands that recent case law has provided a framework upon which a statutory duty of good faith could be based.

- (1) Acting arbitrarily, capriciously, unreasonable or recklessly;
- (2) Acting in a manner that is oppressive or unfair in its result by, for example, seeking to prevent the performance of the contract or to withhold its benefits;
- (3) Failing to have reasonable regards to the other party's interests; and
- (4) Failing to act 'reasonably' in general.

In situations where a company with significant market power and vast resources uses its 'muscle' to damage an industry then it cannot be said to be acting in good faith.

ADF believes the enacting of a statutory duty of good faith will assist in controlling such behaviour.

ADF recommends that a statutory duty of good faith be enacted as part of the Act as soon as possible to provide an appropriate and accepted benchmark of standards of ethical conduct within the Australian dairy industry.

8. Unfair Contract Terms

The dairy industry seeks recognition of the competitive disadvantage faced by farmers (who are essentially small businesses) which places them in a uniquely vulnerable position. This disadvantage is particularly heightened due to the time pressures and logistical disadvantages in supplying perishable goods.

The dairy industry acknowledges the recent release by the Minister for Small Business of a consultation paper on extending unfair contract term protections from consumers to small businesses and endorses this work.

It is essential that the protection offered to consumers in similar circumstances should be considered for small businesses in similarly vulnerable positions.

9. Collective Bargaining Changes

The dairy industry seeks to improve the collective bargaining and boycott regimes, in particular to influence the following outcomes:

- a) relaxation of the 'public interest' test for boycott approvals, to consider the unique nature of agricultural markets;
- b) increase the ability for peak bodies to commence and progress collective bargaining and boycott applications, on behalf of their members.
- c) examining policy options for expanding the 'shared community interest' provision in the current ADF authorisation.
- d) broadening the scope of buyers in the market place able to negotiate with Collective Bargaining Groups so it is not just limited to processors, to include all buyers of milk e.g. brokers, wholesalers, retailers as well as other dairy farmers.

As part of the ADF and Queensland Dairyfarmers' Organisation (QDO) draft Mandatory Code of Conduct, a declared supermarket operator must not refuse to enter into a supply agreement with a supplier because that supplier is, or is not, a member of a collective bargaining group or because that supplier is entering into a supply agreement as a result of conduct or negotiations undertaken by a collective bargaining group.

A declared supermarket operator must not enter into any supply agreement with a supplier unless that supplier has been provided with a reasonable period within which to apply to join or take the benefit of conduct of a collective bargaining group.

10. Removal of Carve-outs

ADF recognises the need for a reasonable level of flexibility in commercial relationships. However, in the absence of an Ombudsman for the Code, the inclusion of carve-outs generates substantial uncertainty for suppliers and potential opportunities for abuse of market power, thus undermining the Code's objective. The dairy industry will only support carve-outs in conjunction with proper oversight of these exemptions, namely through an Ombudsman.

11. Whole Supply Chain Approach

The Australian dairy industry must be viewed as an integrated supply chain. Milk is a perishable product, which must be processed before it can be sold commercially. As a result, dairy production is integrated across the supply chain: dairy farmers cannot operate without domestic processing capacity, nor can processors survive without domestic farm milk supply. The dairy products that farmers and producers supply to retailers form a key category in their store offering.

Significant regional differences continue to characterise the Australian dairy industry – based on market and product mix, farmer confidence as well as current and future growth prospects.

Like the national economy, the dairy industry continues to be characterised by “two speeds” – growth and consolidation in exporting regions, contrasted with faltering confidence and contraction in domestic milk regions.

For most farmers in south-eastern Australia, international conditions determine prices and industry confidence. In Queensland, Central and Northern New South Wales, and Western Australia, however, the industry is geared toward domestic fresh milk supply.

Ongoing intensity in retail competition, unsustainable pricing of milk at \$1 per litre, disruptions caused by changes in private label supply contracts, and uncertainty surrounding processor milk requirements have undermined farmer confidence and supply stability.

These regional differences affect the food system within regions, and, ultimately, the sustainability of a local fresh milk supply. Analysis at the national level fails to show this nuanced picture particularly the de-linking of pricing in the ‘drinking milk’ states from international prices which is becoming apparent and is cause for concern.

ADF therefore recommends that the Code cover the whole of the supply chain in order to facilitate more complete application of the Code’s provisions.