Monday 26 September 2020

Australian Dairy Products Federation
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To: Hannah Ransom

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Re: Queensland Dairyfarmers' Organisation Ltd – application for authorisation AA1000530 – interested party consultation.

The Australian Competition and Consumer Commission (the ACCC) has received an Application for authorisation from the Queensland Dairyfarmers' Organisation (QDO) for a licensing scheme for processors of milk and dairy products to apply a "Fair Go Dairy" (FGD) logo to their products – seeking interim authorisation which would enable QDO to continue to prepare and commence marketing of the FGD scheme and licence agreements with processors.

The Australian Dairy Products Federation (ADPF) has consulted with its members and welcomes the opportunity to provide comment to the ACCC.

The ADPF is the national peak policy body representing commercial, post farm-gate members of the Australian dairy industry, including processors, traders and marketers of Australian dairy products. For the past 30 years, ADPF has worked to represent the interests of members in promoting and protecting dairy products through advocating for improvements in the manufacturing, marketing and trading of dairy. Our members process approximately 85% of Australian milk volumes and provide dairy products for both the domestic and export markets.

The ADPF does not support the proposed Application on the FGD Licensing Scheme and would recommend the ACCC does not grant authorisation.

The process and criteria for the FGD logo is unfounded, bias and risks misleading the consumer and disadvantaging other dairy products that may be of the same or higher quality because of where there are produced – even if it is a voluntary Scheme.

The FGD Licensing Scheme has the potential to discriminate against products for which the farmer *does* receive a fair farm-gate milk price, but the processor has not opted to purchase the FGD logo.

The expansion onto other products and into other states runs the risk of exacerbating this even further.

The implications of announcing *Sustainable and Fair Farm-gate prices* by the end of February each year, could implicate minimum prices that are required to published on 1 June each year, as per the mandatory Dairy Code of Conduct.

As current labelling permissions enable local sourcing to be called out on pack, the risk of introducing the FGD logo outweighs any benefit.

Background

As per the QDO applications, the DFG licensing scheme ***aims to provide price information and pricing transparency to consumers by way of a simple trade mark placed on product packaging that will enable them to better understand what they are paying for and where their money goes, in order that they will make more informed purchasing decisions***.

The FGD logo is intended to signal to consumers that the products bearing the mark are made from milk for which farmers have been paid a *sustainable and 'fair' farmgate price (SFFP), with SFFP determined by QDO and based on cost of production multiplied by the CPI Adjustment Rate – with cost of production defined as the average cost of production for milk published by the Queensland Dairy Accounting Scheme Report [i.e. costs of fodder, irrigation, running expenses, salaries, equipment].*

QDO intends to set the SFFP by 28 February 2020 for the following financial year (2021-2022), with the Scheme Rules to take effect on and from 1 July each financial year.

Under the licensing scheme, QDO will grant a licence to use the "Fair Go Dairy" logo to processors for use on dairy products made *using no less than 80% unprocessed milk purchased from a farmer where:*

- the farmer's farm is located within Queensland
- the milk is derived from dairy cows located within Queensland
- the purchase price for the milk (per litre) is not less than the SFFP
- no milk used in the products may be sourced from outside of Australia.

The products which can display the logo include dairy milk, dairy cream, dairy desserts and cheese, further defined as:

- unprocessed milk (being the lacteal fluid product of the dairy cow)
- dairy produce (within the meaning of the Dairy Produce Act 1986 (Cth)) including (without limitation):
  I. dairy milk – fresh, UHT/long-life milk, powdered including infant formula and flavoured/enhanced milk (including A2, protein, high calcium)
  II. dairy cream – fresh, UHT/long-life milk and flavoured/enhanced milk (including A2, protein, high calcium)
  III. dairy desserts – mousses, ice-cream, custards, yoghurts
  IV. cheese / cream cheese and variants.

The licensing fee for use of the DFG logo is $1,000 (exclusive of GST) – or such lesser amount as the parties may agree in writing.

QDO seeks authorisation for a period of 10 years.

They intend to launch the Scheme for operation in Queensland with an initial focus on fresh milk, and then intend on rolling out the Scheme to other States and Territories in Australia on a broader range of Products – subject to further approval by the ACCC.

QDO are seeking interim authorisation in order to commence negotiations with processors regarding the terms and conditions of possible milk supply agreements, due to the potential uncertainty which is associated with the risk of exposure of liability under the Act.

We make particular reference to the Report from the Parliament Agriculture and Environment Committee April 2017 on The Sustainable Queensland Dairy Production (Fair Milk Price Logos) Bill 2016[1], introduced by the Member for Dalrymple in an attempt to achieve better farm gate prices for the state's dairy farmers and strengthen consumer information. The three recommendations were:

1. *Sustainable Queensland Dairy Production (Fair Milk Price Logos) Bill 2016* ***not be passed.***
2. *The Minister for Agriculture and Fisheries direct his department to investigate options for supporting the Queensland Dairyfarmers' Organisation* ***to devise and operate an industry-operated marketing scheme****, potentially including fair milk price logos.*
3. *The Minister for Agriculture and Fisheries consult with his counterparts in other states and territories, and with the Commonwealth Minister for Agriculture and Water Resources,* ***regarding the institution of similar schemes in order to increase the sustainability of the Australian dairy industry as a whole.***

It concluded that the Bill creates more problems than it seeks to resolve, with significant difficulties arising if the state government returns to the role of making 'fair' price determinations for milk farm gate prices, as the Bill proposes.

Adopting the labelling scheme proposed in the Bill could leave the legislation vulnerable to a future legal challenge on constitutional grounds because it seeks to grant a competitive advantage to Queensland producers not available to inter-state producers whose milk is supplied here – even with it being voluntary.

A number of small milk processors in Queensland are already using labelling and other marketing tools to better position themselves in the competitive drinking milk market. They are creating a marketing advantage on the basis they offer a quality local product and treat farmers and livestock well.

ADPF position

The ACCC has asked for specific comments on eight questions in their assessment of the QDO application considering the public benefit, impact on competition, FGD Licensing Scheme's product criteria – including the SFFP, through to any other public detriment.

The ADPF has opted to provide comment on three broad areas:

1. The 'Fair go Dairy' Licensing Scheme criteria
2. Consumer benefit – purported benefit versus implications
3. Implications on competition.

1. <u>The 'Fair Go Dairy' Licensing Scheme criteria</u>

The ADPF suggests that the proposed criteria are flawed, highly biased and have the potential to undermine the value and sustainability of the dairy industry.

Under the Licensing Scheme, QDO will grant a licence to use the "Fair Go Dairy" (FGD) logo to processors for use on dairy products made *using no less than 80% unprocessed milk purchased from a farmer where:*

- the farmer's farm is located within Queensland

[1] Parliamentary committee: Sustainable Queensland Dairy Production (Fair Milk Price Logos) Bill 2016 Report No. 33, 55th Parliament Agriculture and Environment Committee April 2017

- the milk is derived from dairy cows located within Queensland
- the purchase price for the milk (per litre) is not less than the SFFP
- no milk used in the products may be sourced from outside of Australia.

To be clear, it is proposed that QDO will determine the SFFP in accordance with a strict formula.

ADPF has two fundamental issues with this. First, the process for how the SFFP is determined. And second, which milk qualifies.

A. Sustainable and Fair Farm-gate milk prices

To qualify for the FGD licensing scheme, QDO are proposing the following:

- the purchase price for the milk (per litre) must not be less than the *sustainable and 'fair' farmgate price (SFFP)*
- QDO will determine the SFFP
- SFFP is defined as the *cost of production (CoP) multiplied by the CPI Adjustment Rate – with CoP further defined as the average cost of production for milk published by the Queensland Dairy Accounting Scheme Report [i.e. costs of fodder, irrigation, running expenses, salaries, equipment].*

The ADPF questions the rationale for QDO being responsible for setting the SFFP and the definition and criteria proposed for what is a 'fair' price – and equally whether this is sustainable or could have a negative impact on the viability of the dairy industry.

The ADPF also question the implications of SFFP relative to the announced *minimum farm-gate milk prices* as per the Dairy Code of Conduct. The SFFP are proposed to be set by QDO by 28 February each year for the following financial year. Minimum prices and price justification are required to be published by all processors on 1 June each year, as per the requirements of the mandatory Dairy Code of Conduct. The SFFP has the potential to create additional confusion and uncertainty on farm-gate milk prices offered, particularly if the SFFP is unfairly set. What message does this send to the farmer, to the processor or to the consumer?

If we consider this in more detail, the QDO Application defines SFFP as the average cost of production for milk as published in the *Queensland Dairy Accounting Scheme – Financial and Production Trends Report, Department of Agriculture and Fisheries (supported by the Queensland Government) [QDAS Report],* in respect of the Reference Period (1 July to 30 June) – and includes the costs of fodder, irrigation, running expenses, salaries, equipment for Queensland.

This QDAS Report provides a summary of the physical and financial data from each regional production system to enable more informed business decisions**. It includes the data of *60 farms* in South-East, Central and North Queensland – that is less than 17% of the 356 registered dairy farms in Queensland (2018/2019)**[2]. Officers of the Department of Agriculture and Fisheries (DAF) supervise the collection and processing of data between August and November. Farmer participation in QDAS is **voluntary and free**. There is no independent auditing. **The Report advises that the results and trends should be interpreted carefully as QDAS farms have larger herds and produce more milk per farm than the Queensland average.**

Pricing is a carefully considered mechanism informed by a number of drivers, and firmly lies in the commercial terms of trade between contracting parties.

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[2] Dairy Australia – Australian Dairy Industry – In Focus 2019

The proposed criteria for 'what is the SFFP' can be manipulated in a way, that the price QDO decides to be 'fair' could actually *be much higher than what is required to be 'fair'.*

Production costs may be higher due to production inefficiencies.

Having the SFFP process sit with QDO and being based on the QDAS Report, is flawed and biased.

In the Application, QDO state the SFFP for 2020/2021 would be **71.1c.**

If we consider the recent announcement from Norco, farmers received record prices:

> *Norco paid its members operating more than 200 farms across Queensland and NSW an average of **70.63¢** a litre for milk in 2019-20. The record price came in the first year after supermarket giants Coles, Woolworths and Aldi ditched their $1-a-litre retail price for private label brands. In 2018-19, Norco paid farmers an average of 60.14¢ a litre and in the three years before that 57¢ a litre.*

If we then consider farm-gate milk prices in Queensland over the last five years (Table 1)[3] – in addition to the recently announced minimum farm-gate milk prices on 1 June as part of the mandatory Dairy Code of Conduct (Table 2) – there is a discrepancy between the proposed QDO SFFP of 71.1c.

We thereby question the reality and sustainability of the SFFP and in turn, the message this sends to the stakeholders, including consumers.

Table 1: Indicative factory paid milk prices by state.

		2013–14	2014–15	2015–16	2016–17	2017–18	2018–19 (p)
NSW	¢/litre	51.0	52.8	51.0	49.0	50.5	54.7
	$/kg milk solids	7.10	7.31	7.06	6.81	6.99	7.67
Vic	¢/litre	51.0	47.1	42.8	38.0	44.2	48.2
	$/kg milk solids	6.81	6.24	5.68	5.04	5.87	6.40
Qld	¢/litre	53.4	57.4	58.5	60.0	57.7	61.0
	$/kg milk solids	7.36	7.84	7.99	8.22	7.84	8.31
SA	¢/litre	49.6	46.1	42.5	37.1	42.9	47.2
	$/kg milk solids	7.02	6.53	6.03	5.19	6.06	6.62
WA	¢/litre	46.8	51.0	52.3	50.6	49.9	50.2
	$/kg milk solids	6.63	7.17	7.32	7.06	6.97	7.05
Tas	¢/litre	54.1	49.6	43.7	39.0	47.0	50.3
	$/kg milk solids	6.96	6.33	5.61	4.97	6.01	6.37
Aust	**¢/litre**	**51.2**	**48.5**	**44.9**	**40.9**	**46.0**	**49.7**
	$/kg milk solids	**6.89**	**6.49**	**6.01**	**5.46**	**6.14**	**6.64**

Source: Dairy manufacturers

[3] Dairy Australia – Australian Dairy Industry – In Focus 2019

Table 2: Announced (minimum) prices – 1 June 2020, as per Dairy Code of Conduct

COMPANY	1 JUNE 2020	OCTOBER 2020
LACTALIS QLD	68-69 c/L (annual; includes drought support)	
LION SE QLD	65.6 c/L (annual)	
NORCO	68.2 c/L (July)	70.63 c/L
WOOLWORTHS	$7.67/ kg MS [~56.2 c/L] (annual)	

In the Application QDO quote *"For this reason, milk prices are also largely determined by competition between the processors, noting in particular that higher wholesale and retail prices of products are unlikely to result in higher farmgate prices to farmers (i.e. profits are not being passed down the supply chain to farmers) due to the bargaining power imbalance between farmers and processors".*

Table 1 clearly shows that on average, year on year, farm-gate milk prices have increased whilst for example, the retail price of generic branded milk has stayed stable over the last 10 years – only increasing to $1.10 per litre with the end of $1 per litre milk in March 2019.

The introduction of the Dairy Code of Conduct aims to provide greater transparency on the contracting process between farmers and processors.

However, there is clearly bargaining power asymmetry between retailers and processors, which affects processors' ability to negotiate effectively, such as wholesale price. This is seeing profit margins erode, reducing investment into capital, people and innovation, and impacting industry confidence – and this in turn has consequences downstream.

Farm-gate milk prices (FMP) are often misunderstood within the industry, and therefore there is little surprise that many outside of the industry carry some confusion over how the milk market operates.

The ability of processors to set FMP is heavily impacted by many factors including freight costs, product mix, marketing strategies, manufacturing capacity utilisation and efficiencies, and exchange rate hedging policies. In addition, competition for milk in different production zones has proven to impact FMP often to the advantage of the seller (i.e. dairy farmer).

Australian FMP are based on the milkfat and protein content of the milk produced on farm, with different prices for each component. Unlike many countries around the world, the government has no legislative control over the price milk processing companies pay farmers for milk. Since deregulation in 2000–01 all prices within the industry are set by market forces (globally).

The Southern region comprises Victoria, Tasmania, South Australia and southern NSW – and is where the majority, or 80% of Australia's milk is produced. Production varies by season and the composition of milk, and the importance in the manufacturing process is reflected in the farm-gate price of milk. The region is more exposed to the global markets and international demand, AUD/USD rates and import competition.

The Northern milk region – comprising the other states (Queensland, West Australia, central and northern New South Wales) – has a more stable demand and production profile offered by domestic drinking milk and other fresh, short shelf life products. Higher farm-gate milk prices are paid to ensure year-round supply. The Southern region may help support the continual demand for drinking milk in the Northern regions, as is the case for Queensland – where they do not produce enough milk to service the needs.

Global competition also influences milk prices too, as Australia operates in an open and international competitive market and countries are free to import and export milk. Processor returns from raw milk are exposed to demand for the various products manufactured, which are also regularly exposed to import competition (specifically NZ and EU) and the AUD/USD exchange rate (majority of exports are priced in USD). Approximately 75-80% of milk produced in Australia is exposed to global dairy prices going into butter, cheese and milk powders that are either exported or consumed locally. The remainder is consumed as drinking milk.

B. Which milk qualifies

Under the proposed licensing scheme, QDO will grant a licence to use the "Fair Go Dairy" logo to processors for use on dairy products made *using no less than 80% unprocessed milk purchased from a farmer where:*

- the farmer's farm is located within Queensland
- the milk is derived from dairy cows located within Queensland
- no milk used in the products may be sourced from outside of Australia.

ADPF questions the rationale for 80% and the important contribution of milk from other states to enable the volumes of drinking milk to meet consumer demand.

In considering the two distinct production regions in Australia, namely the Southern and Northern milk regions, we know that 100% of the milk produced in Queensland is used for fresh drinking milk. With this is a requirement for year-round production and no tolerance for seasonality compared with shelf stable products such as cheese and powders. Higher farm-gate milk prices are paid to ensure this year-round supply.

The Southern regions supplement the continual demand for drinking milk in the Northern regions, because Queensland farmers do not produce enough milk to service consumer's needs.

In their Application, QDO explains that the threshold of 80% has been set to allow for processors who produce milk in and around the Queensland and New South Wales border and use more than 80% of Queensland sourced milk (with the other 20% being sourced from a different State or Territory, in particular, New South Wales due to the location of such processors near the New South Wales and Queensland border) to participate in the FGD Licensing Scheme.

ADPF queries the validity of this threshold – does 20% represent the volume of milk coming from other states; does it represent a proportion of it; does it accommodate for future growth volumes?

This threshold also assumes an ability to isolate the milk from other states, as distinct from milk produced in Queensland – be it due to a Queensland based national processing facility or inter-state milk to top-up needed drinking milk volumes.

If we turn to the cost of production, as QDO notes in its application,

> "The CoP is also increasing as a result of the decrease in the number of farms.
>
> With a focus on Queensland, production of milk is currently at a lower rate than consumption by consumers (which is also the case at times in Western Australia and South Australia).
>
> Data provided and compiled by QDO setting out the decrease in milk production in Queensland is provided in item 2 of Attachment H. These results show that there is an increasing demand for products in Queensland, which requires greater production of milk by farmers. In order to meet

such increases in demand, farmers are susceptible to higher production costs, particularly in respect of feed.

The Data contained in items 1 and 2 of Attachment H shows a significant decline in production and farm numbers within Queensland over the past 20 years. QDO has identified that during this *period the number of farms operating has decreased by approximately 81% and the quantity of milk produced (measured in megalitres) has reduced by approximately 63%. QDO considers that such reductions have arisen directly and/or indirectly as a consequence of low farmgate milk prices being achieved by farmers relative the costs of production for such milk. Milk prices may have been adversely impacted by deregulation of the milk industry in Queensland since in or about 2000".*

ADPF acknowledges that producing year-round adds to production costs. However, as noted above processors pay more for that milk to ensure it is produced close to a major market all year round.

Retailers however, have chosen to sell generic-branded milk on national pricing and fixed pricing regimes, despite the fact that farm milk prices vary across states (reflective of input costs), and do not take on the risk of operating to this model, and instead the risk lies with processors.

We encourage the ACCC to consider the outputs of the ACCC Inquiry into Perishable Agricultural Products, as part of their consideration of this Application.

2. <u>Consumer benefit – purported benefit versus implications</u>

ADPF deems the proposed Licensing Scheme and FGD logo are misleading to the consumer and the purported benefits are outweighed by the risks.

The Applicant proposes that the conduct of QDO is unlikely to have a significant impact on the current state of competition in the market of the dairy, wholesale milk purchasing and retail industries.

And that the conduct will provide more choice to consumers when purchasing products, particularly for consumers who are interested about the input costs required to produce certain products.

They claim that the conduct will lead to increased ongoing transparency for consumers when purchasing products from retailers.

Consumers will have the ability to easily identify which products meet the specified SFFP and are objectively paying a fair price to farmers.

Consumers have the option to decide at the point of purchase, whether they want to purchase milk which guarantees a fair price is paid to farmers for milk which such information is unknown at the time of purchase.

The Scheme has a high social value as it supports Australian farmers to ensure they are sustainable in the Australian market.

The applicant claims that use of the FGD Trade Mark does not mean that a product is of a better quality *or is likely to confuse consumers of the quality of the milk, rather is specifically focused on informing consumers which processors are paying farmers the SFPP.*

Further, use of the Trade Mark does not mean the processors of products which do not hold the Trade Mark are not paying farmers such SFFP, but simply that they do not participate in the Scheme.

Whilst ADPF understands the intent of FGD logo, the ADPF suggests that the opposite is true.

Needing to pay for the logo, as well as the proposed qualifying criteria, discriminates products of equal if not higher standards from being able to display the FGD logo on pack.

This can purely be on the basis that the milk or dairy product:

i. was made in Queensland by a larger national processor whose manufacturing plant is unable to separate milk from different states;
ii. contains more than 20% of ingredients from other states, to enable consumer demand for drinking milk to be met (and again assumes the origins of the milk can be separated); or
iii. was not made in Queensland.

We question the rationale for the 80%. We also query whether consumers would be misled into assuming the FGD logo featured on products containing 100% of its ingredients from Queensland.

Most importantly, we are concerned by the definition and criteria for determining a 'fair price', and if a processor chooses not to feature the QDO logo on pack, that the consumer will assume the dairy farmers does not receive a fair price for their milk – when in fact they do.

3. <u>Implications on competition</u>

The ADPF is concerned the proposed QDO FGD Licensing Scheme unfairly impacts competition and lessens the number of products consumers may choose.

The QDO licensing scheme outlines the products which can display the FGD logo as dairy milk, dairy cream, dairy desserts and cheese whereby the dairy products are made using no less than 80% unprocessed milk purchased from a farmer where:

- the farmer's farm is located within Queensland
- the milk is derived from dairy cows located within Queensland
- the purchase price for the milk (per litre) is not less than the SFFP
- no milk used in the products may be sourced from outside of Australia.

The Application claims that "The Trade Mark is to be used by Processors on Products in order to assist **consumers with identifying which brands are paying farmers a SFFP, providing them with the ability to choose the brands that support Australian farmers by paying them a SFFP".**

The criteria are however discriminatory and dictate which processors can display the FGD logo.

It means milk or dairy products of equal or higher standard (i.e. quality, nutrition; social license and responsible production; or pay a 'fair' farm-gate milk price) are disadvantaged, purely because of their origin.

It means the choice of products available to the consumer, is in the hands of QDO, biasing the products they access to.

And, as the FGD Licensing Scheme is intended to be introduced to other States and Territories and across a broader range of products, this impact will only heighten.

Conclusion

The ADPF is supportive of sound policy principles and decisions that foster innovation and the future viability of the dairy industry.

We raise grave concerns over the Application by QDO for the FGD Licensing Scheme and welcome the opportunity to discuss our submission further, to ensure the right decision is made by the ACCC and that authorisation is not granted for this Application.

Yours sincerely

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