Submission No 22

INQUIRY INTO SUSTAINABILITY OF THE DAIRY INDUSTRY IN NEW SOUTH WALES

Organisation: Dairy Farmers Milk Co-Operative Limited

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Dairy Farmers Milk Co-operative Submission to the NSW Parliamentary Inquiry into the Dairy Industry

Dairy Farmers Co-operative is pleased to have an opportunity to express its views on potential improvements in the functioning of the Dairy Industry in Australia.

We have addressed point (a) in the Terms of Reference:

(a) The nature of, and relationship within, the value chain between farmers, processors, logistics companies and retailers and their respective influence on price;

and specifically the functioning of Collective Bargaining Groups and detail the function of DFMC and the current relationship with Lion Dairy and Drinks. In the main this partnership works well and goes someway to addressing the imbalance of power issues faced by farmers in their relationship with processors.

COLLECTIVE BARGAINING IN THE DAIRY INDUSTRY

INTRODUCTION

Collective Bargaining Groups (**CBG**s) for the most part have been ineffective in improving the bargaining position of farmers. The "playing field" is decidedly still in favour of the processor.

The dairy industry needs effective CBGs. Dairy Farmers Milk Cooperative Limited (**DFMC**) has been operating as an effective CBG for the last eight years. DFMC has been successful for three main reasons, namely:

1. it is well funded and resourced;

2. Lion Dairy & Drinks (**LDD**) is contractually bound to deal with DFMC via its Milk Supply Agreement (**MSA**); and

3. in the event of a dispute (including as to price), the dispute can be resolved by binding independent expert determination.

Sadly, in the absence of the above qualities, CBGs are mostly ignored by processors and have little impact in the marketplace.

The purpose of this paper is to highlight the success of the current arrangement between DFMC and LDD and to recommend the model be supported and more widely adopted within the industry.

Dairy Farmers Milk Co-operative Limited

DFMC is a co-operative registered under the Co-operatives National Law.

DFMC currently has 345 farmer members in five regions – Far North Queensland, South East Queensland, Central NSW, Northern Victoria and Central South Australia. DFMC currently supplies approximately 270 million litres of milk per annum to LDD representing around 50% of LDD's overall milk pool purchased from farmers within the regions in which we operate.

DFMC has a board of directors (**Board**) comprising of seven farmer directors, representing the five regions, together with one independent director. Each of the directors has extensive experience in the dairy industry.

In addition to the Board, DFMC has a Ward Representative Advisory Council, which currently consists of 14 DFMC farmer members from the five regions. The advisory council consults with the Board on policy, strategy and regional issues.

Milk Supply Agreement

DFMC started in 2004 as Australian Co-operative Foods Ltd, trading as Dairy Farmers, was preparing to sell the marketing and processing part of the business. In 2008, as part of the arrangements to sell Dairy Farmers to National Foods Limited (now LDD), DFMC entered into a long-term MSA with LDD. The MSA currently terminates in 2019.

The MSA contains a number of key features:

- **Guaranteed offtake** - LDD agrees to take (and collect) all of the milk supplied by DFMC's farmer members;

- **Back-to-back pricing/milk policy** - The price paid by LDD to DFMC is the same as the price paid by DFMC to the farmers;

- **AFD** - LDD can indicate its future milk needs through what is termed 'Anticipated Full Demand' (**AFD**) in each region;

- **Market price** - Farmers are to be paid the market value or price in each region for the milk required to meet the AFD;

- **Dispute** - In the event of disagreement regarding the AFD or the market price, there is a process of mediation and then binding Independent Expert determination - whose decision is final; and

- **Aggregation fee** - LDD must pay DFMC an 'Aggregation Fee' to cover the costs of aggregating the farmers' milk pool.

In 2008, ACCC issued an authorisation in respect of the MSA allowing for "back-to-back pricing/milk policy". This authorisation was renewed in 2013.

A short history of the dairy world in our part of Australia

For many years, the majority of milk produced by farmers was supplied to farmer owned co-operatives. Over time, a number of these co-operatives have ended up being bought by proprietary operators or have listed on the ASX so there are fewer co-operatives now. Examples of former processor co-operatives include Australian Co-operative Foods, Warrnambool Cheese

& Butter, Bega and Bonlac Foods. So far as we are aware, the only remaining processor co-operatives are Devondale Murray Goulburn (which has introduced external investors) and Norco.

Similarly, before its sale, Australian Co-operative Foods (trading as Dairy Farmers) was itself the end product of many amalgamations of co-operatives – (NSW) Hunter Valley Coop, Shoalhaven Coop, the original Dairy Farmers Coop, (QLD) Atherton Tablelands Coop, Queensco Unity Dairyfoods Coop and (SA) Dairy Vale – and all of them, in turn, were amalgamations of other smaller cooperatives.

By and large, co-operatives were run for the benefit of the farmer members and profits distributed to farmer members by way of milk price and/or dividend. The demutualisation/de-co-operatisation of entities within the dairy industry is largely explained by the inability of farmer members to continue to fund the ongoing capital requirements of the business and the increased consolidation of the retail sector (i.e. the supermarkets and convenience stores). As the retail sector became more and more consolidated, dairy businesses needed to similarly consolidate.

How does the MSA work?

Prior to the end of each calendar year, DFMC and LDD discuss any changes (such as changes to quality, composition, logistics and contract terms) that may be required to milk policy.

Before the start of the following financial year, DFMC and LDD discuss any changes to the AFD which might affect pricing negotiations.

The pricing arrangements for each region, taking into account any milk policy changes, are then negotiated with both sides having developed their own independent data about competitive milk pricing.

Any change to the milk policy, AFD or pricing arrangements need to be agreed by both DFMC and LDD. Should the parties be unable to agree, the dispute may be referred to an Independent Expert to determine the issue. The Independent Expert's decision is final and binding on the parties.

The Independent Expert determination is conducted in accordance with the independent expert rules of the Australian Disputes Centre.

Resolving Issues

During the last eight years, DFMC and LDD have been in dispute a number of times.

On some occasions the dispute has been resolved by mediation but the Independent Expert has been used more often (but only approximately three times). The Independent Expert has generally been a QC, such as Walter Sofronoff QC, former Solicitor-General for Queensland and has presided over a range of matters relating to the level of milk payments, the composition of those payments and terms of supply.

The Independent Expert determination process has overseen the resolution of some difficult issues, such as the reduction in DFMC's farm milk supply base in the face of the reality of LDD losing retailer milk contracts (and thus a lower AFD). This has all been achieved with little public comment made despite this being a very difficult time for some farmers.

During the last three years, neither the use of the Independent Expert nor mediation has been necessary. It is our view that the availability of Independent Expert determination ensures the parties do not stray too far into unreasonable territory. The compulsory nature of the process most certainly also plays a part in ensuring disputes are resolved by both parties acting reasonably.

In DFMC's opinion, having the ability to approach an Independent Expert (who is capable of 'sifting the wheat from the chaff') has been the key to the successful collective bargaining arrangements with LDD.

Costs of resolving issues

Generally, DFMC and LDD each bear their own costs associated with the Independent Expert's determination. In addition to the Independent Expert's own costs, the costs include lawyers' fees and the fees of appropriate experts.

LDD is a large and well-resourced organisation. In order for any Independent Expert determination process to be effective, DFMC (or any other CBG) needs to be able to fund the process (including obtaining appropriate third party advice).

Whilst the ability to approach an Independent Expert is central to any successful collective bargaining arrangements, the ability to approach the expert must be real and not illusionary. In DFMC's opinion, it is of critical importance that any CBG has the financial resources to be able to properly fund an Independent Expert determination process.

Other Collective Bargaining Groups (CBGs)

In the dairy industry, there are few operating CBGs, other than DFMC.

Many CBGs have been authorised or have sought authorisation, but few are working examples. The ACCC website indicates there have been 18 CBG authorisations registered covering some 500 farming families[1]. In practice, DFMC is aware of only one other significant group active at this time – Premium Milk in South East Queensland (who supply Parmalat). There are two or three small CBGs who supply relatively small quantities of milk to Woolworths. There are also Collective Bargaining Groups in other agricultural pursuits and other non-agricultural applications.

So, why has the practice not been more widely or actively used in our industry?

In DFMC's view, in the absence of a compulsory obligation to collectively bargain, collective bargaining arrangements are entirely dependent upon the goodwill of the processor with whom the group is negotiating. The problem is that a processor may or may not choose to deal with a CBG – such an example was Progressive Dairy Group in SE Queensland. This means that the processor still has all the power in the relationship – if they think the CBG is a threat or has some real 'power' or negotiating expertise, they simply say they are not interested in dealing with the collective bargaining group and deal with the individual farmers directly.

[1] http://www.accc.gov.au/media-release/accc-extends-dairy-farmer-collective-bargaining-arrangements

Many processors appear to resent having to negotiate price and terms or behave in a similar manner to when they are purchasing other business inputs. Even when processors do deal (on a voluntary basis) with CBGs, an apparent reasonable outcome will only be reached if it suits the processor.

Balance of power

The balance of power in the relationship between processor and farmer, clearly lies with the processor. Even though a market may be dysfunctional in economic terms (e.g. in SE Queensland where there is rising demand but falling supply and possibly reduced prices due to the overall industry impact of '$1 milk'), the processor still has the opportunity to take a short term view and protect itself at the expense of the farmers. Clearly, some processors view the farmers as a 'safety valve' which will allow them to maintain profitability. They do not wish to be in a position where they MUST pay the market price as they would have to with other business inputs such as HDPE plastic pellets or sugar.

Farmers are not necessarily aware of the prices, terms and conditions that they can achieve for their production and do not have the same market information as the processor. The processor knows what they are paying others in the area and often apply confidentiality clauses to keep it that way. Even if the farmer's market knowledge was the same or similar to the processor's, the farmer generally only has one processor to choose from whereas the processor can choose from many farmers. In addition, individual farmers are unlikely to be able to have the resources (both financial and otherwise) to seriously challenge the processor's price, terms and conditions.

Unlike other organisations, DFMC publishes its prices and pricing policies (that have been negotiated and agreed with LDD) in each region so there is complete transparency in relation to individual farmer's arrangements. In DFMC's opinion, the overall lack of transparency within the Dairy Industry around pricing is a substantial impediment to determining whether farmers are being paid the market value or price for their milk.

In DFMC's opinion, an effective collective bargaining mechanism, both as to price and terms and conditions, is fundamental to the Dairy market being fair to everyone (and, in particular, the farmers).

The future of the MSA

DFMC is currently in negotiations with LDD as to the nature of the MSA post 2019.

At this time, there is little certainty around whether LDD will extend the MSA beyond 2019 and/or on what terms. DFMC and LDD have an agreement unlike any other in the dairy industry – one that ensures balance through a means of determining a fair price for farmers for their product while at the same time allowing LDD to buy milk at a price similar to its competitors.

DFMC is encouraging LDD to renew the MSA on the same or similar terms as the current MSA. In the event LDD do not renew the MSA, DFMC's current 345 farmer members will not have an effective collective bargaining platform.

DFMC is also of the view that dairy farmers who currently supply LDD directly have received the benefit of DFMC's collective bargaining platform. Generally, benefits achieved by DFMC in respect of its farmer members, LDD pass on to its approximately 80 direct suppliers.

In short, the non-renewal of the MSA leaves a substantial number of dairy farmers without an effective collective bargaining platform.

Achieving more effective CBGs

In DFMC's opinion, a successful collective bargaining arrangement requires three key components, namely:

1. the CBG must be well funded and resourced;

2. the processor must be bound to deal with the CBG; and

3. in the event of a dispute (including as to price), the dispute can be resolved by binding independent expert determination.

Some of the above components could be achieved by the introduction of a Dairy Industry Code of Conduct, similar to the Food and Grocery Code of Conduct. We note there are current industry discussions being held around the development of an industry code but these discussions are mainly focuses on pricing and contract terms. The current discussions do not address collective bargaining and do not include a mechanism to compel the processor to negotiate with CBGs or otherwise address the current inadequacies around collective bargaining in the industry.

In order to address the key components for successful collective bargaining, for example, any code needs to:

(a) require the processor to pay an "aggregation fee" to the CBG in order to ensure it is funded and properly resourced – *the cost of the "aggregation fee" to the processor should be offset against reduced transaction costs for the processor in having to only deal with a single entity*;

(b) allow individual farmers to "roll over" their milk supply contracts into a CBG and thereafter require the processor to deal with the CBG – *different expiry dates and contract periods make it difficult for farmers to group together at any one time*;

(c) provide a suitable template or recommended model for CBGs (such as the current DFMC/LDD model) – *a suitable template or recommended model would reduce the costs for farmers and assist in the negotiation with the processor*;

(d) require the processor to pay the market value or price for milk – *currently, many farmer contracts do not directly link milk price to market value, which is particularly an issue for farmers who wish to enter into longer term contracts in order to obtain "security of offtake"*;

(e) set out acceptable (and unacceptable) terms and conditions relating to the supply of milk – for example, a common expiry date, notice periods and no confidentiality provision; and

(f) incorporate Independent Expert determination provisions to resolve disputes – *in the absence of a compulsory obligation on the processor to deal with CBGs and compulsory Independent Expert determination provisions, CBGs are entirely reliant on the "goodwill" of the processor*.

DFMC is uniquely placed in the dairy industry and has substantial experience in respect of the operation and effectiveness of collective bargaining platforms within the dairy industry. DFMC would be pleased to assist the ACCC with its enquiries involving collective bargaining and/or the development of effective collective bargaining platforms and/or the development of an appropriate code of conduct for the dairy industry.

CONCLUSION

Individual dairy farmers have a low level of bargaining power when negotiating with processors. We have all seen the recent example where a number of Western Australian milk farmers were abandoned by their current processor.

In DFMC's opinion, an effective collective bargaining mechanism, both as to price and terms and conditions, is fundamental to the dairy market being fair to everyone (and, in particular, the farmers).

DFMC PROPOSED
COLLECTIVE BARGAINING CODE

There is universal agreement that the farmers' bargaining power vis a vis the processor must be strengthened and the best way of achieving the rebalancing of bargaining power is via collective bargaining groups. There also seems to be universal agreement that the current collective bargaining regime is not working effectively in the dairy industry.

In DFMC's view, more effective collective bargaining could be achieved by the introduction of a collective bargaining code of conduct. The code would need to address the main reasons why collective bargaining has not been effective. Primarily, the code needs to incorporate a mechanism to compel processors to negotiate in good faith with the collective bargaining group and provide a mechanism to ensure the collective bargaining group is appropriately funded.

DFMC's view is the collective bargaining code would need to address, amongst other things, the following:

1. Processors must negotiate with the collective bargaining group (CBG) in good faith.[2]

2. CBG's must also negotiate with the processor in good faith.

3. In order for the code to apply, CBG's would need to be of a minimum size (i.e. have a minimum number of farmer members or a minimum volume of milk). (*The minimum size should be sufficient to justify the aggregation fee.*)[3]

4. Processors must not:[4]

    (a) coerce any farmer in the exercise of its right to join and belong to or to refrain from joining or belonging to a CBG, or

    (b) refuse to deal with any farmer because of the exercise of its right to join and belong to a CBG; or

    (c) discriminate against any farmer with respect to price, quantity, quality, or other terms of purchase, acquisition, or other handling of milk because of its membership in or contract with a CBG; or

    (d) coerce or intimidate any farmer to enter into, maintain, breach, cancel, or terminate its membership agreement or contract with a CBG; or

    (e) pay or loan money, give anything of value, or offer any other inducement or reward to a farmer for refusing to or ceasing to belong to a CBG; or

    (f) make false reports about the finances, management, or activities of CBGs; or

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[2] The members of the CBG would need to be, in part, current suppliers of the processor. Unless the CBG consists of current suppliers to the processor, the processor would only be compelled to negotiate if it needed additional milk.

[3] The European Union requires a minimum number

[4] These provisions are based on the US Code

(g) conspire, combine, agree, or arrange with any other person to do, or aid or abet the doing of, any of the above.

5. A "black out period" whereby the processor is unable to negotiate directly with a farmer in respect of the purchase, acquisition or handling of milk if the processor has been notified the farmer is a member of a CBG.

6. A farmer may only be a member of one dairy CBG at any one time.

7. CBGs must promote co-operative principles[5] namely they should:

   (a) be voluntary organisations;

   (b) be democratically controlled by their members;

   (c) provide education and training for their members and elected representatives;

   (d) co-operate with similar or like-minded organisations.

8. The processor must pay an "aggregation fee" to the CBG. The fee is to be negotiated between the processor and the CBG and should be a rate per litre of milk supplied (*this should be justifiable having regard to the reduced transaction costs for the processor in only dealing with a single entity*).

9. Farmers may "roll over" any existing milk supply contracts with the processor into a CBG.[6]

10. Any dispute between the processor and a CBG must be resolved by binding independent expert determination. The independent expert determination would cover disputes around price and other contract terms.[7]

11. Costs incurred in respect of independent expert determination should be borne equally unless otherwise determined by the expert.

In DFMC's view there is no need for the code to apply to processors which are co-operatives such as Murray Goulburn and Norco. Farmer suppliers to these processors are generally already members of the processor and the processor must act in the best interests of its members.

In addition to an effective collective bargaining mechanism, there also needs to be a code of contracting practice dealing with, amongst other things, transparency, pricing, contract variations and termination. These 2 matters namely, collective bargaining and contracting, could be integrated into the one code.

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[5] Co-operative principles are more comprehensively set out in section 10 of the Co-operatives National Law.

[6] Chronologically aligned dates for all milk contracts would assist this process.

[7] Other industries have, or intend to introduce, compulsory dispute resolution processes (eg. sugar and the cattle and beef sector).