Submission
No 74

INQUIRY INTO LONG-TERM SUSTAINABILITY OF THE DAIRY INDUSTRY IN NEW SOUTH WALES

Organisation: Dairy Farmers Milk Co-Operative Limited

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NSW LEGISLATIVE COUNCIL INQUIRY INTO THE LONG-TERM SUSTAINABILITY OF THE DAIRY INDUSTRY IN NSW

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SUBMISSION BY DAIRY FARMERS MILK CO-OPERATIVE

INTRODUCTION

Dairy Farmers Milk Co-operative (DFMC) is pleased to have an opportunity to express its views regarding the long-term sustainability of the NSW Dairy Industry.

The DFMC is a farmer-run, farmer-owned milk supply co-operative, functioning largely as a collective bargaining group. We represent some 230 dairy farming families, uniquely from as far north as the Atherton tablelands, to the Fleurieu peninsular in South Australia and cover most of the key dairy regions in between. We pool approximately 200 million litres for our processing partner Lion Dairy and Drinks. It is important to note DFMC are not direct suppliers to supermarkets but co-dependent on processing partner(s) success.

Our current NSW supply Region consists of farmers from the Central West, South Coast, Sydney Basin and the Hunter Valley supplying approximately 70 million litres from 38 farms. In the 2009/10 financial year DFMC supplied 400 million litres from close to 350 farms across NSW. The major reduction in farms and supply in our opinion due to the loss of both generic supermarket branded contracts by Lion Dairy and Drinks and the implementation of "$1/L" milk campaign by the supermarkets.

We will address terms of reference points (a) to (g) in this submission. We are also aware of and, through DFMC management, had some input into the submission by Dairy NSW and clearly support their position. Due to some perceived potential conflicts we will not address section (e) in any great detail.

(A) THE NATURE OF, AND RELATIONSHIP WITHIN, THE VALUE CHAIN BETWEEN FARMERS, PROCESSORS, LOGISTICS COMPANIES AND RETAILERS AND THEIR RESPECTIVE INFLUENCE ON PRICE,

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 NSW where there is rising demand but falling supply and downward pressure on prices due to the overall industry impact of Retailer Own Brand (ROB), 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.

The Mandatory code has increased some transparency however 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 has always published its prices (not just a minimum price) 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. ***See also section (F) Minimum Price announcements.***

Whilst the Code has improved the visibility and transparency of (minimum) farm-gate milk pricing it is still difficult for individual dairy farmers to accurately interpret how their particular production characteristics will fare under the pricing and terms of another processor. Individual farmers are unlikely to be able to have the resources (both financial and otherwise) to seriously challenge the processor's price or terms and conditions.

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. It is worth noting that processors are significantly advantaged by going through a negotiated price discovery journey with farmer-led groups as well. The feedback and advisory nature of the process adds integrity to announced prices.

COLLECTIVE BARGAINING IN THE DAIRY INDUSTRY

Collective Bargaining Groups (CBGs) 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 11 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.

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 has been extended currently terminates in 2022.

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;
- **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.

OTHER COLLECTIVE BARGAINING GROUPS AND CO-OPEATIVES

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.

In the dairy industry today, there are a number of emerging entities operating as CBGs, setting up to give farmers a "seat at the table". These entities are variously formal co-operatives, incorporated associations, and informal groupings. Further, there is evidence that milk processors have entered into arrangements with these groups acknowledging the efficiency in negotiating with single entities for larger volumes of milk.

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 for milk processors to negotiate with collective bargaining groups, 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. 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. An element of dividing the supplier base has been evident by some processors in the past.

ACHIEVING MORE EFFECTIVE COLLECTIVE BARGAINING GROUPS

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.

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 – *the Mandatory Code has addressed the issue* of *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) 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 NSW Government 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.

(B) THE IMPACT OF EXTERNAL INFLUENCES ON THE DAIRY INDUSTRY, INCLUDING BUT NOT LIMITED TO DROUGHT, WATER, ENERGY AND PRICE SETTING

There is clear long-term supportive evidence the cost of producing raw milk rises the closer to the tropics a dairying region is. (ADP, 2020). Heat, humidity, rainfall variation (summer/winter) along with the availability of large suitable tracts of dairying land all contribute to the higher cost of production pre farm gate when compared to Victorian and Tasmanian production systems. Combine these factors with smaller scale businesses with a larger geographical spread (distance between farms) raw milk supply chain costs pre factory door are also considerably higher than Southern Australia.

It is DFMC's view that these increased costs need to be considered at the retail end of the supply chain and we call on the abolishment of the supermarket national pricing practices currently in place.

DFMC is committed to solutions that create a sustainable dairy industry. Clearly farmgate prices are important, particularly as they relate to the cost of production to ensure farmers remain viable. The current range of farm gate milk pricing within regions across Australia is a contentious issue for many farmers. Drought levies and fodder payment supplements paid directly by supermarkets to farmers are causing inequities within dairy farming communities. Having fought for drought support for farmers long before retailer initiatives were introduced, we note the use of levies to support farmers has created inequities amongst dairy farmers with "haves" and "have nots". Within NSW, for example, there is close to a $2.50/kgMS (18 cents per litre) range between the highest and lowest farm gate milk prices for a very similar bottled product.

(C) THE IMPACT OF PREVIOUS POLICIES, IN PARTICULAR, THE DEREGULATION OF THE DAIRY INDUSTRY.

Deregulation of the dairy industry has played a significant role in reshaping the Australian Dairy Industry. Simply, there has been a significant transfer of value from pre farm gate (farmers) to retailers and consumers. It is DFMC's view deregulation has been against the National Interest of Australia when measured in its entirety.

DFMC believes a new national approach is needed rather that a complicated return to regulation.

The key issue is **National Retail fresh white milk price**. This is a one low price for all home-brand milk no matter where the product is sold – i.e. what area it is sold in and/or cost to deliver the product there. Retailers use this as a marketing tool. They apply a weighted average price to justify the national retail price, disguising the potential loss leading. For example, cheaper Victorian milk at farmgate also has cheaper inbound logistics and distribution costs to a small state with a denser population base. This is likely to be profitable and "cross-subsidises" northern state milk with inherently higher costs throughout the supply chain. Processors of branded white milk cannot compete profitably in the northern states, challenging the sustainability of the industry.

The major retailers have the ability to "loss-lead" in some regions on a couple of product lines, like milk, and make it up from the other 40,000 or more products lines sold. Further, the cost of servicing smaller regional retail outlets is clearly much higher than metropolitan areas.

The dairy industry has been impacted materially from this national retail pricing approach. Acknowledging that the different farming systems, farm sizes and regional, climatic issues, equals greater cost of production Queensland has a farm gate milk price approximately 15cpl higher than Victoria. When coupled with a large regional footprint driving distribution costs higher, the fresh milk supply chain is not sustainable. The National retail price is lower than the cost to supply milk in NSW and processors, and in turn farmers, are losing millions of dollars to stay in this market.

Home brand milk now saturates the market with coffee shops, restaurants and school tuck shops using Coles and Woolworths as a wholesaler as it is cheaper to buy milk there than have it delivered. Shelf space, internal restocking and re-ordering policies all influence and manipulate the volume of home brand milk that is sold in comparison to branded milk. Is this an abuse of market power, dumping, loss leading?

(D) THE ROLE OF GOVERNMENT IN ADDRESSING KEY ECONOMIC CHALLENGES TO THE INDUSTRY.

REGIONAL MARKET ECONOMICS AND ACCC ASSESSMENT

We do not purport to be expert, nor have we sought legal advice, in competition law but perusal of ACCC guidelines and legislation there appears to be little to no reference to state or regional boundaries or acknowledgment of the difference in markets. It could be suggested that there are different markets for dairy commodities and fresh drinking milk, which has a more regional boundary for markets. The ACCC did find in some regions milk was sold at a loss. **We believe that the "test" for dumping, loss-leading and the abuse of market power needs to be carried out on a state by state basis.**

For the dairy industry to continue to prosper there are five key farm driven components which in DFMC's view need addressing:

CRITICAL INDUSTRY CLUSTER

Geographic diversity and distance between Dairy Businesses is increasing costs within the supply chain. Whether it is the distance between farms milk tankers travel to maximise logistic efficiencies or the time it takes to get a veterinarian on farm the spread between farms is increasing the cost of doing business for some parties. It is DFMC's view the formation of Dairy Industry Specific "Critical Agricultural Industry Clusters" in the following locations is needed. The Manning, Hunter, Kangaroo & Bega Valleys, The Shoalhaven, Forbes & Cowra Districts.

STAMP DUTY EXEMPTIONS

For Dairy Businesses within these cluster zones to be recognised as major economic contributors to their local economies and the abolishment of stamp duty for new and or existing dairy businesses wishing to expand and purchase additional assets for the purpose of dairying within these cluster zones.

A CAPABLE WORKFORCE - SUBSIDISED TRAINING PROGRAMS

The lack of people wanting to work across the dairy industry is having a significant impact on productivity. Partly due to the negative dialogue within the industry, partly due to the low profitability in the farm and processing sector and partly due to the low level of education and training programs, specifically focusing on Dairying as a career path.

DFMC believes a major injection in funding for traineeships, subsidised university dairy specific degree's, and specific dairy TAFE programs are needed to fill the void in personnel within the industry.

The expectation of today's dairy farmers is much higher than previous generations - from animal nutrition, animal health, business and people management, environmental, etc. It is acknowledged that farmers are highly skilled - they can do anything just not everything all the time! Therefore, the need for qualified and focused workforce is needed and must be able to attract and retain those skills.

INCREASED ONE ON ONE SUPPORT FOR DAIRY BUSINESSES

Today's dairy farm business is complex and requires a higher degree of management capability than ever before. There is an urgent need for "one on one", ongoing professional consultancy type support for Dairy Businesses, to help those businesses transition into flourishing profitable sustainable businesses. Call it "Dairy Farm Coaching" rather than just extension services rolling out more group workshops. Farmers need help to implement the knowledge and management techniques within their own enterprises.

CLEARLY DEFINED WATER POLICY FOR FOOD PRODUCING INDUSTRIES

The Dairy industry can only operate in regions of high reliable rainfall or a reliable stored water source. Access to these reliable water storages at economic prices for dairying is paramount to the continuation and expansion of the NSW industry. The current practice of water trading by entities who are not the final user of the water is creating an artificial price during years of low supply. Dairy is a staple of the Australian diet and consumers are increasingly focusing on locally produced product in the current climate with national food security threatened. DFMC believes there is a need for water policy and pricing to reflect the nature of the water use, what is produced with that water and what price that commodity commands.

(E) THE APPOINTMENT, OPERATION AND EFFECTIVENESS OF THE NSW GOVERNMENTS FRESH MILK AND DAIRY ADVOCATE, AND THE DAIRY INDUSTRY ADVISORY PANEL

As DFMC Regional Manager Tony Burnett sits on this panel it is inappropriate to comment directly.

(F)DAIRY CODE

DFMC has supported the introduction of the Dairy Code to improve transparency and assist in addressing the obvious imbalance of power between farmers and processors. It is worth underscoring the point that DFMC is in a unique position in the industry insofar as whilst we are first and foremost a farmer-led and owned representative group yet we are defined in the code as a processor. This gives us a unique perspective.

As an organization we have always sought to be active participants in the industry and to constructively contribute. Having a staff member on the ACCC Dairy Consultative Committee is a recent demonstration and we provide the following comments constructively.

MINIMUM PRICE ANNOUNCEMENTS

DFMC believes minimum price announcements need to be reflective of what is paid as a weighted average by that processor within that region. In addition to a minimum price announcement DFMC recommends competing processors within a region quote net farm gate prices based on a set of theoretical model farms within that region. The region to be in line with current Dairy Australia sub regions and farm sizes to be based on the relevant range of farm sizes within that region. This will allow farmers within that region to gain a further insight into the competitive nature of the farm gate market.

STANDARD FORMS OF AGREEMENT AND MINIMUM PRICES

The requirement in the Dairy Code to publish standard forms of agreement and minimum prices by June 1st is well intentioned and undoubtedly improves transparency within and between processors for farmers. However, the notion that (international) corporate processors will announce a price reflecting the most they can afford to pay, just as a vertically integrated co-operative would have done in Australia in the past, is fanciful. Indeed, they have an obligation to their shareholders to pay as little as they can for the primary input in their product offerings. To that end they will pay what they “have to” to be competitive to retain farmers as suppliers or indeed recruit farmers depending on their needs and plans. It was inevitable therefore that several processors made subsequent announcements lifting prices. Many farmers and some industry observers neither understood nor respected this dynamic and generated significant negative commentary around what was inherently positive for farmers. The requirement to include a price justification did make some processors appear disingenuous.

COOLING OFF PERIOD

In our view a 14-day cooling off period is disproportionally long when there is a 30-day window between price announcements and the first milk collection under the new agreement. DFMC believes this period should fall in line with other standard contracting practices of 7 days. A 14-day period allows for too much uncertainty of supply for processors in fresh demand driven markets.

MULTI-YEAR PRICING

An unintended consequence of the implementation of mandatory code of conduct is the reduction of multiyear contracts offered in some regions. A majority of processors appear to have reduced or abolished their commitment to agreements greater than a one-year period. It appears there is confusion within the code between a step down falling below the minimum price and a year to year price change due to market conditions.

UNILATERAL TERMINATIONS OF MILK SUPPLY AGREEMENTS BY FARMERS

Notwithstanding the apparent dwindling of multi-year contracts offered, the issue of farmers occasionally being coerced to breach a supply agreement and supply another processor needs explicitly addressing in the Code. The pre-Code practice has been somewhat informal with representative staff from the respective processors providing the contract status for "target" farmers. We acknowledge there are other bodies of law to potentially address these circumstances and arguably the Good Faith provisions in the Code could apply. With the penalty that applies to a farmer for unilateral termination being relatively low there remains a risk that the aggressive practices of some processors could remain.

(G) ANY OTHER RELATED MATERS

GENERIC HOME BRAND MILK

Generic home brand milk has suffocated the dairy industry for nearly 10 years and has a major deflationary impact on sustainable milk pricing across Australia.

The retail price does not represent the true cost of the product, including production, processing and distribution. A milk processor's ability to recommend higher prices, let alone sell branded milk at a higher price, is limited and when a consumer makes a choice to buy Generic milk over branded, money is lost somewhere in the supply chain that simply can't be replaced.