



Australian Government  
Department of Agriculture  
and Water Resources

# Dairy industry (farmer-processor transactions) code of conduct

## Regulation impact statement

OBPR ref: 24428



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# Summary

This regulation impact statement (RIS) examines options to address widespread anti-competitive and unfair terms in the standard contracts between dairy processors and dairy farmers. The situation is a legacy of the industry's pre-deregulation business structures, embedded by the imbalance of bargaining power between processors and farmers. These problems have been considered by a series of parliamentary and Australian Competition and Consumer Commission (ACCC) inquiries since 2009.

To help address these long-running concerns, the Australian Dairy Industry Council (ADIC) (2017) developed the voluntary *Code of practice for contractual arrangements between dairy farmers and processors in Australia*. The ACCC (2018) reviewed the code as part of its dairy inquiry and found that the code required strengthening in a number of areas and recommended it be replaced by a mandatory industry code of conduct.

The department has considered four options for a dairy industry code of conduct:

- 1) Voluntary industry code of practice (status quo)
- 2) Voluntary prescribed code of conduct
- 3) Mandatory prescribed code of conduct (targeted scope)
- 4) Mandatory prescribed code of conduct (whole of industry).

After considering the affected parties, benefits, weaknesses, costs and consultation feedback for each option, the department will recommend option 3, a mandatory code of conduct with a targeted scope towards larger processors, as the preferred way forward.

Section 1 provides information on the Australian dairy industry including dairy farmers (number of dairy farmers, herd size and production systems), processors (including products and operating environment) and the current situation in Australia's dairy industry.

Section 2 of this RIS describes the current situation in Australia's dairy industry, the problem present in the industry that the government wishes to address, why an intervention is required and the four options for intervention.

Section 3 describes in detail the proposed impact that each of the four options would present if selected as the way forward, as well as feedback from public consultation on each option.

Section 4 describes the department-led public consultation process that ran from November 2018 to February 2019. The consultation was run in two phases and included face-to-face and one-to-one meetings with key stakeholders around the country.

Section 5 provides detailed reasoning and analysis that supports the department's recommendation of a mandatory prescribed code with a targeted scope.

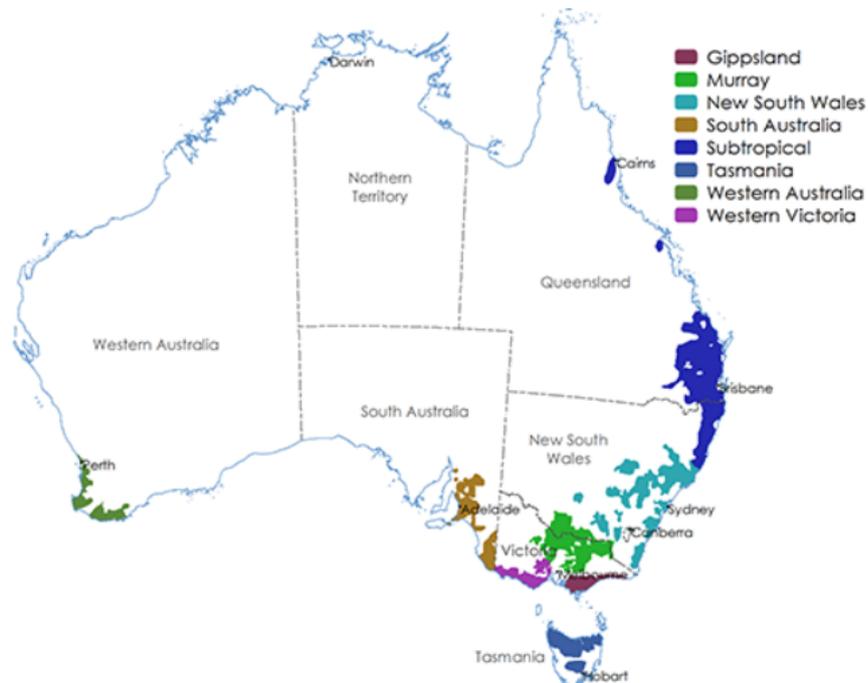
Section 6 details the proposed next steps of a mandatory code of conduct, including the challenges in the drafting of a code and how transition, education and evaluation will take place.

# 1 Background

## The Australian dairy industry

The Australian dairy industry consists of around 5,700 dairy farm businesses (Dairy Australia 2018b). Around 67 per cent of these farms were in Victoria, 11 per cent in New South Wales, 8 per cent in Tasmania, 7 per cent in Queensland, 4 per cent in South Australia and 3 per cent in Western Australia (Weragoda, Friley & Ashton 2018; based on 2016–17 data). Most dairy production is located in coastal areas where pasture growth is generally reliant on rainfall and near major cities, which are significant markets for drinking milk. There are also several inland dairying regions reliant on irrigation schemes, most notably in northern Victoria and the New South Wales Riverina (Dairy Australia 2018b; Figure 1).

**Figure 1 Australia's dairy regions**



Source: ABARES 2018.

Around 98 per cent of dairy farm business are family owned and operated. The remaining 2 per cent of farms are owned by corporate entities and consist of several large-scale farming operations and conglomerations operating primarily in southern Australia (Dairy Australia 2018b). Farms range in size from 100 head or less, through to several large-scale operations running more than 1,000– 2,000 head of milking cows in single operations and across a range of sites. The current average herd size is around the 300-cows, which is significantly larger than the average herd size in the US (115) and EU (35) however smaller than that of NZ (400) (Dairy Australia 2018b).

The dairy industry had an estimated farm-gate value of \$4.3 billion dollars in 2017–18 (Dairy Australia 2018b), based on total milk production of 9,289 million litres (Cameron 2018a). Of this production, 2,548 million litres (27 per cent) was used for the production of fresh drinking milk,

with the remaining 6,741 million litres (73 per cent) used for the production of manufactured dairy products, such as butter, cheese, milk powder, yoghurt and custard (Cameron 2018a). Cheese is consistently the major product stream, accounting for more than a third of Australia's milk production in 2017–18. Recent increases in cheese production capacity suggest that this will become the case even more so in the future. Drinking milk and skim milk powder/butter production were the two next largest users of milk, accounting for 27 per cent and 23 per cent of Australian milk (Dairy Australia 2019).

Exports of dairy products were valued at 3.4 billion in 2018–19. Over the medium term, ABARES expects that increased exports of infant milk formula, skim milk powder, cheese and other value added dairy products will contribute to an increase in the value of Australian dairy exports to \$3.7 billion in real terms by 2022–23 (Cameron 2018b).

Australian dairy farmers generally operate within one of two production systems, either a seasonal based system where cows calve in line with feed supply and therefore the farm has significant peaks and troughs in production, or a year-round system whereby cows calve consistently all year to target a flat production curve. The former system generally supports production focused on export markets (Victoria and Tasmania) and the latter generally exists in Queensland, New South Wales, South Australia and Western Australia where demand comes from domestic fresh milk markets (Dairy Australia 2018b; Weragoda, Friley & Ashton 2018).

All milk must be pasteurised before it can be sold for consumption to reduce potentially pathogenic bacteria to safe levels. Around 74 businesses participate in the Australian milk processing industry producing drinking milk (Thomson 2018). Figures later in this document refer to 87 dairy processing businesses, which takes into account additional processors that produce only non-drinking milk dairy products. The industry is relatively concentrated with four processors, Fonterra Co-operative Group Ltd, Saputo Dairy Australia Pty Ltd, Parmalat Australia Pty Ltd and Lion Pty Ltd Milk expected to account for around 60 per cent of industry revenue in 2018–19 (Thomson 2018). Dairy manufacturing industries, such as butter and cheese manufacturing have similarly concentrated market shares, with the milk powder sector more highly concentrated with the top four manufacturers accounting for around 80 per cent of industry revenue in 2018–19 (Vuong 2018).

The milk processing and dairy manufacturing industries are highly competitive. Australian milk processors compete against each other in the domestic market, with multiple brands competing at retail level, including supermarket private label branded \$1 per litre milk. From an export perspective, Australian dairy manufacturers are largely price takers in international markets and face strong competition from producers in other countries such as New Zealand. Competitive advantages in the milk processing and dairy manufacturing sectors mainly revolves around lower production costs, greater quality, branding, consistency of supply, product differentiation and innovation (Reeves 2018).

The manufacturing of dairy commodity products for export has become steadily more concentrated in the southeast of Australia. Southeast Australia's climate and natural resources are generally favourable, allowing cows to be predominantly pasture fed, which results in lower cost milk production (Dairy Australia 2018b). However, the use of supplementary feed – grains, hay and silage – is widespread and has increased significantly over the past decade as farmers adapt to drier conditions (Dairy Australia 2018b). This increases the risk of dairy farmers being exposed to large input price rises in times of drought, when these inputs are in high demand (Cameron 2018b).

## 2 Regulation Impact Statement

This regulation impact statement (RIS) addresses the department's proposal to prescribe a mandatory code of conduct for the dairy industry with a targeted scope. It describes the problem the government is seeking to address, explains why an intervention is needed and assesses the merits of four options to determine a preferred course of action.

### **The problem**

The Australian dairy industry was deregulated in 1999. Since then, the structure of the industry has changed significantly as a result of the consolidation of dairy farm enterprises and widespread privatisation of processors (ABARES 2018; Senate Economic References Committee 2017). At the time of deregulation more than 75 per cent of milk processing was controlled by farmer-owned cooperatives (ACCC 2001). The industry has now mostly transitioned away from cooperatives, with most major processors now multinational or listed companies (ACCC 2018).

Some of the business practices, pricing arrangements and contracting terms that were developed in the former operating environment have been retained as standard industry practice (ACCC 2018). These standard practices are subject to a range of competition and fair trading concerns. These concerns contributed to the establishment of an Australian Competition and Consumer Commission (ACCC) inquiry and a number of parliamentary inquiries into the industry (ACCC 2018; Senate Economics References Committee 2010, 2011, 2017). These inquiries have produced relatively consistent findings on market failures arising from the structure of the industry and the terms of contracts offered by dairy processors to farmers, including:

- an imbalance in bargaining power between dairy farmers and processors
- some standard industry practices deterring farmers responding to market signals
- potential unfairness of some standard industry practices and unreasonable transfer of risk to farmers.

### **Dairy farmer and processor bargaining power imbalance**

Dairy processors have significant bargaining advantage over farmers. There are approximately 5,700 dairy farms in Australia (Dairy Australia 2018a). Dairy farm businesses are typically small operations that specialise in dairy production and are mostly substitutable for each other.

Processors are much larger and financially stronger businesses. Four processors account for 55 per cent of the milk-processing market, with another 70 accounting for the remaining 45 per cent (Johnson 2017). Most regional markets for raw milk in Australia are concentrated or highly concentrated (ACCC 2018). In addition, as raw milk largely is a generic product, processors' options for buying milk outweigh farmers' options for selling it.

This is aggravated by the very nature of the dairy industry, with limited numbers of competing processors in some regions and the perishable nature of milk, which prevents farmers from withholding supply to negotiate better terms with processors (ACCC 2018). Farmers are unable to store raw milk for extended periods and so are reliant on proximate processors (up to 600 km

from the farm) to process their supply in a timely fashion. Farmers are also required to continuously milk for animal welfare reasons.

As a consequence of the imbalance in bargaining power, dairy farmers are rarely able to negotiate contracts or prices with processors (ACCC 2018). There is also an absence of effective dispute resolution processes. This leads to farmers having limited mechanisms in which to raise or resolve issues in a way that does not create concerns from farmers about their ability to maintain an ongoing relationship with their processor or other processors. This issue is particularly important in areas across Australia with limited numbers of processors.

Dairy farmers operate under a range of contracting arrangements. A common practice is for processors to release a supplier handbook and a milk supply agreement that collectively form a contract. However, a supplier handbook, unlike a milk supply agreement, is able to be varied by the processor at any time without the approval of the farmer. Such changes may include the milk quality requirements which directly relate to the specifications for payment and can result in financial loss for the farmer.

Additionally, the unilateral ability of a processor to adjust terms in the supply handbook without notice is at odds with the amount of time it takes a farmer to respond to market signals to increase supply, decrease herd size, change processor or exit the industry. These processes can take significant amounts of time and preparation. The uncertainty for farmers of the supply handbook conditions that will be applied within a contracting period highlights the power imbalance that exists between them.

Some agreements also extend into the operations of a farm, including requiring a farmer to seek approval from the processor before they are able to alter the size of their herd. Additionally, spreading the sum of the contract over multiple documents makes it harder for farmers to understand and compare agreements.

This power imbalance is also exacerbated by an understanding from processors that a farmer's business success depends on the success of one's processor, while a processor's business success seldom depends on a single farmer's performance.

### **Deterrents to farmers responding to market signals**

Standard industry practices can deter farmers from responding to market signals, such as by switching to competing processors, and in this way prevent farmers from responding to market signals. This reduces competition and results in inefficient allocation of farmer resources. Some terms in contracts and other business practices can result in market failure where they affect a farmer's ability to make efficient investment decisions and where they act as a deterrent to switching to a competing processor when it is in their interests to do so. These practices include:

- Initial price offers from processors being announced very close to the commencement or after the commencement of a new contracting period. This allows farmers insufficient time to compare alternative offers and to make well-informed decisions about production and budgeting.
- Delayed loyalty payments for previous milk supply that are only available after the producer has entered into another supply contract with the same processor.

- Excessively long contract termination notice periods and automatic contract rollover arrangements, which hinder farmers' ability to exit contracts and switch between processors.

Currently processors release an opening price before the start of the season. These announcements can occur over a period of several weeks which makes it difficult for farmers to compare prices prior to the season commencing. However, farmers are also required to provide notice of their intention to leave (the length depends on the agreement). This notification period is often required to be made prior to the current processor or their competitors releasing their pricing and contract terms for the following year. Farmers also run the risk that they need to align the termination and commencement of collection between processors to ensure that a gap does not occur which has several issues including loss of income and disposal of the raw milk.

An example raised at many of the face-to-face consultation meetings of a switching deterrent behaviour from processors involved pricing of multi-year contracts. It was common for some farmers to seek a multi-year contract (3 to 5 years) in order to achieve supply certainty. However, some processors' multi-year contracts are only offered with pricing for the first 2 to 3 years, leaving the final 2 to 3 years of the contract without a price or any indication of what the price may be. Furthermore, these contracts would often not provide a way for a farmer to leave during the life of the agreement, despite the price uncertainty in the final years of the contract.

Processors use these arrangements to lock in their supply without providing transparent pricing information that farmers would otherwise be able to use to inform their contracting decisions and to respond to shifts in the market. There are some dairy farmers that are willing to trade price for supply certainty, but in areas where there is limited availability of processors or high competition, many farmers feel obligated to accept such unfair contracts even where more transparent pricing conditions would assist farmers to best plan and manage their businesses and risks.

### **Unfair standard industry practices**

Farmers can face significant uncertainty in the price they receive for their milk. This largely reflects the market uncertainty faced by processors (ACCC 2018). Although farmers are exposed to downside commercial risks from the market and commercial decisions made by processors, they are not guaranteed to share the benefit from unanticipated improvements in commodity prices. The ACCC noted that some processors passed uncertainty and risks to farmers by:

- offering only indicative pricing for a contract period (in some case changing farmgate prices unilaterally mid-contract)
- incentivising flat milk supply (or penalising seasonal milk supply)
- offering only short-term supply contracts
- requiring farmers to enter exclusive supply arrangements with a processor and implementing a two-tier milking pricing arrangement.

Concerns about indicative pricing were highlighted in 2016 after the retrospective 'step down' in farmgate milk prices by Murray Goulburn and prospective reductions by Fonterra forced affected dairy farmers to accept a price reduction of more than 10 per cent in their milk prices for the entire year.

The ACCC (2018) concluded that the combined effect of these problems led to a range of inefficiencies in the dairy industry, including:

- deterring productivity-enhancing investment by farmers unable to capture sufficient share of the returns to make their investment worthwhile
- softening competition between processors, suppressing farmgate milk prices.

## Why is action required?

The current operation of the dairy industry has led to market failures because of the imbalance in bargaining power between farmers and processors. Addressing market failures in the dairy industry could improve the overall efficiency of the supply chain and improve the total welfare of supply chain participants (ACCC 2018).

### General competition law

There is a clear role for government in promoting competition and fair trading. This is recognised in the objective of the *Competition and Consumer Act 2010 (CCA)*, which is 'to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'. The CCA includes unfair contract terms and restrictive trade practices provisions that are able to retrospectively address conduct that harms efficiency and competition in the dairy industry.

The ACCC (2018) assessed that the market failures present in the dairy industry are not effectively addressed through current remedies available under the CCA. In particular, that:

- Enforcement action under the CCA is taken after the event and typically for specific occurrences of conduct. The imbalance of power present in the industry is systemic and requires industry-wide change, rather than enforcement action being taken to specific events.
- Collective bargaining provisions of the CCA are less likely to be successful because milk is a perishable product and a farmer is limited in their ability to boycott because of the costs of storing milk and environmental laws preventing it being dumped.
- Unfair contract terms (UCT) law can be applied only in specific instances and do not address systemic industry-wide issues. Additionally, these laws do not address information asymmetry issues between farmers and processors or the absence of dispute resolution provisions in contracts.

On 3 December 2018, following a long period of engagement with several milk processors, the ACCC announced that specific terms in agreements would be amended to ensure that they complied with the business-to-business UCT law enacted by the Australian Government in November 2016.

The ACCC (2018) note the effectiveness of the UCT law is currently undermined by some fundamental limitations with the current regime:

- There are limited incentives for businesses offering standard form contracts to comply, given that the inclusion of UCTs in standard form contracts is not illegal, and there are no penalties available to be imposed by a court on a business that uses UCTs in its standard form contracts.

- There is minimal deterrence resulting from a compliance or enforcement outcome.

The following factors are also relevant to the potential application of the UCT laws to the dairy industry:

- A number of factors need to be considered to determine whether a contract is a standard form contract, including whether the other party was given an effective opportunity to negotiate the terms of the contract. If a processor allows an amendment to be made to a term in contracts with only one or two of their dairy farmer suppliers, it is unclear whether this is enough for the processor to demonstrate that its contracts are not standard form contracts across all its customers. If so, this may push contracts which were intended to be covered by the UCT regime outside of it.
- Where the upfront price payable under a contract exceeds \$300,000 (or \$1,000,000 if the contract is for a duration of more than 12 months) UCT laws do not apply. A number of contracts for a fixed volume and price for fresh milk for the duration of the contract would exceed this threshold.

### **Industry code of practice**

The dairy industry's voluntary *Code of practice for contractual arrangements between dairy farmers and processors in Australia*, was released in July 2017 (for more detail see Appendix A). The code was developed by the peak industry body for the Australian dairy industry, the Australian Dairy Industry Council (ADIC), to help ensure greater transparency and fairness in milk supply and pricing. ADIC includes farmers through Australian Dairy Farmers (ADF) and processors through the Australian Dairy Products Federation (ADPF).

The ACCC (2018) considered the effectiveness of the industry's voluntary code of practice as part of its dairy inquiry. The ACCC reported the voluntary code had a positive impact on some contract terms offered by some processors to some farmers for the 2017–18 dairy season. In particular, processors that signed on to the code made improvements to contract terms for setting and varying prices, exclusivity supply clauses and loyalty and other bonus payments.

The ACCC (2018) found that the non-enforceability of the voluntary code is an inherent weakness. These weaknesses cannot be addressed through the ADIC review of the code:

- Processors can choose to stop complying with the voluntary code at any time, which compromises the long-term effectiveness of the code in preventing the conduct that led to its development.
- Major processors Norco and Brownes and many smaller processors have not signed up to the voluntary code despite there being no penalty for signatories that breach the code. Some non-signatory processors continue to use delayed loyalty payments, have the ability to reintroduce two-tier pricing and have inadequate dispute resolution clauses.
- Processors who are not signatories are unlikely to become signatories to the voluntary code if it is strengthened.
- Signatories to the voluntary code can breach the code with little or no consequences.
- There have been varying degrees of compliance with clause 10 of the voluntary code, which requires processors to include a process for handling disputes between parties.

- Allegations have been made about potential breaches of clause 5 of the voluntary code, which requires that a farmer be entitled to all accrued loyalty and other payments where they have supplied to the end of a contract term.
- Despite provisions in the voluntary code that require transparency when setting and varying farmgate prices, processors appear to retain full discretion over the method of price notification they can use.
- The voluntary code does not contain a mechanism for resolving disputes that arise under the code, including about compliance with the code itself.

The ACCC (2018) also found that it would be challenging for the industry to agree to include a mechanism under the voluntary code for monitoring compliance or determining whether a breach has occurred, such as a review of processor contracts for problematic terms.

ADIC commenced a review of the code to address the findings of the ACCC's dairy inquiry, which was released April 2018. During the process of completing this review—and in light of the ACCC's findings and recommendations—ADF changed its position on the best approach to implement the code and requested that it transition to a mandatory code of conduct.

The department's objective for any regulatory reform developed through this RIS is to:

**Ensure regulatory intervention does not impose unnecessary compliance costs on regulated businesses and individuals, while helping to rebalance the level of commercial risk that farmers face.**

## Options that may achieve the objective

Four regulatory options are assessed in this RIS:

- **Option 1: Status quo.** Under this option, the Australian dairy industry would continue with the current voluntary code of practice and/or update the voluntary code to reflect contemporary industry concerns.
- **Option 2: Voluntary prescribed code of conduct.** Under this option, a code of conduct would be drafted by government, informed by industry consultation and prescribed by regulation under the CCA. The code would be enforceable for those parties that agree to become and remain signatories to the code, but not compulsory for industry participants to sign up or remain as signatories.
- **Option 3: Mandatory prescribed code of conduct (targeted scope).** Under this option, a code of conduct would be drafted by government, informed by industry consultation and prescribed by regulation under the CCA. The government would be the final decision-maker on the terms of the code. The code would be enforceable. Micro-scale processing businesses would not fall within the defined scope of the code.
- **Option 4: Mandatory prescribed code of conduct (whole of industry).** Under this option, a code of conduct would be drafted by government, informed by industry consultation and prescribed by regulation under the CCA. The government would be the final decision-maker on the terms of the code. The code would be enforceable. All industry participants would be automatically bound by it.

## 3 Impact analysis

### Option 1: Status quo

#### Description

Under option 1, there would be no new action taken by government and the Australian dairy industry would continue with the current self-regulated voluntary code of practice and/or update the voluntary code to reflect contemporary industry concerns.

The industry-made voluntary code of practice commenced on 30 June 2017 and is administered by the Australian Dairy Industry Council (ADIC). The ACCC did not have a role in the development of this code and does not have any compliance or enforcement power over it.

Processors who have signed up can withdraw at any time, though they will still be held accountable by the administering body for breaches that occurred while they were signatories. While a processor is a signatory of this code, it is only enforceable to the extent that it has an enforcement mechanism and process that participants choose to be bound by.

In practice, if this status quo option were selected, the government would encourage as many processors as possible to participate in a voluntary code, but there would be no deadline or enforceable way to obligate their membership.

#### Affected parties

Eight of the largest dairy processors are signatories to the voluntary industry code of practice: Fonterra, Bega, Lion, Murray Goulburn (now Saputo), Warrnambool Cheese and Butter, Burra Foods, Australian Consolidated Milk, Freedom Foods Group. The majority of dairy farmers supply these processors.

#### Analysis

Benefits	Weaknesses
<ul style="list-style-type: none"> <li>• Less prescriptive, providing industry with flexibility and agility to adapt to market conditions</li> <li>• Greater industry ownership of the code and demonstration of industry leadership</li> <li>• Some improvement in contract terms and conditions</li> </ul>	<ul style="list-style-type: none"> <li>• Competition and fair trading concerns not fully addressed as processors unlikely to voluntarily support a strong code</li> <li>• Absence of independent dispute resolution, enforcement and penalties</li> <li>• Not all processors are participating</li> <li>• Lack of full industry coverage does not fully address the competition and fair trading concerns</li> <li>• Processors benefitting from the current power imbalance are unlikely to support sufficiently strong changes to the code.</li> </ul>

#### Benefits

Industry self-regulation is less likely to be overly prescriptive and provide industry with the flexibility and agility to adapt the rules to changing circumstances and market conditions than government regulation (options 2, 3 and 4) (The Treasury 2017).

Industry involvement in the drafting of a voluntary industry code can lead businesses to have greater ownership of the code.

The changes made by those processors who are signatories to the voluntary code of practice provide benefits to their farmer suppliers. Improved contract terms include:

- increased certainty around processor pricing decisions and the positive effect this has on investment decisions by dairy farmers
- increased ability of farmers to switch processors, providing greater competition in the market for raw milk
- increased incentives for processors to offer innovative contract terms.

The voluntary code of practice prohibits some historical contractual arrangements, such as retrospective price step downs.

The voluntary code of practice provides for periodic (or as needed) reviews of the code. Industry can amend the code to strengthen provisions after Australia-wide consultations initiated by the Minister for Agriculture and Water Resources.

The voluntary code of practice allows the industry to demonstrate leadership.

### **Weaknesses**

This option does not fully address competition and fair trading concerns in the relationships between dairy farmers and processors and does not fully deliver the benefits possible under options 2, 3 and 4.

The terms of the voluntary code of practice are determined by industry. Processors that benefit from the current imbalance of bargaining power are unlikely to support sufficiently strong provisions being included in the voluntary code of practice. In support of this, the ACCC's (2018) review of the industry code of practice indicated:

- most processors had not signed on to the code and some continued to implement arrangements that gave rise to competition and fair trading concerns such as contracts not explicitly allowing a farmer to exit an agreement without penalty if a step down occurs
- among processors that had signed on to the code, there is a lack of clarity around the application of certain provisions of the code in commercial contracts
- the code did not address some areas of concern to the ACCC, on dispute resolution and processes to set and announce prices
- it had no appropriate mechanism to monitor and enforce compliance with the terms of the code.

The ACCC also indicated that the general provisions of competition law are not well suited to resolving the issues affecting relationships between dairy farmers and processors. This is because action by the ACCC against individual businesses in relation to specific instances of conduct were unlikely to achieve necessary change given the widespread nature of the issues within the sector. The ACCC also indicated a lack of clarity on the application of some provisions of unfair contract law to issues of specific concern to it in the dairy industry. This is because of the need to consider the fairness of contracts as a whole rather than individual clauses in isolation (ACCC 2018).

Resolving disputes in the dairy industry can be costly and resources intensive, again highlighting the advantage of a processor over a farmer. The voluntary code lacks an effective dispute resolution processes, enforcement of infringements and penalties. This leads to farmers having limited pathways to raise or resolve issues without concern about their ability to maintain an ongoing relationship with their processor or other processors. This is a particularly important issue in areas with limited numbers of processors.

The behavioural change associated with dispute resolution obligations would not be realised through the use of the unfair contract terms (UCT) law. While UCT law can be found to be breached, it only applies in specific instances, not repeated instances in similar contracts, and does not address systemic industry-wide issues. Additionally, there are no penalties available to be imposed by a court on a business that uses UCTs in its standard contracts.

The voluntary code lacks a process for handling non-compliance with the code itself.

### Costs

Under option 1, the regulatory burden estimate is nil. This is because any up-front establishment costs to processing businesses that have signed on to the voluntary code of practice have already been paid (sunk costs) and would not have to be paid again. This would not be the case if the terms of the industry code of practice were changed in a way that placed additional costs on the industry.

**Table 1 Option 1—average annual regulatory burden estimate**

Change in costs (\$m)	Business (\$)	Community organisations (\$)	Individuals (\$)	Total change in cost (\$)
Total, by sector	0.0	-	-	0.0

### Feedback

During consultation, many farmers believed that while the existing industry voluntary code of practice was a step in the right direction, it was not doing enough to ensure protection against the behaviours that led to the current situation.

Processors that provided feedback told us that their involvement in the voluntary code has been an improvement to their businesses and contracts. They reported that their involvement in the development process saw them offering improved terms in milk supply contracts.

Some small processors who are not signatories to the voluntary code noted that while they are not beholden to the voluntary code, they have introduced aspects of it into their existing contracts for the benefit of their suppliers.

As consultation continued from November 2018 to February 2019, there was diminishing feedback supporting the continuation of the voluntary industry code of practice.

## Option 2: Voluntary prescribed code of conduct

### Description

Under option 2, a code of conduct would be drafted by government, informed by industry consultation, prescribed by regulation as a voluntary industry code under the CCA, and administered by the ACCC.

A voluntary prescribed code of conduct would only apply as law to processors who voluntarily sign up. Processors who sign up can withdraw at any time without penalty, though they will still be liable for breaches that occurred while they were signatories.

While a processor is a signatory of this code, the ACCC can take enforcement action against them, such as injunctions, damages and compensatory orders. While penalties or infringement notices may apply, they are more likely in a mandatory code.

In practice, if this option were selected, there would be a period of education and transition towards the voluntary prescribed code of conduct. During this time processors would be encouraged to participate and become signatories, but there would be no deadline or enforceable way to obligate their membership.

### **Affected parties**

It would be at the discretion of dairy-processing businesses to elect to be a signatory to the prescribed mandatory code. Dairy farmers who supply a signatory processor would be required to comply with the prescribed mandatory code.

### **Analysis**

<b>Benefits</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>• Some improvement in contract terms and conditions</li> <li>• Some flexibility to changing circumstances in the industry</li> <li>• Allows for enforceable dispute resolution process</li> </ul>	<ul style="list-style-type: none"> <li>• Not all processors are likely to sign up</li> <li>• Lack of full industry coverage will not fully address the competition and fair trading concerns</li> <li>• Moderate compliance costs</li> </ul>

#### **Benefits**

Prescribed industry codes under the CCA can be legally enforced against their signatories. The ACCC is responsible for regulating these codes, monitoring compliance and taking enforcement action where necessary. These strengthened enforcement arrangements would address some of the limitations observed by the ACCC with the current industry code of practice (option 1). In the process of translating the current voluntary industry code of practice into a voluntary prescribed code of conduct, it is possible that some provisions would be strengthened.

A voluntary prescribed code of conduct would allow for the development of a dispute settlement mechanism that includes mediation and binding arbitration.

#### **Weaknesses**

This option may not fully address competition and fair trading concerns in the relationships between dairy farmers and processors. This is because not all dairy processors are likely to sign on to the voluntary prescribed code of conduct. Signatories are also able to advise the ACCC of their wish to rescind their involvement with the voluntary prescribed code. This is the case with the current voluntary industry code of practice and could be more so if the voluntary prescribed code were revised with strengthened obligations on processors (ACCC 2018).

The level of uptake and compliance with the existing voluntary code may be indicative of the likely uptake of a prescribed voluntary code. Additionally, processors are not, to a large extent, public-facing businesses, making them unlikely to face strong moral pressure from the general public to sign up to a prescribed voluntary code.

Farmers who supply processors who are not signatories will have limited or no ability to leave due to the same contractual difficulties that code seeks to address, as well as the limited number of processors operating in some regions.

### Costs

Under option 2, the regulatory burden estimate is the smallest of the three options for changed government policy settings. This is because the regulatory burden would only be incurred by processors who voluntarily became signatories to the code.

**Table 2 Option 2—average annual regulatory burden estimate**

Change in costs (\$m)	Business (\$)	Community organisations (\$)	Individuals (\$)	Total change in cost (\$)
Total, by sector	0.21	-	-	0.21

### Feedback

There has been limited support for this option from farmers and processors. Those who support this option often preferred it as a second choice after status quo. They believe that this option would mitigate unintended consequences through its limited reach to only signatory processors. They think that while a voluntary prescribed code is in effect, it would act as a satisfactory guide to behavioural change in the industry without obligating all industry members to regulation that might not be fit for purpose.

Most feedback against this option came from farmers and smaller processors. Farmers, and some processors, who provided feedback against this option believed that it would be no different from the status quo voluntary code, which is currently not adjusting behaviour to their satisfaction.

Feedback from the smaller processors outlined their desire to see the larger processors be obligated to be part of a code. They hoped that a mandatory code would increase competition between all processors by curbing behaviours that smaller processors felt kept them non-competitive against the larger businesses.

## Option 3: Mandatory prescribed code of conduct (targeted scope)

### Description

Under this option a code of conduct would be drafted by government, informed by industry consultation, prescribed by regulation as a mandatory industry code under the CCA and administered by the ACCC. Businesses would be automatically and legally bound by the code upon it entering into force. Micro-scale processing businesses would be out of scope.

The ACCC can take enforcement action against all industry participants specified in the code. These actions can include injunctions, damages, compensatory orders, infringement notices and penalties.

In practice, if this option were selected, there would be a period of education and transition towards a selected date of effect for the mandatory code of conduct. During this time processors and farmers would be encouraged to adjust and amend their current business practices that are not compliant to the code.

There are a number of small processors (such as boutique cheese manufacturers) who can be identified as micro-scale processors. These businesses process relatively low volumes of milk (see Figure 2), generally for the production of specific products for regional markets.

The ACCC (2018) proposed that keeping small processors out of scope should be considered in the development of a mandatory code of conduct, suggesting that dairy farmers have more countervailing bargaining power in their dealings with micro-scale processors than they do with large processors. In order to secure raw milk supply, these micro-scale processors need to adjust their behaviour to meet the higher standards expected of the market or risk losing suppliers to processors offering better terms.

For micro-scale processors the cost of being covered by a code may be disproportionate to the amount of milk they purchase and therefore imposes a greater cost burden. This cost can potentially deter entry or expansion of micro-scale processors, whose participation in the dairy industry is important for competition.

### Affected parties

Large dairy businesses would be covered under a mandatory code and micro-scale processors would be out of scope. Fonterra, Bega, Lion, Saputo, Warrnambool Cheese and Butter, Burra Foods, Australian Consolidated Milk, Freedom Foods Group and their related entities would be included. The majority of dairy farmers would be covered by the code because the largest dairy processors buy most of the milk.

Meeting the requirements of the code would be better practice for all processors. However, there is a risk that businesses on the cusp of the selected scope threshold may over the course of several years oscillate between being obligated and not required to be part of the code.

### Analysis

Benefits	Weaknesses
<ul style="list-style-type: none"> <li>• Improved contract terms and conditions by covered processors</li> <li>• Micro-scale processors relieved of unnecessary regulatory burden</li> <li>• Independent dispute resolution</li> <li>• Stronger enforcement arrangements</li> </ul>	<ul style="list-style-type: none"> <li>• Drafted by government with more prescriptive requirements</li> <li>• Possible unintended consequences</li> <li>• Industry codes may not address higher-level market forces that affect processor and farmer behaviour</li> </ul>

### Benefits

Because of the scope of this option, aspects of the code that are intended to rebalance bargaining power inequalities will have significantly more effect on industry-wide behaviour than options 1 and 2. At the same time, micro-scale processes will be relieved from compliance costs and regulatory burden, which would be a very large proportion of their business costs in relation to the larger processors.

This option would allow for the development of a dispute settlement mechanism that includes binding arbitration, if agreed between the parties, and mediation that is independent, fast and accessible. More details around the exact process will be settled closer to finalisation of a draft code.

The ability of the ACCC to take enforcement action against industry participants specified in the code will lead to increased compliance from the businesses that process a vast majority of Australia’s milk pool.

### Weaknesses

While this option would reduce business compliance costs for micro-scale processors, it may not fully address competition and fair trading concerns in the relationships between dairy farmers and micro-scale processors. However, in the absence of a code market forces alone are likely to be sufficient to discipline the conduct of micro-scale processors in their dealings with farmers.

Binding arbitration may not be available under this option. This is because of legal issues that arise where determinations about existing legal rights and obligations are regarded as an exercise in judicial power. While industry codes can contain binding arbitration, this is limited to pre-contractual arbitration only—where determinations are made on future rights and obligations, not existing ones. However, if both parties to a dispute agree to enter arbitration, the result will be binding on both parties.

It is a potential risk that there would be an increase in agreements entered immediately before a mandatory code of conduct commences in order to avoid the obligations that would arise once the code was in effect. However, the effect would be somewhat lessened in the dairy industry with the voluntary industry code of practice already in place. There are also avenues available to farmers to limit the duration of agreements entered into immediately before a mandatory code of conduct commences.

Industry codes of conduct manage anti-competitive behaviours that could make day-to-day business transactions unnecessarily costly or reduce competition by excluding efficient businesses. However, a mandatory dairy industry code of conduct might only improve fairness and transparency in processor-farmer relationships (without decreasing farmgate prices) if larger market forces that could lead to power imbalances are also addressed, such as geographic isolation or prevailing climate.

This option could address the unfair behavioural symptoms of the power imbalance between farmers and processors, but it may not address the structural characteristics of the market that create economic incentives for the unfair contract terms to exist.

If persistent egregious power imbalances and unfair contract terms are suspected, this option may need to be complemented by other policy options that address possible higher-level causes of these issues (e.g. geographic isolation or prevailing climate).

### Costs

Under option 3, the regulatory burden estimate is larger than for option 2 because option 3 is mandatory code. However, the estimate is lower than for option 4 because micro-scale processors are out of scope from incurring any compliance costs.

**Table 3 Option 3—average annual regulatory burden estimate**

Change in costs (\$m)	Business (\$)	Community organisations (\$)	Individuals (\$)	Total change in cost (\$)
Total, by sector	0.51	0	0	0.51

### **Feedback**

Feedback on a mandatory code option indicated support from farmers all over the country, but predominantly outside of Victoria and the southern milk pool. Processors were less supportive of a mandatory code option.

The prevailing opinion of processors of all sizes that provided feedback was that if a mandatory code was selected, it must include all processors. They believed that micro-scale processors need to be in scope to ensure that the entire industry is beholden to the same rules.

Micro-scale processors that provided feedback were supportive of not being in scope for a mandatory code. They noted that while being out of scope would decrease costs to their businesses, they often comply as much as possible with prevailing best practice in the industry to remain competitive for milk supply.

Feedback from farmers that supported a mandatory code was split roughly in half between keeping micro-scale processors out of scope and a code applying to all businesses.

Farmers that supported option 3 believed that decreasing the business costs to micro-scale processors that they supply would help to keep their farmgate prices higher and continue with innovation in dairy processing. They also did not want high compliance costs to act as a barrier to entry for new businesses and entrepreneurs in the dairy industry.

Farmers supportive of a full mandatory code understood that the costs to micro-scale businesses could be great in that scenario, but remained supportive of a code applying to every member of the industry, regardless of size. Additionally, many believed that it would be too difficult to settle on a fair threshold to determine the lower scope of the code.

Farmers from Victoria and other regions feeding into the southern milk pool expressed that their regions are different from other parts of the country. Many of these farmers believed that due to characteristics such as a greater choice of processors and more exposure to the fluctuations of the international market, establishing a mandatory code would be an inflexible solution and limit their business choices. These farmers were aware that their scope of choice in processor and business model was very different to the rest of the country's dairy farmers.

The farmers from those southern regions that provided feedback supportive of a mandatory code were largely also supportive of micro-scale processors being out of scope of a code for similar reasons as farmers from other parts of the country.

## **Option 4: Mandatory prescribed code of conduct (whole of industry)**

### **Description**

Under this option a code of conduct would be drafted by government, informed by industry consultation, prescribed by regulation as a mandatory industry code under the CCA and administered by the ACCC. Businesses would be automatically bound by the code once it comes into effect.

The ACCC can take enforcement action against all industry participants specified in the code. These actions can include injunctions, damages, compensatory orders, infringement notices and penalties.

In practice, if this option were selected, there would be a period of education and transition towards a selected date of effect for the mandatory code of conduct. During this time processors and farmers would be encouraged to adjust and amend current business practices they have that are not code compliant.

### **Affected parties**

All dairy farmers and processors would need to comply with a mandatory prescribed code of conduct.

### **Analysis**

<b>Benefits</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>• Fully addresses the competition and fair trading concerns.</li> <li>• Treats all members of the industry equally.</li> <li>• Allows for enforceable dispute resolution process.</li> </ul>	<ul style="list-style-type: none"> <li>• Drafted by government with more prescriptive requirements.</li> <li>• Highest compliance costs.</li> <li>• Deters entry of expansion of micro-scale processors that are sources of competition and innovation.</li> <li>• Minimal increase in farmer coverage from option 3.</li> <li>• Industry codes may not address higher-level market forces that affect processor and farmer behaviour.</li> </ul>

#### **Benefits**

The introduction of the mandatory prescribed code of conduct has the potential to deliver greater benefits than options 1 and 2. This is because all processing businesses that fall within the scope of the code would automatically be covered by it—they would not have the option of not signing onto it or remaining a signatory, as is the case with either form of voluntary code. However, the full coverage of option 4 (all dairy farmers and processors) would create risks for micro-scale processors and could deter entry or expansion.

This option would allow for the development of a dispute settlement mechanism that includes binding arbitration, if agreed between the parties, and mediation that is independent, fast and accessible.

#### **Weaknesses**

Although this option would fully address competition and fair trading concerns in the relationships between dairy farmers and processors, it is also the option with the highest compliance costs.

Binding arbitration may not be available under this option. This is because of legal issues that arise where determinations about existing legal rights and obligations are regarded as an exercise in judicial power. While industry codes can contain binding arbitration, this is limited to pre-contractual arbitration only—where determinations are made on future rights and obligations, not existing ones. However, if both parties to a dispute agree to enter arbitration, the result will be binding on both parties.

Some industry reports have indicated concern that the costs of the ACCC's monitoring and enforcement of the code of conduct would be cost-recovered from industry (ADF 2018). This is

not the case. As with the other industry codes of conduct administered by the ACCC, the ACCC would be funded to undertake its compliance, enforcement activities and education in relation to the code. The costs of these activities will not be recovered from the dairy industry.

It is a potential risk that there would be an increase in agreements entered into immediately before a mandatory code of conduct commences due to processors seeking to avoid the obligations that would arise once the code came into effect. However, this would be somewhat lessened in the dairy industry because the voluntary industry code of practice is already in place. There are also avenues available to farmers to limit the duration of agreements entered into immediately before a mandatory code of conduct commences.

Industry codes of conduct manage anti-competitive behaviours that could make day-to-day business transactions unnecessarily costly or reduce competition by excluding efficient businesses. However, a mandatory dairy industry code of conduct might only improve fairness and transparency in processor-farmer relationships (without decreasing farmgate prices) if larger market forces that could lead to power imbalances are also addressed, such as geographic isolation or prevailing climate.

This option could address the unfair behavioural symptoms of the power imbalance between farmers and processors, but it may not address the structural characteristics of the market that create economic incentives for the unfair contract terms to exist.

If persistent egregious power imbalances and unfair contract terms are suspected, this option may need to be complemented by other policy options that address possible higher-level causes of these issues (e.g. geographic isolation or prevailing climate).

### Costs

Under option 4, the regulatory burden estimate is the highest of the four policy options because the new policy settings would be applied without a targeted scope.

**Table 4 Option 4—average annual regulatory burden estimate**

Change in costs (\$m)	Business (\$)	Community organisations (\$)	Individuals (\$)	Total change in cost (\$)
Total, by sector	0.9	0	0	0.9

### Feedback

Feedback on a mandatory code option indicated support from farmers all over the country, but predominantly outside of Victoria and the southern milk pool. Processors were less supportive of a mandatory code option.

The prevailing opinion of processors of all sizes that provided feedback was that if a mandatory code was selected, it must include all processors. They believed that micro-scale processors need to be in scope to ensure that the entire industry is beholden to the same rules.

Some of the smaller processors that provided feedback and supported full coverage noted that the introduction of a mandatory code would not significantly affect their business practice. They already operate under many of the proposed changes in the draft code in order to attract suppliers from the larger processors.

Feedback from farmers that supported a mandatory code was split roughly in half between keeping micro-scale processors out of scope and a code applying to all businesses.

Farmers supportive of a full mandatory code understood that the costs to micro-scale businesses could be high in that scenario, but remained supportive of a code applying to every member of the industry, regardless of size. This full coverage would ensure that every farmer is covered by the code and protected by its clauses. Additionally, many believed that it would be too difficult to settle on a fair threshold to determine the lower scope of the code.

Farmers from Victoria and other regions feeding into the southern milk pool expressed that their regions are different from other parts of the country. Many of these farmers believed that due to characteristics such as a greater choice of processors and more exposure to the fluctuations of the international market, establishing a mandatory code would be an inflexible solution and limit their business choices. These farmers were aware that their scope of choice in processor and business model was very different to the rest of the country's dairy farmers.

## 4 Consultation

On 31 October 2018 the Hon. David Littleproud MP, Minister for Agriculture and Water Resources announced consultation on a mandatory code of conduct for the dairy industry. Minister Littleproud's announcement followed announcements on 10 September 2018 by ADF and 12 September 2018 by ADPF supporting a mandatory code and support to develop a mandatory code (respectively).

In the period November 2018 to February 2019 the department consulted with key stakeholders around the country. This consultation was undertaken in two phases and sought to assess the merits of prescribing a code of conduct for the dairy industry.

### Key stakeholders

A code of conduct for the dairy industry is of interest to a wide range of stakeholders. These include:

- dairy farmers
- dairy processors
- relevant state farming organisations
- relevant industry organisations
- Australian state and territory governments
- members of the public.

### First phase public consultation

The purpose of the first phase of public consultation was to:

- confirm industry support as purported by industry bodies
- confirm and supplement the conclusions of the ACCC dairy inquiry report
- clarify what aspects of the industry should be considered as part of a code
- canvass how a code could affect farmers and processors.

Additionally, the first phase of public consultation sought to inform dairy farmers and processors about what a dairy code could and could not do.

The first phase of consultation began on 31 October 2018 and concluded at the end of November 2018.

A 'Have Your Say' web page was created on the department's website, and a dedicated dairy code phone line and email address were established. The page provided a link to the ACCC dairy inquiry report as well as documents to show the public policy rationale and key issues in considering a code, including compliance costs and possible scope of a code. These documents included:

- Dairy industry code of conduct – farmer to processor transactions
- Mandatory code – key consultation issues
- Factsheet: A guide to dairy farmers.

During November 2018, departmental officers travelled to meet with dairy farmers and processors in all eight Australian dairy production regions:

**Table 5 Locations and dates of first round face-to-face consultation meetings**

Dairy region	Location of consultation	Date of consultation
DairyTas	Devonport, TAS	8 November 2018
DairySA	Mount Gambier, SA	13 November 2018
	Adelaide Hills, SA	14 November 2018
Western Dairy	Brunswick, WA	15 November 2018
	Margaret River, WA	15 November 2018
Dairy NSW	Bega, NSW	19 November 2018
	Nowra, NSW	20 November 2018
	Wauchope, NSW	21 November 2018
Subtropical Dairy	Lismore, NSW	20 November 2018
	Gympie, QLD	21 November 2018
	Boonah, QLD	22 November 2018
	Malanda, QLD	26 November 2018
WestVic Dairy	Camperdown, VIC	26 November 2018
Murray Dairy	Shepparton, VIC	27 November 2018
GippsDairy	Maffra, VIC	28 November 2018

These two-hour face-to-face consultation meetings were advertised on the 'Have Your Say' web page, in joint media releases between the minister and local Members of Parliament in that region, and distributed to dairy farmer representative organisations and processors to pass on to farmers. All consultation meetings were open to the public and did not require registration.

In addition to the above 15 face-to-face consultation meetings, the department held one-on-one consultation meetings with 12 processors and relevant industry organisations.

Topics presented by the department for discussion and feedback at all (face-to-face and one-on-one) consultation meetings included issues that are common to commodity industry codes of conduct, and some specific to the dairy industry:

- exclusive supply
- step downs – retrospective and prospective
- cooling-off periods
- terminating contracts
- dispute resolution

- penalty regimes
- costs generated by a code
- potential for exemptions.

Key stakeholders raised additional topics, including: farmgate prices; the scope of a code; the role of retailers; milk swaps; cartage and transport; milk testing; and the implementation and review of a code.

A detailed list of the issues discussed at the first phase face-to-face consultation meetings can be found at Appendix D.

Sign-in sheets were passed around at each face-to-face consultation meeting and attendees could choose to provide their name, organisation, email address and phone number to ensure continued communication from the department on the progress of the consultation process. Individual consultation meeting summaries were prepared and distributed to attendees via email.

## **Second phase public consultation**

The purpose of the second phase of public consultation was to:

- obtain detailed feedback on draft clauses for a dairy code
- clarify support for regulatory options 1-4
- identify issues or unintended consequences for regulatory options 1-4
- clarify current business practices and costs for regulatory options 1-4.

A second phase of consultation was announced by Minister Littleproud on 15 January 2019 and closed on 15 February 2019. The following documents were available on the 'Have Your Say' web page:

- draft clauses for a dairy code
- an early assessment RIS.

Two supporting documents were also available on the page:

- draft clauses for a dairy code—overview for farmers
- issues discussed at public consultations on a dairy code summarising round one discussions.

Three face-to-face consultation meetings were held in the three Victorian dairy regions only:

**Table 6 Locations and dates of second round face-to-face consultation meetings**

Dairy Region	Location of consultation	Date of consultation
GippsDairy	Warragul, VIC	29 January 2019
Murray Dairy	Echuca, VIC	31 January 2019
WestVic Dairy	Warrnambool, VIC	1 February 2019

Key stakeholders in Victoria felt additional face-to-face meetings were required in that state. Victoria was also the state where the department received the most varied stakeholder feedback. All three face-to-face consultation meetings were open to the public and did not require registration.

Two telephone “town hall” meetings allowing for dial-in capability for stakeholders across the country as a way to facilitate additional feedback from regions where the department was not able to hold additional face-to-face consultation meetings.

As well as being listed on the ‘Have Your Say’ web page, the face-to-face and town hall consultation meetings were announced in the Minister’s press release on the second round, advertised in three local newspapers and two national rural-focused newspapers, and detailed in an email and text message from Dairy Australia to all dairy produce levy payers.

Sign-in sheets were passed around at each face-to-face consultation meeting and attendees could choose to provide their name, organisation, email address and phone number to ensure continued communication from the department on the progress of the consultation process. Individual consultation meeting summaries were prepared and distributed to attendees via email.

In addition to the three face-to-face and telephone town hall consultation meetings, the department held one-on-one consultation meetings with 22 processors and relevant industry organisations, state farming organisations and state governments.

The department also provided an online survey on the ‘Have Your Say’ web page asking about various aspects of the code and common business practice.

To ensure continuous and broad-based feedback on stakeholder views, the public email address and hotline remained open, and the department held additional face-to-face consultation meetings in three dairy regions that reflected the most diverse opinions on a code for the dairy industry.

The department used the feedback from these different consultation avenues to clarify ambiguities in the draft clauses, gauge industry opinion of the different policy options, and to document additional obligations and associated costs and to update cost estimates.

A summary of issues raised at the face-to-face and town hall consultation meetings from the second phase of consultation can be found at Appendix E.

## 5 Recommended option

The consultation indicated broad support for a mandatory code of conduct with a targeted scope. However, there was a diverse range of views on the clauses of a code. The views varied significantly across the different dairy regions and between farmers and processors. The key message presented to the department from all stakeholders was that any new regulation needs to be strong enough to affect meaningful change in the industry and flexible enough to not prescriptively bind the various business models and regional differences in the dairy industry to a piece of legislation that is not fit for purpose.

In determining what option to recommend, the department assessed the net benefit and overall balance of each option. To do so, the options were assessed in their capacity to deliver the objective of *ensuring any regulatory intervention does not impose any unnecessary compliance costs on regulated businesses and individuals, while helping to rebalance the level of commercial risk that farmers face*. The overall practicalities of implementing the options was also considered.

On this basis, the department recommends that the government implement the regulatory option that it considers delivers the greatest net benefit, which is **option 3—mandatory code of conduct (targeted scope)**.

### **Option 3: Mandatory code of conduct (targeted scope)**

This is the preferred option due to its potential to deliver greater benefits than options 1 and 2. Option 3 has less regulatory burden than option 4 because all processing businesses that fall within the scope and threshold of the code would automatically be covered by it under option 4. Under option 3, micro-scale processing businesses would not fall within the defined scope of the code.

This option would address competition and fair trading concerns in the relationships between dairy farmers and large processors, and will have less compliance costs than the other mandatory code option. Additionally, this option allows for the introduction of a mandatory dispute settlement mechanism.

The total number of processors covered by the code would depend on the threshold used to determine the scope of the code. Because of the difficulty in determining an Australia-wide equitable minimum threshold of the amount of milk processed, it is proposed that micro-scale processing businesses would be defined as per the definition of a small business entity in the *Income Tax Assessment Act 1997*. Under the Act, these have an aggregated turnover (excluding GST) of less than \$10 million annually. This threshold has been selected with the intent that it will allow the code to cover roughly half of the 87 registered dairy processors in the country, which is estimated to account for about 99% of Australia's total milk pool.

The intention of this option is to offset the disproportionately large effect the code would have on micro-scale processors if they were include in the scope of the code. Like large processors, micro-scale processors are likely to need to seek external advice (such as legal advice) to understand and meet their regulatory obligations. For micro-scale processors the potential cost

and regulatory burden is disproportionate to the amount of milk they purchase and therefore imposes a greater cost burden to their comparatively small operation.

Noting the intention of the code to rebalance information and bargaining disparity between farmers and processors, dairy farmers have more countervailing bargaining power in their dealings with micro-scale processors than they do with large processors. Micro-scale processors are unlikely to possess disproportionate bargaining power in their relationships with dairy farmers due to the small scale of their business and the need to offer roughly equivalent terms to large processors in order to attract milk supply from farmers.

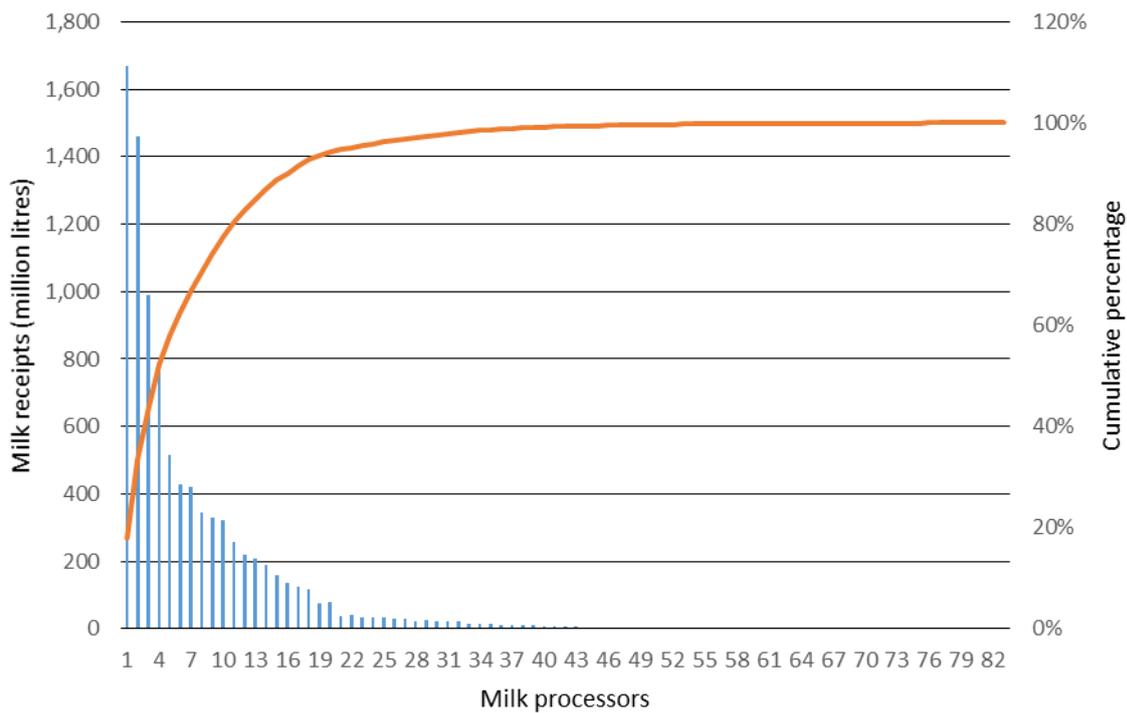
A code with a targeted scope would ensure that regulatory compliance costs are distributed appropriately relative to businesses' capacity to manage them. Disproportionate compliance costs may deter entry or expansion by micro-scale processors, whose participation in the dairy industry is important for competition and innovation. Furthermore, a code with a targeted scope would ensure that the ACCC's monitoring and enforcement resources are targeted to deliver most public benefit.

### **Defining the scope**

The vast majority of dairy farmers would be covered by a code because the largest dairy processors buy most of the milk. Furthermore, the majority of dairy processors are small businesses that buy only a small volume of raw milk from dairy farmers.

The Department of Agriculture and Water Resources collects the dairy produce levy from processors that are the first point of sale for raw milk. Figure 2 provides details of milk volume delivered to individual processors (which then paid levies to the department) in the 2017–18 financial year. In that period 83 processors received 9.35 billion litres of milk, with 20 processors receiving 95 per cent of milk and 40 processors receiving 99 percent. The 20th ranked processor received 75 million litres and the 40th ranked processor received 7.5 million litres. Some processors operate multiple accounts to collect levy returns. Twelve processors did not submit returns for 2017–18, indicating they may not have purchased raw milk in the period or may have temporarily or permanently ceased operations.

**Figure 2 Dairy processor raw milk receipts, 2017–18**



Assuming the code would cover about 40 of the largest dairy processing businesses (out of 87 in total), the business compliance costs would be reduced proportionately. Further, the benefits from that compliance cost reduction would be delivered to those micro-scale processing businesses that would be disproportionately affected by the regulatory burden of the code due to their small size and not being signatories to industry’s voluntary code of practice.

**Considerations**

While this option would reduce compliance costs for micro-scale processors a code with a targeted scope means that competition and fair trading concerns between dairy farmers and micro-scale processors would not fully be addressed. However, as noted previously in this RIS, market forces alone are likely to be sufficient to discipline the conduct of micro-scale processors in their dealings with farmers. To support this, it is expected that farmers will prefer supplying code-compliant processors regardless of their size, which will act as an incentive for micro-scale processors to comply with the code to the greatest extent possible and reasonable.

Despite attempting to decrease compliance costs for micro-scale processors, there will be businesses of similar size that will fall on either side of the threshold. Some processors that are relatively much smaller than the largest five or ten processors would still be above the threshold and be obligated to comply with the code, and some businesses may oscillate to either side of the targeted scope threshold. This will introduce costs to these businesses, but at this threshold level these costs are expected to be negligible when combined with other legislative obligations that a growing dairy processor must comply with. For example, dairy processors of all sizes must comply with workplace health and safety regulations, professionalism in food handling, and other food safety requirements in the processing of dairy products.

This option represents a risk that including transparency requirements for a minimum price, and rules regarding allowable price step downs, could have unintended consequences. These could include:

- facilitating concerted practices through price signalling by processors
- muting market signals that reduce the likelihood that the supply chain will respond efficiently to changes in market conditions
- processors releasing conservative or suppressed opening prices that have the effect of passing on market risk to farmers.

The possible consequences of the obligations of a mandatory code (as outlined in Table 7 below) on the business operations of dairy farmers and processors and farmgate prices, could be examined in an additional analysis of the industry.

### Obligation under a code

During the consultation process, possible obligations under a code were interrogated as to how they would address the issues identified as key hurdles in the industry:

- dairy farmer and processor bargaining power imbalance
- deterrents to farmers responding to market signals
- unfairness of standard industry practices.

Table 7 lists the obligations under a mandatory code and how they align to the above key issues based on feedback from both phases of public consultation.

**Table 7 Obligations under a code and key issues identified**

Obligation under a code	How it aligns with issues identified in Chapter 1
Require parties to deal with each other in good faith and to operate with fair dealings by having due regard to the other party's legitimate business interests	Addresses a range of contractual and business relationship issues by aligning a dairy industry code of conduct with other industry codes managed by the Australian Competition and Consumer Commission. ( <i>Dairy farmer and processor bargaining power imbalance and Unfairness of standard industry practices</i> )
Prevent unilateral changes to agreements	Aligns the dairy industry's contracting behaviours to the broader economy. ( <i>Unfairness of standard industry practice</i> )
Require that annually on a set date processors publically release a standard form agreement covering the terms of supply and a price (and if applicable a pricing mechanism for longer-term agreements) that covers the term of the agreement	Will increase farmers' knowledge of other offers available, increasing their bargaining power for better prices and conditions, as well as the possibility of responding to market signals, such as by switching to another processors that better suits that farmer. ( <i>Deterrents to farmers responding to market signals &amp; Dairy farmer and processor bargaining power imbalance</i> )
Prevent retrospective price step downs	Aligns the dairy industry's contracting behaviours to the broader economy. ( <i>Unfairness of standard industry practice</i> )
Prohibit prospective step down unless in specific circumstances such as force	Informs farmers of the circumstances that could lead to a step down, the ability of processors to respond to those

Obligation under a code	How it aligns with issues identified in Chapter 1
majeure, or exceptional market circumstances or major changes in global market conditions	circumstances, and outlines farmers' rights in such cases. <i>(Deterrents to farmers responding to market signals and Unfairness of standard industry practices)</i>
Prohibit exclusive supply arrangements in combination with two-tier pricing	Farmers will get a fair price for additional milk they produce when exclusively supplying one processor, possibly leading to pricing and supply innovations for farmers. <i>(Dairy farmer and processor bargaining power imbalance)</i>
Prohibit processors withholding loyalty payments if a farmer switches processors	Frees farmers from forward-binding loyalty payments, ensuring promised income on milk provided and allowing them to seek a different processor without disadvantage. <i>(Deterrents to farmers responding to market signals)</i>
Introduce a dispute resolution process for matters related to contracts between farmers and processors	Gives farmers and processors an enforceable mechanism to bring complaints and issues forward to be addressed. <i>(Dairy farmer and processor bargaining power imbalance)</i>

## Non-preferred options

The department considers that the following regulatory options will not deliver sufficient net benefit to the dairy industry:

- **Option 1: Status quo** - While there would be no additional costs to businesses and no unintended consequences due to government interventions, many competition and fair trading concerns in the relationships between dairy farmers and processors would not be addressed, and there would be no dispute resolution process that includes penalties for processors that have contracts that do not comply with the code.
- **Option 2: Voluntary prescribed code of conduct** - Would have compliance costs for businesses and some competition and fair trading concerns in the relationships between dairy farmers and processors would not be fully addressed. A prescribed voluntary code of conduct would create an uneven playing field between processors who sign up versus the competition who do not, as there is no compulsion for processors to become signatories and they can leave at any point. The objective of the code is not certain to be achieved.
- **Option 4: Mandatory prescribed code of conduct (whole of industry)** - Would generate the highest compliance costs for business, may create risks for micro-scale processors, could deter entry or expansion and carries the greatest risk of unintended consequences.

## 6 Next steps

### Legislation

The implementation of industry codes is detailed in the Treasury's *Industry Code of Conduct Policy Framework 2017* document available on its web page.

The implementation of option 3 would be achieved by the Minister for Agriculture and Water Resources making a regulation under the CCA to prescribe a mandatory code of conduct for the dairy industry.

Following Government policy approval, public consultation and submission of a draft RIS, the Minister for Agriculture and Water Resources will present a final RIS (this document) that outlines results of the public consultation and preferred policy option.

The department will then work with the Office of Parliamentary Counsel (OPC) to draft the text of the code (and its associated regulation) to ensure it meets Commonwealth legislative standards. This will be released as exposure draft legislation (with a draft explanatory statement) to seek additional public feedback and comment.

The draft code may undergo subsequent legislative drafting changes in light of stakeholder views. The Minister for Agriculture and Water Resources will seek the Treasurer's agreement before finalising the proposed code.

At the conclusion of this process, the code will be submitted to the Federal Executive Council (by the Minister for Agriculture and Water Resources with the agreement and on behalf of the Treasurer) for approval. If the Executive Council approves the code, the Governor General will be asked to make regulation to this effect.

The code regulation will be registered and then tabled in each House of Parliament, where it can be disallowed within 15 sitting days in each House.

### Additional impact analysis

There may be complex macro- and microeconomic outcomes from the implementation of a code of conduct (with the obligations outlined in Table 7) for the dairy industry - both positive and negative. To ensure these are fully understood, the department recommends undertaking further analysis on the potential pricing and business operation impacts of a mandatory code in order to help inform the detailed drafting of the code. This impact analysis should cover:

- the practical effect of a mandatory code on the business operations of various-sized industry participants (small and large dairy farmers and small and large processors)
- the impact of a mandatory code on farmgate price and overall market operation
- examination of the larger market forces that led to power imbalances in the dairy industry.

This impact analysis would build on the industry analysis undertaken by the ACCC as part of their report (2018) on the dairy industry. The terms of reference for the impact analysis would be agreed between the Minister for Agriculture and Water Resources, Treasurer and Prime Minister.

## Drafting and implementation challenges

Option 3 represents a risk that including transparency requirements for a minimum price, and rules regarding allowable price step downs, could have unintended consequences. These could include:

- facilitating concerted practices through price signalling by processors
- muting market signals that reduce the likelihood that the supply chain will respond efficiently to changes in market conditions
- processors releasing conservative or suppressed opening prices that have the effect of passing on market risk to farmers.

In developing requirements under the code, it is important to strike a balance between tackling the policy problem with the need to retain flexibility in the code so that requirements:

- are not overly prescriptive and do not stifle innovative approaches and business models
- do not unfairly burden micro-scale processing businesses
- recognise the differences in dairying practices occurring in the different dairy regions around Australia.

These points have been heavily consulted on and will be key considerations in creating the exposure draft for public release. The possible impact of a code (and its unintended consequences) would be analysed in the above recommended impact analysis prior to drafting the final details of a mandatory code. Additionally, draft legislation and clauses for the code would be made available for public consultation again prior to the Federal Executive Council. In these ways the regulatory burden required to achieve the policy objective of the code is minimised.

It is likely that there would be an increase in agreements entered immediately before a mandatory code of conduct commences in order to avoid the obligations that would arise once the code was in effect. However, the effect would be somewhat lessened than in other industries because the voluntary industry code of practice is already in place for many major processors.

Drafting the final clauses of a code with sufficiently and unambiguously defined terminology will be another challenge. For example, there are downward variations in milk price that are not necessarily considered prospective step downs in the various existing pricing models around the country. There may be regular downward pricing adjustments through an agreement period that do not drop below an agreed minimum, or a farmer may have agreed to a possible new price at the start of every year of a multi-year agreement. These price drops would not be considered to be prospective step downs in either example.

Feedback from face-to-face consultation meetings and the one-on-one meetings with processors and farmer representative organisations has guided new and more appropriate versions of the definitions in the code. These will be discussed with OPC during the drafting of the next version of the code.

It is highly likely that the implementation of a mandatory code will be seen as a major event in the dairy industry, similar to the de-regulation of the industry in 1999. Regardless of other possible causes, the code could be considered the source of any potential drop in farmgate price

or other issues that arise across the industry, including the exit of farmers. Continued discussion with industry bodies, processors and dairy farmers during the first few years of the code's operation, followed by the planned review after three full years of operation will provide substantial evidence to the role the code has played in predicted and unforeseen events in the dairy industry.

## **Regulatory burden**

The business compliance costs will depend on the final terms of a code, and how these differ from the current voluntary industry code of practice and normal efficient business practice.

The Regulatory Burden Measurement framework measures regulatory burden over and above what a normally efficient business would pay in the absence of regulation. If a business is required by regulation to undertake what is a normal business practice, this may not result in an increase in regulatory burden because a normal business may undertake the practice anyway (Department of the Prime Minister and Cabinet 2016).

The estimated annual regulatory burden of each option can be found in Table 1, Table 2, Table 3 and Table 4. Assumptions for the calculation of the regulatory burden are included at Appendix B and Appendix C.

## **Transition**

The regulation prescribing the code would commence after the regulation has been signed into law. This transition period would provide dairy farmers and processors with time to update their business practices prior to the code commencing. The obligations specified in the voluntary industry code of practice would continue to apply before the commencement of a mandatory code.

A Dairy Code Mediation Adviser, appointed by the Minister, would establish the register of independent assessors and mediators that may be engaged by the parties affected by the code.

The ACCC will monitor and enforce the code in a similar fashion to other mandatory industry codes, such as the horticulture and bulk wheat port codes of conduct.

## **Stakeholder education**

The introduction of the code would be accompanied by awareness-raising and education activities supported by the Department of Agriculture and Water Resources, the ACCC and industry.

An education and communication program will be implemented to ensure that members of the dairy industry (including farmers and processors) are aware of the reforms and how they can comply with the new obligations under the code. The department will work with the ADF, ADPF, Dairy Australia and dairy farmer representative organisations to develop guidance and information packets on changes to the industry under the code and on education and outreach activities.

## **Evaluation**

A review of the code would be carried out during the fourth year of its operation. This will involve a public consultation process to seek feedback from a wide range of stakeholders. The

review will be conducted by Department of Agriculture and Water Resources or by an independent body or industry experts. Feedback received during consultation indicated strong support for carrying out a review earlier than proposed, after two full years of operation.

The Minister for Agriculture and Water Resources will need to seek the agreement of the Treasurer prior to commencing consultations as part of a review.

# Appendix A: Voluntary industry code of practice

The voluntary code of practice aims to address a number of issues with dairy contracts under Australian Consumer Law and the unfair contract terms (small business contracts) laws which came into effect on 12 November 2016. It contains 11 elements:

- 1) Transparency—requires contracts to be drafted in plain English and the publication of standard form contracts.
- 2) Pricing—requires contracts to set out either a clear price or pricing mechanism or price notification process.
- 3) Pricing mechanisms—requires contracts to specify the details of pricing mechanisms or formulas, if used, to be specified in contracts.
- 4) Contractual variations – sets conditions on acceptable price adjustments and processor obligations and farmer rights in the event of price step downs.
- 5) Loyalty payments—requires any loyalty payments to be not contingent on a farmer being a supplier in a future season.
- 6) Volume/exclusivity clauses—requires contracts between farmers and processors to allow farmers to supply any additional milk (more than the already contracted volume) to other processors.
- 7) Contract duration—provides for supply agreements to be for fixed terms or rolling arrangements.
- 8) Termination/Notice to terminate—requires contracts between farmers and processors to provide reasonable notice of termination periods, which is negotiated between farmer and the processor and should apply to both parties.
- 9) Termination on fundamental breach—requires contracts to provide for either party to terminate the contract if the other party breaches its terms.
- 10) Dispute resolution—requires contracts to include a dispute resolution process.
- 11) Review—requires the code of practice to be reviewed periodically or as needed.

# Appendix B: Assumptions underpinning regulatory burden estimates

**Table B1 Assumptions that underpin the estimates for regulatory burden totals**

Category	Assumptions
<b>Number of regulated businesses</b>	<p>We estimate 87 dairy processing businesses purchase raw milk from farmers and would be covered by the code.</p> <ul style="list-style-type: none"> <li>• There are an estimated 122 dairy manufacturing businesses, including 74 milk processing businesses in Australia (Johnson 2017; Thomson 2018). Some of the 122 dairy manufacturers do not buy raw milk directly from farmers, but instead buy processed milk and transform it into other products.</li> <li>• Industry levies are paid on raw milk at the first point of sale. In 2017–18 the department collected dairy produce levies from 87 dairy-processing businesses (Department of Agriculture and Water Resources 2018). Australia has an estimated 5,700 dairy farm businesses (Dairy Australia 2018a).</li> </ul>
<b>Work-related labour costs (in-house)</b>	<p>Default cost of \$68.79 per hour (\$39.31 per hour and 75 per cent on-costs and overhead costs; Department of the Prime Minister and Cabinet 2016). Legal service costs of \$131.25 per hour (\$75 per hour and 75 per cent on costs and overhead costs).</p>
<b>Revision of standard term contracts</b>	<p>Time: 38 hours Costs: legal service costs, at \$131.25 per hour Frequency: once Number of businesses: 8 (option 2), 40 (option 3) or 87 (option 4)</p>
<b>Record-keeping obligations</b>	<p>Time: 0 additional hours compared with current practice. Costs: n/a Frequency: ongoing. Number of businesses: 5,787</p>
<b>Processor reporting requirements</b> Includes publishing contract; additional information on market conditions underpinning price notifications; publishing or providing other records to other parties.	<p>Time: 16 hours Costs: default costs, at \$68.79 per hour Frequency: ongoing—three times per annum Number of businesses: 8 (option 2), 40 (option 3) or 87 (option 4)</p>
<b>Dispute resolution</b>	<p>Costs: horticulture and franchising code mediations cost \$330 per hour, with a minimum of 3 hours of mediation. We assume 7.5 hours of mediation will be required to resolve disputes, with a total cost of \$2,500 per case. Work-related labour costs: we assume 22.5 hours of preparation, plus 7.5 hours of participation in the mediation by two staff at the legal services cost (\$131.25) for a total cost of \$7,875 for each party to the case. Frequency: In 2017, 149 franchising cases went to mediation. Dispute resolution mechanisms in the horticulture code are seldom exercised (fewer than four cases a year). Dispute resolution mechanisms in the wheat port code have not been exercised since the code was introduced in 2014. Given the franchising sector is much larger than the dairy sector—1,284 franchises and 96,680 franchised businesses (Burgio-Ficca 2018) compared with 87 dairy processors and 5,700 dairy farms—and the low rate of recourse to formal dispute resolution in other industry codes, we assume 8 (option 2) or 10 (option 3 and option 4) cases progress to mediation under the dairy code per annum.</p>

# Appendix C: Likely regulatory burden from code obligations

**Table C1 Likely regulatory burden the obligations under a code**

<b>Business practice</b>	<b>Normal efficient business practice (current practice)</b>	<b>Voluntary code (current practice)</b>	<b>Possible mandatory code</b>	<b>Additional regulatory burden</b>
The need to revise contract terms	Revision may be required to ensure compliance with general competition law.	Required a range of revisions to contracts to ensure compliance with general competition law.	Will require a range of revisions to contracts.	Yes—upfront cost to revise contracts.
Record keeping by farmers and processors	Record keeping is a standard business practice.	Not specified a	Required.	Only to the extent this is over and above normal efficient business practice.
Publishing standard form contracts online	In the past, this has not been a standard industry practice.	Required (excluding any confidential clauses).	Possibly required.	Only to the extent this is over and above normal efficient business practice.
Price notification arrangements	This is a standard industry practice, which can include written advice on prices and regional farmer workshops.	Yes—with details of the process at the discretion of the processor.	Required—possibly strengthened to require written advice from processors to farmers to include information about market conditions.	Only to the extent this is over and above normal efficient business practice.
Price determination mechanisms, such as pricing formulas	These are standard industry practices	Yes—contracts should specify the exact pricing formula (if used).	Required—possibly on similar terms to the voluntary code.	No.
Dispute resolution	In the past, this has not been a standard industry practice	Yes—via a process specified in the contract.	Required—possibly via an independent process.	Only to the extent this is over and above normal efficient business practices.
Other business processes	These are standard industry practices.	Specifies minimum or maximum time frames for certain business processes.	Will specify minimum or maximum time frames for certain business processes.	No—the costs for administering the processes are unchanged.

**a** The ADIC (2017) revised draft code of practice specifies record-keeping requirements.

# Appendix D: Issues discussed at first round of public consultations on a dairy code

At each meeting, the department sought advice from attendees about eight issues. Attendees raised an additional nine issues that were discussed at the meetings. On every issue there were a number of views. The range of views are captured in this document.

## Issues raised by department

### Exclusive supply

- Most attendees agreed that processors should not be allowed to impose both exclusive supply and two-tiered pricing.
- Many agreed farmers should be able to negotiate clauses in their contracts, such as for exclusive supply.
- In areas with few processors, some farmers were concerned that if exclusive supply was not required, they would be left with large amounts of excess milk with no other processor to sell to.

### Step downs

- All attendees agreed that retrospective step downs should not be allowed under a code. However, they disagreed on whether prospective step downs should be allowed and under what conditions.
- The majority of attendees considered all step downs should be banned.
- Those who supported allowing prospective step downs noted that this could negatively affect farmgate prices.
- Some attendees believed that a code should differentiate between domestic and export markets and only allow step downs in export markets. Others believed that not allowing step downs could affect a processor's ability to manage their risk when responding to fluctuations in domestic and international markets.
- Generally, attendees did not support prospective step downs in situations where poor management decisions necessitated the step down.
- However, attendees generally recognised that some events, such as an economic shock (for example, a global financial crisis) or a major trade impact (for example, an international market closure) could have a major impact on trade-exposed processors.

### Notification period

- Some attendees supported having at least 30 days' notice for a prospective price step down. Others supported having longer notice periods of up to 90 days.

- Many attendees supported having a 30-day release period to exit the contract if a step down occurs, with a 21-day period for farmers to rescind their exit notification.
- Some attendees suggested that if a farmer exits a contract at the announcement of a step down and then returns during the cooling-off period, processors cannot offer a price lower than what the farmer originally walked away from.

#### **Measurement of a step down**

- Some attendees supported having a cap for prospective step downs. In these cases, the cap would be determined by an independent party or ombudsman, not the Australian Competition and Consumer Commission (ACCC), and should not be calculated on an internationally based metric.
- Attendees suggested that step downs should be a percentage amount or based on a corresponding percentage reduction in a composite of products in the global market.

#### **Cause for a step down**

- Some attendees suggested that if termination of a contract is allowed for mid-season step downs, then termination should also be allowed if the opening price in any year of a multi-year contract is below the opening price of any prior year of the contract.

#### **Force majeure**

- Attendees discussed whether a prospective step down would only be allowed in the event of force majeure. There was support for and against this option.
- Many attendees suggested that if prospective step downs were allowed, processors would have to justify the decision and state when the contract would revert back to the original price.

### **Contracts and cooling-off periods**

#### **Price announcement**

- Many attendees supported having a 1 June price release and a 30-day consideration period, but some attendees sought a 6- to 8-week consideration period.
- Many attendees believed that all contract start dates should align, and that all prices should be announced at once on a central database or website.
- Some attendees did not support confidential contracts or confidentiality statements.

#### **Cooling-off periods**

- Attendees proposed different lengths for cooling-off periods, including 3 days, 14 days (general support), 21 days and 4 weeks.

#### **Contract length**

- Attendees expressed a range of views on the length of contracts, including a minimum 12 months, a standard of 12 months or otherwise negotiated, or any length agreed to by both parties.

### **Terminating contracts**

- Many attendees agreed that a termination notification period should be any length of time agreed by both parties. Some attendees proposed a standard termination notification period of 30 days.
- Attendees were unable to agree on specific termination notification time frames. Many supported having a shorter notification period for farmers to notify processors and a longer notification period for processors to notify farmers.
- Some attendees suggested that processors should have to provide reasons for terminating a contract with the 30 days' termination notification.

### **Dispute resolution**

- The majority of attendees supported having a dispute resolution process included in a code, as long as disputes of all sizes/values were covered, and acknowledging that the cost of entering dispute resolution is a business decision.
- Many attendees were concerned that processors might take retribution on farmers if they raised a dispute.

### **Management of dispute resolution process**

- Attendees raised several suggestions about the management of disputes
  - the dispute resolution process should be managed by an independent body/ombudsman or should remain inside the industry
  - mediation panel members need to be independent, have experience in dairy and comprise representatives from different regions
  - attendees wanted clarification on who a dispute resolution officer reports to when they work for a processor.

### **Time frames**

- Attendees supported a rapid dispute resolution option to account for the perishability of milk and for recurring issues such as disputes about milk testing outcomes. They proposed setting a maximum time for arbitration, to keep processors from stalling.
- Many attendees were concerned about what might happen to the dispute process if a farmer moved to a different processor mid-dispute or at the end of a contract period.

### **Cost of dispute resolution**

- Most attendees agreed that both sides should be responsible for their dispute resolution costs. However, many attendees believed these costs would eventually be passed down to farmers anyway.
- Attendees expressed concern that the cost of bringing forward a dispute would dissuade farmers from making formal complaints given the imbalance in power and financial resources between farmers and processors.
- Some attendees suggested costs could be reduced by requiring mediation before arbitration.

## Penalties

- A majority of attendees believed that penalties should be applied to both processors and farmers. They supported a model where a breach of good faith would have the highest penalty.
- However, most attendees were also concerned that penalties would be properly scaled for larger processors to ensure penalties were big enough to dissuade bad behaviour. Some attendees believed that the cost of penalties to processors would be passed on to farmers eventually.

## Regulatory costs

- Generally, most attendees believed that farmers would eventually bear all costs of a code because processors would pass the costs along.
- Other attendees expressed a view that the direct costs for farmers would be minimal, with possibly larger direct costs for processors. They noted that a lot of regulatory costs are already applied to processors for normal business practice.
- Some attendees were concerned that many farmers who do not have contracts may need costly legal assistance to work through any new contracts.

## Exemptions

- Attendees expressed a range of opinions on exemptions, from no exemptions for anyone who buys milk from a farmer to exemptions only for small businesses to support business growth.
- Attendees who supported exempting small business from a code were unable to agree on a fair minimum threshold of exemption. Different minimum processing threshold levels were suggested, ranging from 500,000 litres per year to 10 million litres per year. Other attendees suggested using the Australian Taxation Office definition of a small business.

## Issues raised by attendees

### Farmgate prices

- Attendees across the country stressed that farmgate prices paid in all dairy regions are too low.
- Some attendees believed that without an increase in farmgate prices, farmers will be exiting the industry and few young farmers are interested in taking on a dairy farm.
- Some attendees called for re-regulation of milk prices via
  - a milk price floor
  - farmers being paid their production costs plus a fair margin
  - other price-setting mechanisms
- Despite the ACCC dairy inquiry report findings, many farmers felt that \$1 milk does affect farmgate prices by putting an artificial cap on the price of milk and dairy products.

## Scope of a code

- At almost every meeting, attendees set out the milk arrangements in their region and noted how different they were to other regions.
- Some attendees suggested a code should have different settings for the domestic-focused and export-focused markets. Others suggested that a code should be informed by the behaviour of similar foreign dairy markets and their codes of practice and conduct.

## Role of retailers

- At almost every meeting, some attendees said that a dairy code should include retailers because through their market power they obliged processors to agree to contracts that did not offer a fair return. As a result, retailers were charging less for milk than they were for water, which was unfair to farmers.
- Many attendees believed that the Food and Grocery Code of Conduct is not doing enough.

## Milk swaps

- Some attendees proposed that
  - milk swaps should be banned
  - a code should cover milk swap behaviour between processors
  - milk swaps should be classified as trades and priced to improve transparency.
- Some attendees believed milk swaps should remain because they allow processors to increase efficiency and profitability. This should improve prices for farmers.

## Cartage/transport

- Some attendees stated that farmers should not have to pay cartage/transport costs to subsidise processors' transport and logistics costs.
- Other attendees believed the cartage/transport costs were reflected in the farmgate price irrespective of whether a fee was charged on their milk statement or not.

## Milk testing/volume

- Some attendees suggested a code should establish an independent milk testing body to address testing disputes. Farmers felt that processors should not have the final word on milk tests.
- Some attendees suggested there should be a standard method to measure the tanker volume to ensure all parties agree on the amount of milk that has been picked up.

## Finance arrangements

- Some attendees noted that farmers are sometimes restricted from moving to another processor for a better price because they have a debt agreement with the processor.
- Some suggested a code should restrict debt arrangements from locking a farmer into supply with a processor.
- Other attendees believed that a code should allow farmers and processors to arrange financial agreements in addition to and separate from supply contracts, because this is a business decision at the discretion of the farmer.

## **Payment cycle**

- A majority of attendees considered the 30-day payment cycle should remain.
- Some supported a 15-day payment term, noting that 30-day pay periods are from an older era in technology and finances.

# Appendix E: Issues discussed at second round of public consultations on a dairy code

On 15 January 2019 the Hon. David Littleproud MP, Minister for Agriculture and Water Resources announced a second round of consultation on draft clauses for a dairy code and potential regulatory impacts. The draft clauses were developed based on feedback from the first round of consultation, the Australian Competition and Consumer Commission (ACCC) dairy inquiry and the Australian Dairy Industry Council's revised voluntary code.

This round of consultation included three face-to-face meetings in Victoria, two national tele-town halls and feedback from email submissions, phone calls, and online surveys, and closed on 15 February 2019. Feedback raised during the consultation period will be provided to the Australian Government for consideration.

## Issues raised

### Good faith

- Attendees raised questions around how 'good faith' will be defined under a dairy code. The final definition will be harmonised with other industry codes, such as the Food and Grocery Code and Horticulture Code.
- A dairy code could also include the principles of 'fair dealing'. Principles of fair dealing go further than good faith and would help to ensure whether a processor's actions lead to a fair outcome for the supplier in all circumstances.

### Agreements

- Many attendees wanted to ensure that the standard form agreements (SFA) are flexible enough to account for contracts of all lengths, as well as regional variations.
- Attendees considered 1 June, 10 June or 1 July for the release of the SFA. Earlier release dates such as 1 June and 10 June had the most support.
  - Some attendees supported extending the period between the release of price and commencement of the agreement from 30 days to 60 days.
- Some attendees called for SFAs to include a default period of 3 or 6 months. However, reduced periods may lead to increased price volatility. Others supported the proposal that the length of an agreement should be negotiated between farmer and processor.
- Attendees also expressed some concern about the practicality of having the different varieties of agreements. They were particularly concerned with how the processors' field officers will be able to manage many contracts over a short period.
- Attendees were also interested in a proposal for processors releasing a case study or prices based on different production curves to help farmers consider their options.

## Pricing

- Attendees expressed a range of views on the provision of minimum, opening or weighted prices in contracts, such as:
  - a greater preference for the code to require an ‘opening price’ instead of a ‘minimum price’, with a clear definition of the chosen option
  - concern that if the code uses the opening price model, processors may open with a high price to attract farmers and then drop significantly throughout the course of a contract
  - less support for the use of weighted average pricing in their contracts and a preference for contracts to specify fat, protein, cartage prices etc.
  - concern that requiring a minimum price will encourage processors to release low opening prices. In some regions those prices won’t be mitigated by competition. However, processors may lose business from farmers if they do not put out a competitive minimum price.
- Some farmers were concerned that processors will create highly localised milk pools through varied regional milk prices. Others believed that this could be a good thing and that there are good economic reasons for milk prices to vary around the country.
- Attendees suggested various methods for pricing, such as:
  - a mechanism to predict an average Australian milk price
  - a standard income estimator that allows farmers to input their farm data and be provided a standard price and contract that is suitable for their situation
  - supply curve information to assist farmers to work out what their prices would be based on their supply arrangements
  - mandating that the opening price lasts for a minimum period to stop multiple price rises soon after the start of the contracting period
  - a monthly breakdown of prices with fat and protein variables to ensure transparency of price and to allow farmers to compare between processors more easily.

## Cooling-off period

- Farmers supported a cooling-off period, but many also recognised that a longer cooling-off period is a large cost and business risk for processors.
- Attendees felt that, although a code will include a cooling-off period, this period could be mutually agreed to be waived.
- Some attendees were concerned that the cooling-off period may create an ‘auction’ for milk and consequently a potential risk to processors.

## Exclusive supply

- Most farmers supported a default setting of exclusive supply, but with the ability to negotiate for dual or multiple supply. Based on feedback, the department advised that the draft clauses had been amended to prevent exclusive supply with no two-tier pricing. However, a processor should not unreasonably withhold dual supply from a farmer who requests it.

- Many farmers were concerned that if exclusive supply was not the default position, processors might begin to set volume requirements which would be difficult to achieve consistently.

### **Contract termination**

- Attendees discussed the different levels of risk for processors and farmers. A processor who loses one farmer still has capacity to continue their business. However, a farmer who loses the processor has a greater level of risk. As such, attendees believed that processors should give a longer period of termination notice than farmers.
- General preference is for 90 days' notice from processor to farmer to commence or terminate a contract.
- Many people wanted to see the exit clause broadened from death and disability (see draft clause 41) to include other factors such as selling a business.

### **Step downs**

- Attendees expressed unanimous support for banning retrospective step downs
- However, many expressed a range of views on prospective step downs:
  - some considered step downs as a way for processors to manage risk and prevent low opening or minimum prices
  - others believed that if processors were allowed step downs, farmers should be able to demand step ups to account for increasing water and energy prices
  - some supported allowing prospective step downs in limited circumstances such as unforeseen market events.
- The department noted that if prospective step downs were banned, processors could still negotiate with farmers to mutually agree to step down and enter into new contracts.
- Attendees also commented on the parameters for how a step down may operate, such as:
  - increasing length of notice from 30 to 90 days for a step down
  - capping the step down to up to 20 per cent
  - requiring a certain percentage of farmers to agree to a step down for it to occur
  - clarifying the definition of a step down.

### **Loyalty payments**

- Most attendees supported the proposal that farmers should receive a loyalty payment if they serve their terms, and would not have it withheld if they leave the following season.

### **Dispute resolution process**

- Many attendees commented on the clarity of the dispute resolution process. The current order of clauses will be amended and the intended approach is as follows:
  - **Internal complaints handling procedure**—A processor must have a complaints-handling procedure and a handling officer to manage complaints impartially and consistently with the code. All disputes should first try to be resolved through this process.

- **Mediation**—Following unsuccessful resolution via a processor’s internal complaints handling procedure, a dispute could escalate to mediation. The government would fund a mediation adviser on retainer. Costs for accessing their services on a user-pays basis would be split equally between parties and capped at a set hourly rate.
- **Arbitration**—An unresolved dispute could escalate to arbitration, which both parties must consent to take part in. If both parties consent to participate in arbitration, any decisions made from arbitration will be binding.

## Breaches and penalties

- The ACCC would be responsible for investigating alleged breaches of the code. In some instances a financial penalty may be awarded if the code is breached.
- Some attendees believed that processors will continue bad business practices by paying a fine rather than abiding by a code if it is more cost effective.
- Many attendees discussed how fines would operate, how large they would be and what offences they would apply to.

## Exemptions

- Attendees expressed mixed support for exempting small businesses under a code, with some noting that many of the processors in Victoria would not fall under the proposed threshold of \$10 million annual aggregated turnover (ATO definition of small business).
- Some attendees expressed concern that large processors could be exempt by creating smaller entities. However, this action would be covered under ‘Related Entity’ clauses in the *Corporations Act 2001*.

## Regulatory costs

- Some attendees wanted to see a further breakdown of the costs of the code. This will be included in the final version of the regulation impact statement.

## Scope of the code

- Attendees expressed concern about issues that will not be addressed by the code, including:
  - separate codes for different states/regions/markets
  - re-regulation or other mechanism to determine farmgate prices
  - sign-on bonuses for milk contracts
  - sampling and testing of milk collected at the farm gate
  - milk swaps.
- Attendees expressed concern that the behaviour of retailers and the practice of milk swaps would not be covered under a code.
- Attendees raised the issue of including cell counts for milk in a code. Cell counts are covered by food safety regulations and not the code. However, where penalties or bonus payments apply for certain milk quality standards, the agreement must be clear what the levels and rates are.
- Some attendees suggested a code should restrict debt arrangements from locking a farmer into supply with a processor. Others believed that a code should allow farmers and

processors to arrange financial agreements separate from supply contracts as a business decision at the discretion of the farmer.

### **Other issues raised**

- Attendees felt the role of a processor's field officer as the farmer's first contact point if there is an issue was vital.
- Some farmers expressed concern at the difference in payment rates between large and small farms. Larger farms may be paid more and their milk collection prioritised even if they are further away than a smaller supplier.
- Some attendees expressed concern that production incentives which reward higher volumes of milk can make up a significant portion of the milk price and could discourage farmers from switching to another processor.
- Some farmers suggested that the final payment for milk should be made on normal payment arrangements, and not used as leverage against upcoming contract pricing or to prevent farmers from leaving a processor.
- Some people believed that better education of the Australian public was needed to make more informed choices as consumers.

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