Opinion n° 09-A-48 of 2 October 2009
relative to the operation of the dairy sector

The *Autorité de la concurrence*,

Having regard to the letter, registered on 11 June 2009 under the number 09/0085 A, by which the Economic Affairs Committee of the Senate refers to the *Autorité de la concurrence* to obtain an opinion on the operation of the dairy sector;

Having regard to the Treaty establishing the European Community, and in particular articles 33, 36, 81 and 82 thereof;

Having regard to book IV of the Code of commercial law (*code de commerce*) relative to the freedom of prices and competition;

Having regard to the Rural Code (*code rural*);

Having regard to the other documents of the file;

Having heard the Case Officer, the Deputy General *Rapporteur* and the Government Official during the session of the *Autorité de la concurrence* on 22 September 2009;

Having heard the representatives of the Ministry of Food, Agriculture and Fishing and of the National Interprofessional Centre for the Dairy Sector (*Centre national interprofessionnel de l'économie laitière*) on the basis of article L. 463-7 of the Code of commercial law (*code de commerce*);

Having duly called the representative of the Economic Affairs, Sustainable Development and Territorial Planning Committee of the Senate;

Issues the present opinion in response to the submitted request:

INTRODUCTION

1. The crisis currently faced by the dairy sector, notably characterized by a sharp fall in production prices (more than 37% between September 2008 and April 2009), has prompted the Economic Affairs Committee of the French Senate to seek, on the basis of article L. 461-5 of the French Code of commercial law (*code de commerce*), an opinion from the *Autorité* on the operation of this sector.

2. Since 1997, producers and processors met within the framework of the National Interprofessional Centre for the Economy of the Dairy Sector (*Centre national interprofessionnel de l'économie laitière* - hereinafter "CNIEL") and began to disseminate production price recommendations. In 2008, in a context of the decrease of household purchasing power, which notably stemmed from a severe rise in prices of raw materials, the Ministry for the Economy (Directorate General for Competition, Consumer Affairs and Fraud Control - DGCCRF) warned the interprofession of the risks that such practices could entail, with regard to competition rules. The latter therefore put an end to these practices.

3. Insofar as some operators of the market feel that price recommendations are necessary in order to address the crisis, the Economic Affairs Committee of the Senate would like the *Autorité* to specify "*the scope of the prohibition of the price setting of milk in French and Community competition law*".

4. It also requires the *Autorité*’s opinion on the operation of the sector and its recommendations to improve it, with a notable interest in a "*tripartite system* [producers, processors, distributors] *which could steer the aforementioned price in compliance with competition rules*."

5. To begin with, the *Autorité* recalls that, when it is consulted pursuant to article L. 461-5 of the French Code of commercial law (*code de commerce*), it is allowed to express an opinion with regard to general competition matters. In this context, ruling as to whether a given practice is or would be contrary to articles L. 420-1 and L. 420-2 of the French Code of commercial law (*code de commerce*), and 81 or 82 of the EC Treaty, or on the possibility of an exemption on the basis of articles 81, paragraph 3, of the EC Treaty or L. 420-4, I, 2° of the French Code of commercial law (*code de commerce*) does not fall in its remit. Such a decision could only be made after a formal complaint or submission, which would have to be investigated and adjudicated with due regard to the right to a fair hearing.

I. Observations

A. DESCRIPTION OF THE SECTOR

6. The dairy sector comprises three different levels: milk production, its processing into products intended to be consumed or stored, and distribution, which allows end consumer to reach dairy products[1].

1. MILK PRODUCTION

a) Production at the European level

7. In 2007, the European Union produced more than 147 million tonnes of cow milk, thereby representing more than 26% of worldwide production (as compared with 19% for North and Central America, and 16% for Asia).

8. Milk is the Community's largest agricultural production, representing more than 14% of the total value of the production of agricultural goods at the level of breeders, i.e. 45 billion euros. Germany is the largest producer, ahead of France, the United Kingdom, the Netherlands and Italy, as the following chart shows.

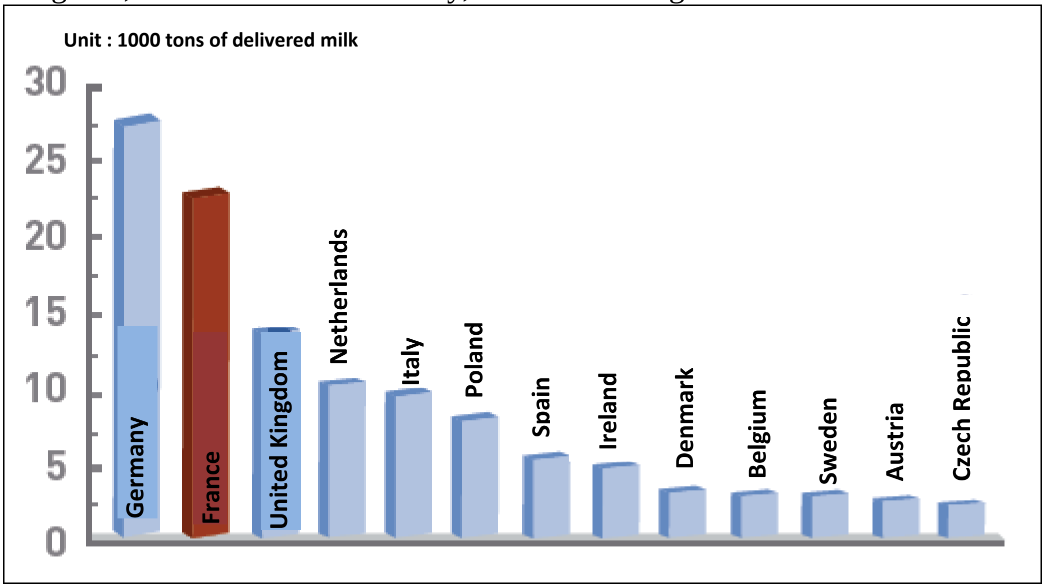


Figure 1- Milk delivery by farms during the 2006 / 2007 season (source: European Commission)

[1] Certain products may undergo an additional step between processing and distribution, notably the ones that are used by agri-foodstuffs industries.

9. Production is very different amongst Member states, both in terms of size of the farms (in some Member States, such as the Netherlands, large farms are the majority, contrary to some others, such as Italy) and in terms of yield (figures 2 and 3).

Figure 2- Distribution of dairy farms according to the number of dairy cows (2007) (source: CNIEL)

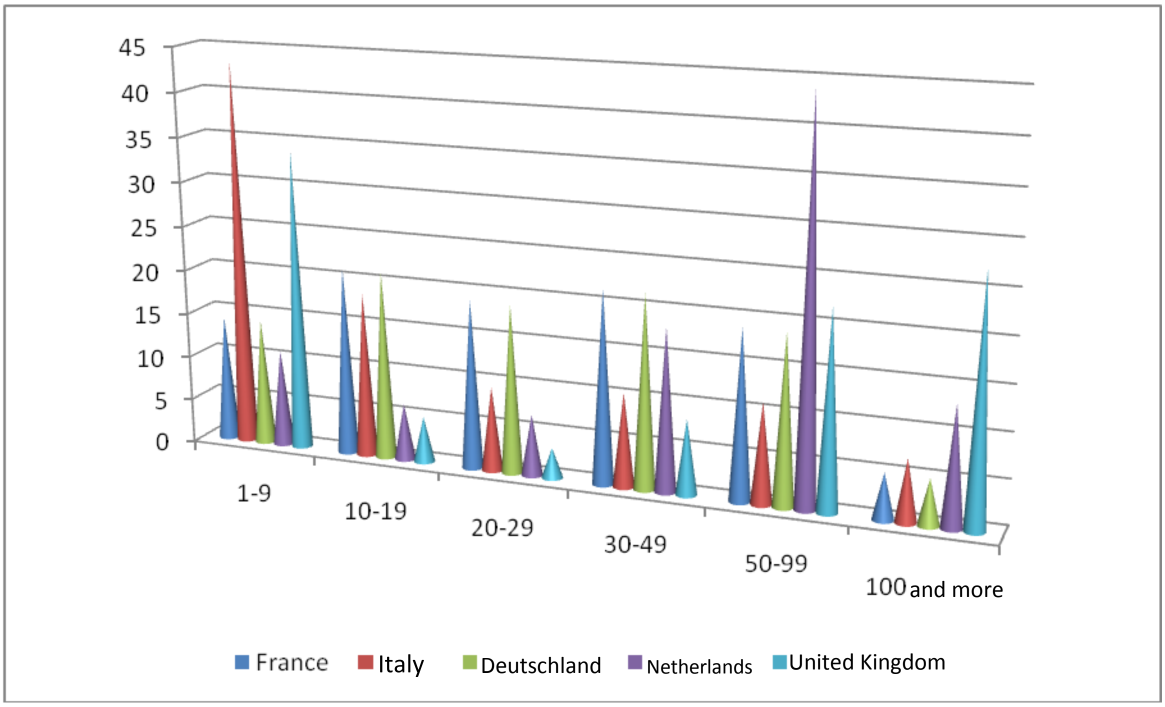
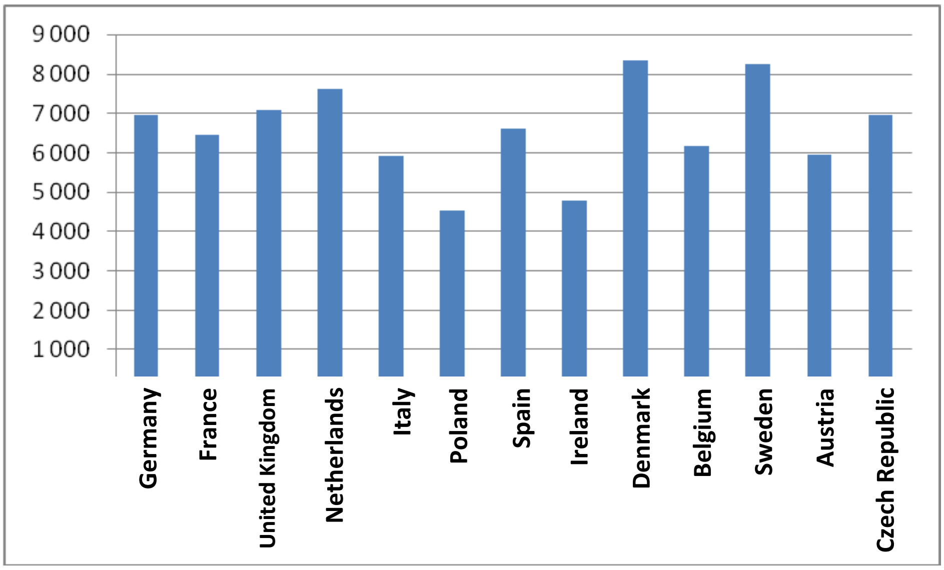


Figure 3- Annual yield per dairy cow in 2007 (in kg/year) (source: CNIEL)



French milk production

- Key production figures

10. In 2007, France had 97.000 farms with dairy cows, comprising a herd of 3,8 million animals and an annual production of more than 23 billion litres of milk.

11. French milk production varies considerably across regions, both in the number of farms (as shown in figure 4) and in terms of yield (as shown in figure 5).

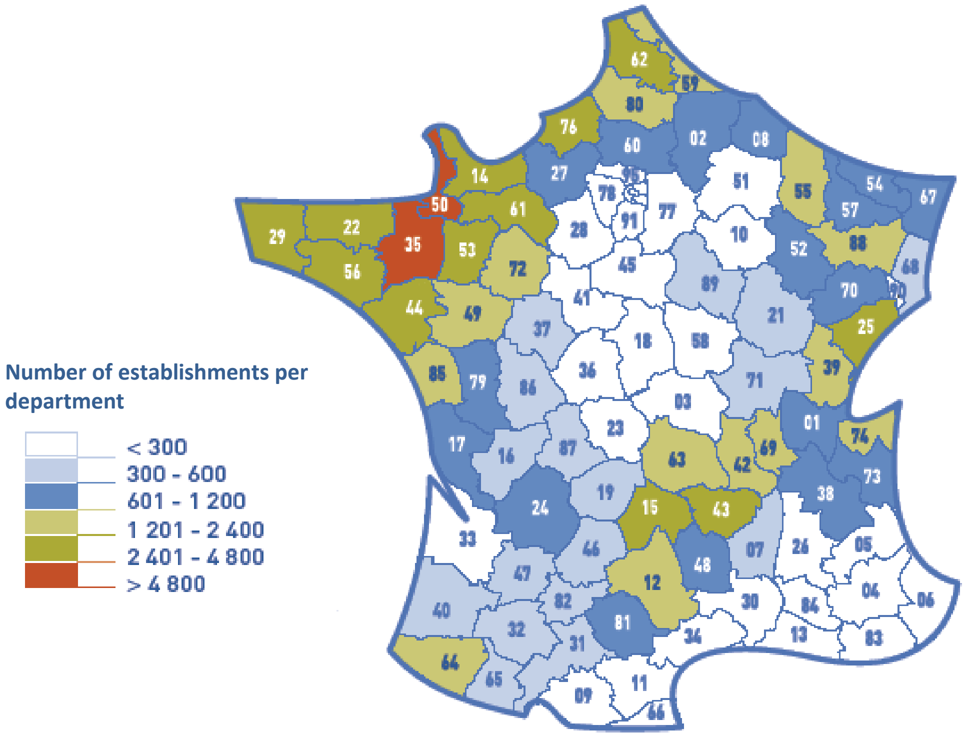


Figure 4- Number of dairy farms per *département* during the 2006/2007 season (source: *Office of cattle breeding*)

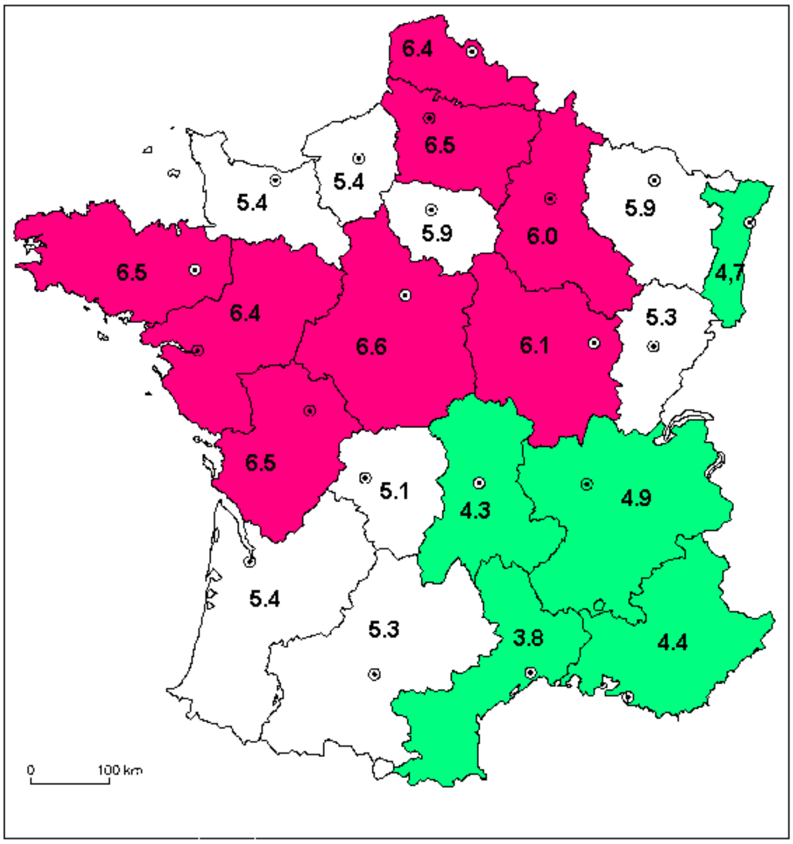


Figure 5- Yield per region
(in millions of litres per cow and per year, 2007) – (source: CNIEL)
(in pink, regions where yield is greater than 6000 litres per cow, in green, regions where the yield is below 5000 litres per cow)

12. The cost borne by farms is also heterogeneous, notably depending on whether their location (plains or mountains).

13. Dairy production has undergone a major restructuring since the start of the 1980s. Thus, in 1983, France had 439.000 farms with dairy cows, with more than 7.000.000 animals and an average of approximately 16 cows per farm. In 2007, as previously indicated, there remained only 97.000 farms (-78%), with 3,8 million heads of cattle (-46%) and an average of more than 39 (+143%) cows per farm.

- Prices cashed in by farmers

14. Farmers store milk in a milk "tank", which is emptied by a collector on average every other day. Half of the dairy production is collected by cooperatives, the remaining part by processors.

15. In France, since the enactment in 1969 of the "Godefroy" law[2], milk is paid for on the basis of several criteria: bacteriological quality (determined according to the number of microorganisms present in 1 mL of milk), health quality (defined according to the number of somatic cells in 1 mL of milk), butyric germs, lipolysis and studies on inhibitors (antibiotics). The proportion of fat (reference = 38 g per litre) and milk protein (reference = 32 g per litre) defines "standard milk" (referred to

[2] Law n° 69-10 of the 3 January 1969, relative to the establishment of the payment for milk on the basis of its composition and quality, which stipulated that "Producers are paid for their milk on the basis of its composition, and of its hygienic and health quality".

as "38/32"), in reference to which producers are paid for. Milk containing more fat or protein receives a bonus.

16. Set by collectors, milk prices are subject to seasonal variability due to calving periods, which are themselves tied to the grass cycle, as grass is the main fodder. Figure 6 illustrates this seasonality.

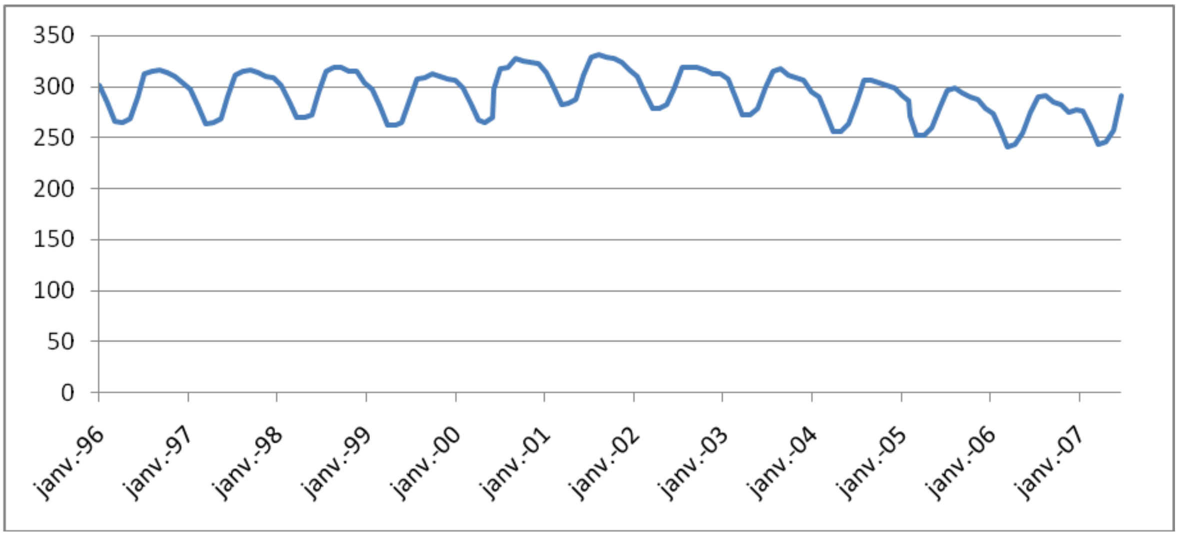
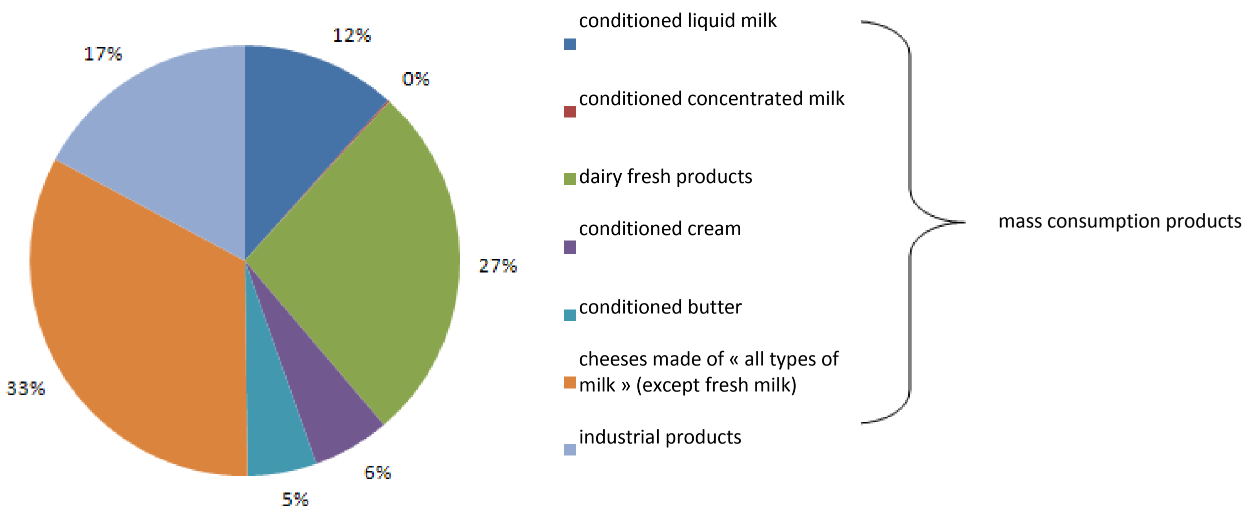


Figure 6- Price for standard milk (38/32) for production in euros for 1000 litres (source: AGRESTE-INSEE, DGPEI)

2. PROCESSING

17. In 2007, the dairy processing industry in France generated a pre-tax turnover of more than 22 billion euros, i.e. more than 17% of that of the agri-food industry. This industry is characterized by the great diversity of its products, which are generally grouped into two categories: consumer goods (milk, butter, milk desserts, cheeses) and industrial products (bulk butter, milk powder). The valuation of these products is shown in figure 7.

Figure 7 - Valuation of the various dairy products (as a percentage of the processing sales figure, 2007) (source: CNIEL)



18. The processing sector consists of two major families, each representing about 50% of milk collection: cooperatives formed by milk producers, that generate approximately 35% of the processing sales figure, and processors such as Bongrain, Danone or Lactalis, that represent nearly 65% of the sales. The latter are typified both by the volume of milk collected (cf. figure 8), and by the size and diversity of their production.

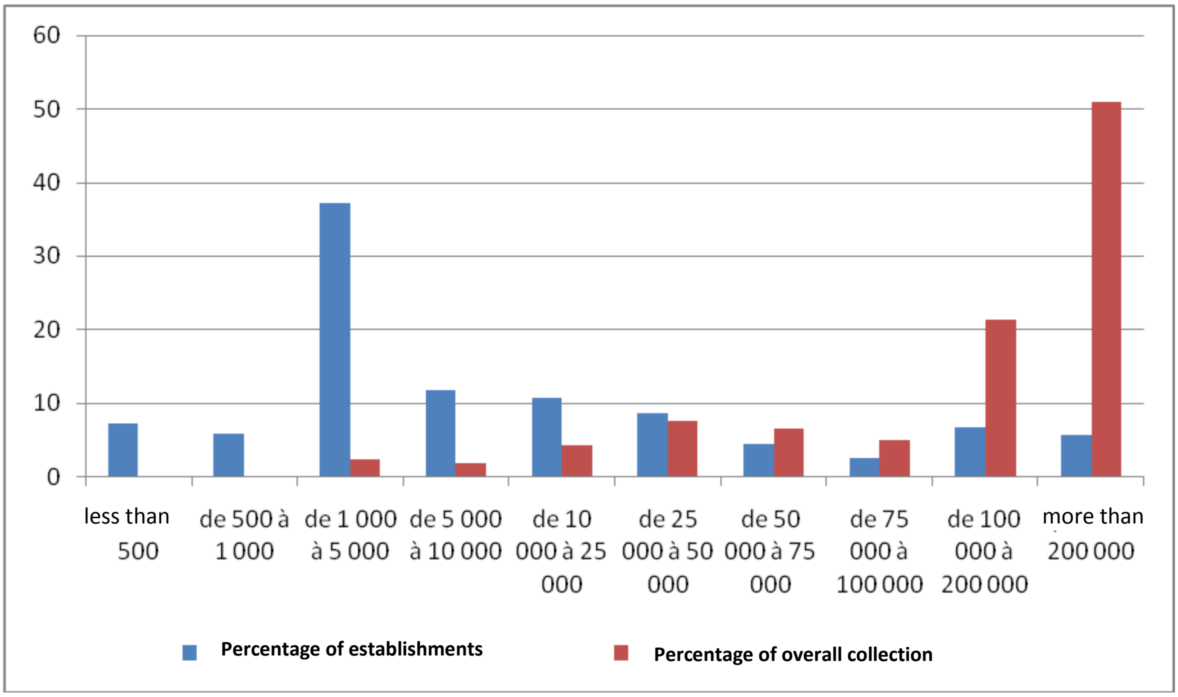


Figure 8- Distribution of collectors in function of the annual volume of milk they collect

Blue: percentage of establishments. Red: percentage of the overall volume of milk collected in thousands of litres, 2007 (source: CNIEL)

3. CONSUMPTION

19. In 2007, average consumption of dairy products by a European person amounted to 265 kg of milk or equivalent. This mean figure however conceals significant disparities, with Finland being out in front with 394 kg, and Slovenia being last with 143 kg. France is ranked third, with 336 kg, notably because of its high consumption of cheese and butter.

20. In general terms, demand for agricultural products is relatively inelastic. In the case of dairy products, this feature is even more evident as no other product contains calcium and can therefore be substituted to milk. This is what chart 9 seems to indicate, as it shows a disconnection between price increases, which start in 2007, and consumed tonnage.

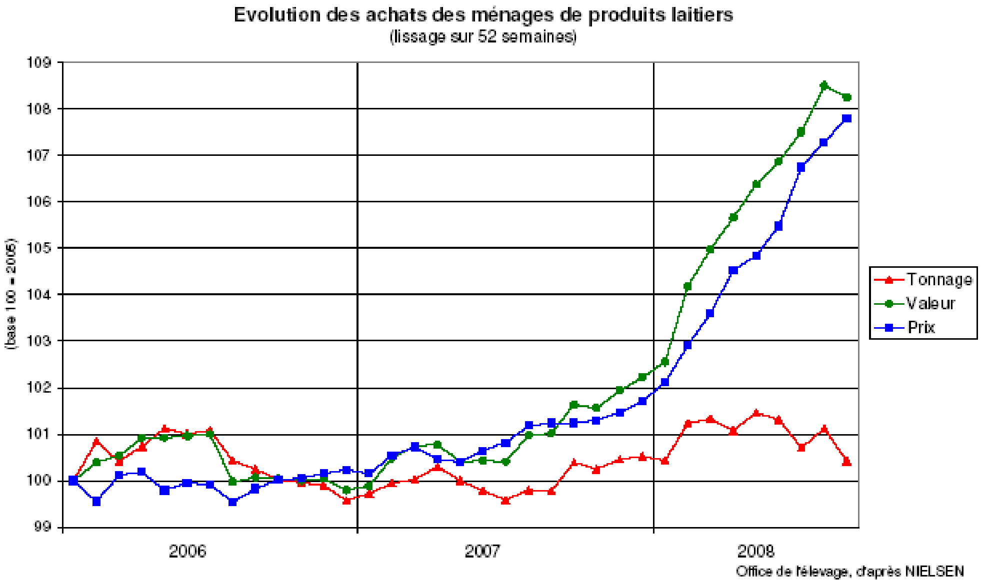


Figure 9- Evolution of household consumption of dairy products (source: *Office of cattle breeding*)

B. THE OPERATION OF THE SECTOR

21. The dairy sector is governed by Community rules but, until 2008, it was also the subject of national price self-regulation.

1. THE COMMUNITY LEGAL FRAMEWORK

22. Until the end of the 1990s, the dairy sector was heavily regulated, as its organization was entirely defined by a Common Market Organization (hereinafter "CMO"), created in 1968 and supplemented by a quota system in 1984. This regulation was based on:

- instruments intended to regulate volumes: dairy quotas, public and private storage and aid for exports or consumption in order to sell off surpluses;
- instruments intended to support production prices: a target price, representing what the Council of European Ministers felt to be the fair price that should be paid to producers, an intervention price for industrial products (butter and milk powder), and customs duties on imports.

23. As a result of criticism directed at the management instruments (encouragement of overproduction, quota rents for producers, extra costs for consumers...), the system underwent successive reforms, notably:
    - the successive discontinuation of customs duties (1999), target prices (2008), and dairy quotas (the latter will take full effect in 2015);
    - the decrease of the level of intervention prices and of their conditions of implementation.
24. Moreover, the dairy sector was altered by a major reform of the common agricultural policy in 2003, which led to the decoupling of aid for farmers (rights to single payment) from production or prices.
25. The dairy sector is now governed by the single CMO system, which was introduced in 2007 by Council regulation (EC) n° 1234/2007 of 22 October 2007.
26. The current crisis linked to the significant decline of prices has prompted the European Commission to adopt market support measures, that notably include intensified storage, both private and public, as well as a re-introduction of export refunds, at a total estimated cost of more than 600 million euros[3].

2. NATIONAL SELF-REGULATION

a) The interprofession's price recommendations

27. For some ten years, producers and processors (cooperatives and dairy industrial companies) have, on a quarterly basis, disseminated price adjustment recommendations via the interprofession.
28. These recommendations took the shape of a variation of the price in euros for 1000 litres that corresponds with an increase or decrease relative to the previous year's price. They mechanically resulted from the changes of various indices, the composition of which changed during the period when the system was implemented. In 2008, it involved:
    - the evolution of the quotations for "industrial products" (butter and milk powder);
    - the evolution of the price of exported consumer goods;
    - the evolution of a France-Germany competitiveness index, in order to take international competition into account.
29. In April 2008, the DGCCRF warned the CNIEL of the risks that it was running as a result of such practices, notably stating that "*it does not fall into the prerogatives of*

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[3] These measures are outlined in the Commission's communication to the Council on the situation in the milk market in 2009, dated 22 July 2009.

professional bodies to issue any kind of recommendation regarding prices, price evolutions or production: such practices are constantly deemed illegal both by the Conseil de la Concurrence and by the European Commission".

30. A halfway system was then developed. The CNIEL has disseminated indices, on the basis of which regional interprofessions issue their own price recommendations.

b) The June 2009 agreement

31. Under the aegis of the Minister for agriculture, negotiations between the three major families of the interprofession led, on 3 June 2009, to an agreement. It was intended to address the dairy crisis and is threefold. First, it sets out three trend indicators that the CNIEL is invited to disseminate. It also encourages operators to define a framework for contractualization between producers and processors by the end of 2009. Last, it sets target prices depending on the weight of the ratio between the production of industrial products "IP" and of consumer goods "CG" within each processor. This resulted in a range of milk prices between €28/hL of milk for companies that produce primarily CG, and €26,2/hL of an IP specialized milk processor. Farmers' unions, including the National Federation of Farmers (*Fédération nationale des syndicats d'exploitants agricoles* - FNSEA), are not satisfied with this agreement. Nevertheless, the FNSEA processors that they should not ignore it.

C. THE CRISIS IN THE DAIRY SECTOR

1. THE CHARACTERISTICS OF THE CRISIS

32. In April 2009, the milk price paid to producers, i.e. €21,7/hL, was 30% lower than the price paid in April 2008. It should nevertheless be noted that the situation in 2007 and 2008 was exceptional, with particularly high price levels. As such, excluding the period 2007/2008, the general trend has been downward, notably due to the decrease of the intervention prices set by the European Commission.

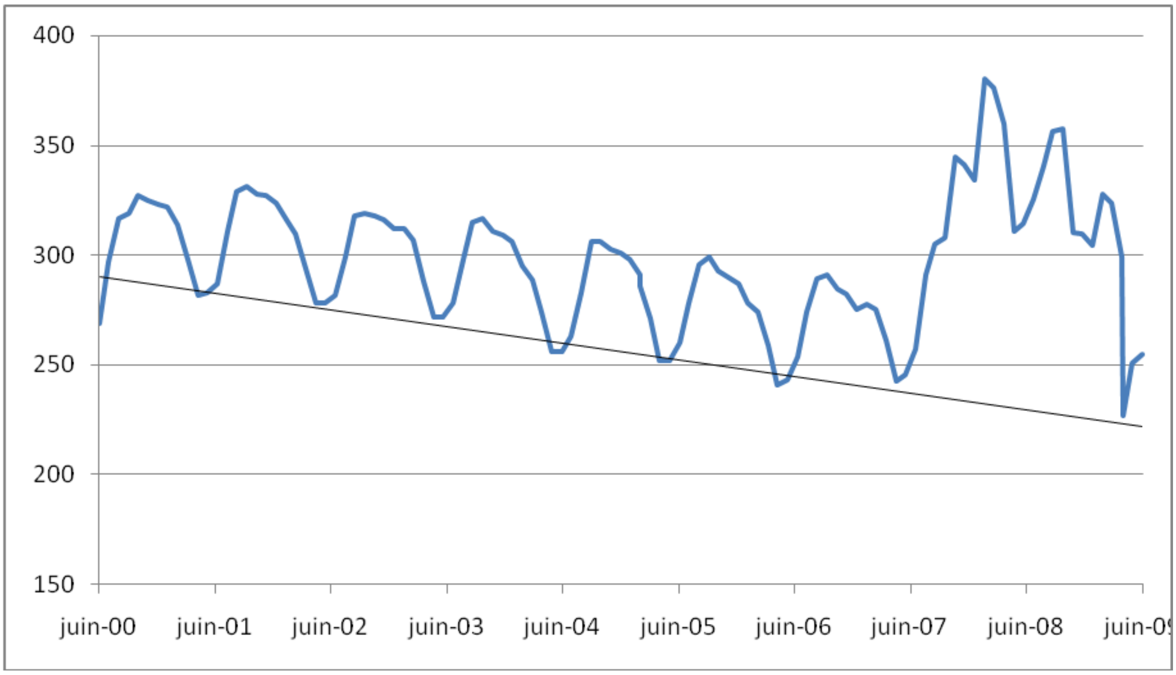

Figure 10- Evolution of milk production price for 1000 litres
(source: Agreste Insee DGPEI and *Office de l'élevage* for the last three months)

33. The dairy industries of the other Member States are also faced with significant price cuts. The decline is greater in countries where a high proportion of milk is processed into exportable industrial dairy products (butter and powder). In these countries, such as Ireland, prices actually depend mainly on world prices. Conversely, in countries like Austria or Italy, where the share of high added value products is greater, the decline of milk prices has been more modest. Prices can be very different from one country to another. In April 2009, they ranged from €300 / 1000 litres in Austria and Italy, to €200 / 1000 litres in Ireland. France was on the lower end of the average within the European Union.

34. The decline in milk prices, combined with high price for cattle feed that stemmed from the evolution of cereal prices, has created a "squeeze" effect on the income of milk producers. Thus, on the basis of the 2006 data[4], if one takes into account higher overall food costs[5]and the decrease of milk prices, one finds that the average net margin of producers is negative in April 2009, at a level between -2 and -1.2 euros per hectolitre of milk. In spite of this negative net margin, which involves no remuneration for independent workers, many producers continued to produce, since the turnover exceeded the break-even point and could cover fixed expenses. Moreover, milk producers are obliged to feed and milk their cows[6] unless they wish to exit and sell or slaughter their herd.

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[4] Agreste study "Résultats économiques de l'agriculture" available at the address:

http://agreste.agriculture.gouv.fr/IMG/file/Gaf09p042-046-054(1).pdf

[5] The Insee series on the cost of feed for dairy cows brings to light an increase of between 15 and 30% between 2006 and April 2009.

[6] The technical solutions for modifying a dairy workshop's production level are very limited. Farmers can slightly change the volume and composition of the feed, which will influence the cow's productivity. They can also slightly anticipate or delay the date when cows are taken out of service (business exit).

35. For all that, figures for the sole month of April are insufficient for assessing the situation of the dairy sector. Indeed, milk prices follow an annual cycle, the low point of which is in April. Also, estimates are needed for the whole of 2009. Table 1 below shows the 2006 data, updates them for April 2009 and presents hypotheses for 2009.

In €/hL of milk	***2006***	***April 2009***		***2009***	
		Low hypothesis	***High hypothesis***	***Low hypothesis***	***High hypothesis***
Variable cost, including animal feed	*9,4 5,1*	*11,1 6,8*	*10,3 6*	*11,1 6,8*	*10,3 6*
Fixed cost	*21,4*	*21,4*	*21,4*	*21,4*	*21,4*
Total cost (1)	*30,8*	*32,5*	*31,7*	*32,5*	*31,7*
Price (2)	*30,2*	*23,2*	*23,2*	*26,3*	*28,2*
Subsidy (3)	*7,3*	*7,3*	*7,3*	*7,3*	*7,3*
Net margin = (2)+(3)-(1)	*6,7*	*-2*	*-1.2*	*1,1*	*3,8*

Table 1- Breakdown of the costs and proceeds of a dairy farm (source: Agreste-Insee-Inra, Production costs econometric model[7])

36. Based on the adopted hypotheses, the average net margin of dairy farms dropped considerably between 2006 and 2009, though without necessarily becoming negative. It should be stressed that these results must be analysed with care, since they are based on simplifying hypotheses and conceal great diversity of the economic situations of dairy farms.

2. THE ORIGINS OF THE CRISIS

37. The level of dairy quotas was increased in the perspective of the future lifting of this mechanism by 2015. This is one of the causes that have been mentioned to explain the strong fall in milk prices. Indeed, the increase of dairy quotas might have encouraged higher production, and therefore a fall in milk prices in 2009 or 2010. And yet, all in all, Member States have not overrun or even reached their milk quotas: over the first 11 months of the 2008/2009 season (i.e. from April 2008 to February 2009), milk collection in the EU-27 has fallen by 1%. Farmers have not indeed produced milk up to the level of extra quotas available.

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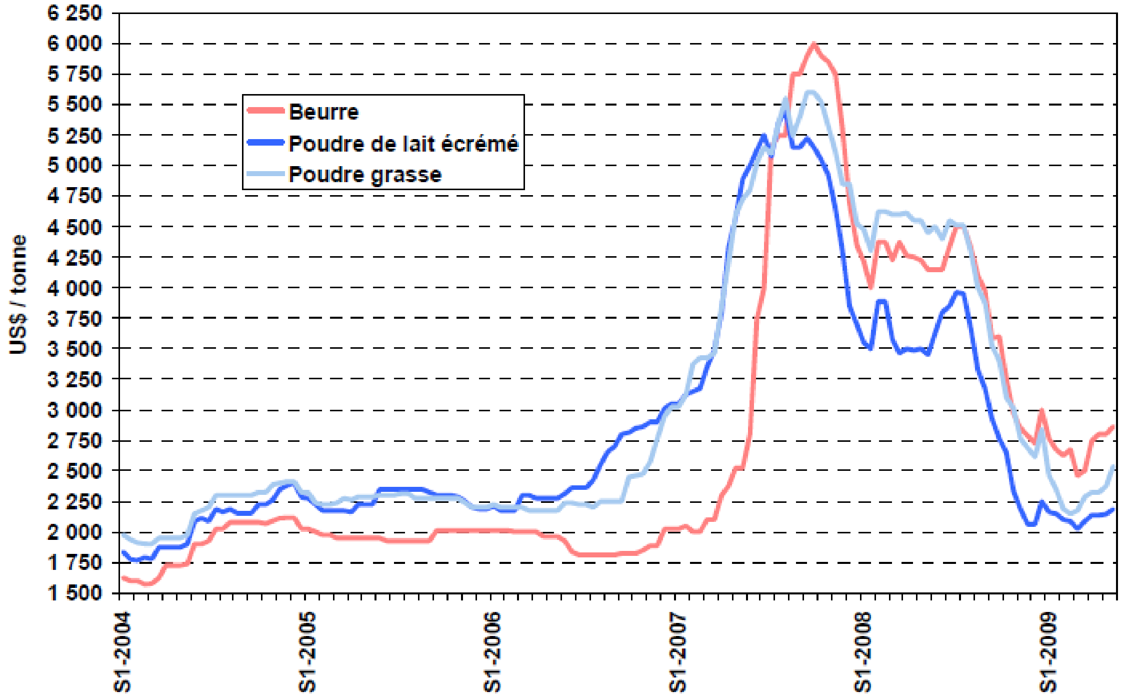
[7] The following hypotheses have been adopted:

- Costs have not changed since 2006, except for animal feed;
- Subsidies have not changed since 2006;
- The milk price in April 2007 is the one provided by the *Office de l'élevage*, to which we add the average quality bonuses;
- The average price for 2009 falls between the prices in June 2009 and July 2009, with these two dates traditionally delimiting the year's average price. To that we add the average quality bonuses, i.e. €8 for 1000 litres (source: *Office de l'élevage*).

38. The increase of dairy quotas has thus played at most a minor role in the on-going crisis. The decrease of milk prices rather seems to be connected with the strong decline of international prices of industrial products (butter and skimmed milk powder), as figure 11 shows.



Source : FranceAgriMer d'après l'USDA

Figure 11- Worldwide prices of butter (red) and skim milk powder (deep blue) and full cream milk powder (light blue)

39. Prices of industrial products had increased sharply in 2007. This was mainly caused by the combination of a depleting supply (poor climatic conditions in Oceania, the main worldwide "exporter" of industrial dairy products, low prices in certain European countries, notably France, which did not encourage production), and a strongly increasing demand (growing demand from emerging countries). The wide range of the fluctuations can be explained by a low price elasticity of demand (almost exclusively human consumption) and a particularly rigid production cycle, which limits the ability of farmers to increment production when prices peak up (low elasticity of supply in the short term).

40. The decrease of the prices of industrial products in 2008 and 2009 can be explained by an upper level of worldwide production resulting from the previous increase of milk prices, notably in Oceania (where the meteorological conditions were very favourable in 2008), in the United States, South America and China, and, more recently, by a falling demand, in particular for the most expensive dairy products, as a result of the economic crisis. Prices also seemed to be affected by a lower milk consumption in China due to the contamination of milk by melamine.

41. Although speculation by some operators is likely, its impact on prices has been limited. A study by the Directorate General of the Treasury and Economic Policy [8]

[8] "Le rôle des facteurs financiers dans la hausse des prix des matières agricoles", W. Arrata, B. Camacho, C. Hagege, PE. Lecocq, I. Odonnat July 2008, Trésor Eco.

relative to all food products showed that the effect of financial speculation on prices of agricultural raw materials did not prevail over the effect of supply and demand factors. As such, the strong increase of agricultural raw material prices in the summer of 2007 was primarily driven by a higher demand, which was not met by supply.

42. Thus, the on-going crisis seems to spring from the peculiarities of the dairy sector rather than from exogenous factors.

II. The peculiarities of the economics of the dairy sector

A. THE SPECIFICITIES OF THE OPERATION OF THE MILK COLLECTION MARKET

1. POOR COMPETITION DYNAMICS IN THE MILK COLLECTION MARKET

43. At first glance, the level of concentration of processors does not appear to be very high, as the top 20 establishments, collect 40% of the volumes and account for about 5% of the operators that collect milk in France.

44. Nevertheless, these average figures do not reflect the situation of the market for specific milk products. For instance, the manufacturing of butter and consumer liquid milk is relatively concentrated (the top 20 establishments respectively account for 93% and 80% of the national production), whereas the manufacturing of cheese is much less concentrated (the top 20 establishments only generate 45% of the national production).

45. The French situation is quite singular relative to other European countries, notably Denmark and the Netherlands, where a single cooperative group holds a very dominant position as regards processing. However, the low level of concentration in France must be put into perspective as the level of concentration on the production side is extremely low: 88.000 farms delivered cow milk in 2007, while only 538 companies collected it. Table 2 below reflects the diversity of the producer / collector relations.

Annual collection in thousands of litres	Number of establishments	Personnel of the delivering firms	Average number of delivering firms per establishment
Under 500	39 (7%)	79 (0%)	2
From 500 to 1.000	31 (6%)	143 (0%)	5
From 1.000 to 5.000	200 (37%)	2.712 (3%)	14
From 5.000 to 10.000	63 (12%)	2.220 (3%)	35
From 10.000 to 25.000	57 (11%)	4.691 (5%)	82
From 25.000 to 50.000	46 (8%)	6.460 (8%)	140
From 50.000 to 75.000	23 (4%)	5.382 (6%)	234
From 75.000 to 100.000	13 (2%)	4.594 (5%)	353
From 100.000 to 200.000	36 (7%)	19.519 (22%)	542
More than 200.000	30 (6%)	41.999 (48%)	1.400
Total	**538**	**87.799**	**163**

Table 2- Distribution of the establishments according to the size of the collection (2007) (source: Agreste)

46. Indeed, while the bargaining power of certain farmers towards their collector is fairly balanced, the bargaining power of 70% of farmers towards their collector is very low as they compete in average with 500 other producers. For example, Danone confirms that 3.900 farmers supply the milk it processes.

47. Unequal bargaining power is not necessarily a source of concern as, in some Member states , collection is mainly carried out by cooperatives owned by farmers, which implies that their interest is taken into account. But in France, cooperatives only account for 50% of the milk collection.

48. Moreover, there is no genuine milk "spot market" that could serve as a reference for prices as transport and storage costs for raw milk are particularly high.

49. Finally, in certain cases, local monopsonies do not allow farmers to switch collectors if they are dissatisfied. This situation is caused by high collection costs, which prompt processors to rationalize their costs and purchase milk in neighbouring zones.

50. Competition is therefore very limited. The operation of the dairy sector becomes more competitive after the first stages of milk processing[9]. As butter and milk powder are easy to store and transport, exchanges of these products can be carried out at local, Community and international levels.

2. CONSEQUENCES OF THE POOR OPERATION OF THE DAIRY SECTOR

51. As recalled by the *Conseil de la Concurrence* in its opinion n° 08-A-07 of 7 May 2008 relative to the economic organization of the fruit and vegetable sector, in

[9] Collection is carried out either by operators that only look after the first processing into butter and milk powder, or by operators that look after the processing right through to the production of consumer goods.

which the bargaining power of distributors is quite similar to that of dairy processors:

"*the imbalance in the commercial relations between producers and distributors results in two problems: firstly a problem of profit sharing between upstream and downstream, and secondly a problem of economic efficiency.*

As such, the first problem does not in principle relate to competition policy, which does not aim at achieving a fairer sharing of surpluses between operators. However, the weakening of the upstream sector as a result of the virtual oligopsony of the downstream market power is likely, in the medium term, to result in a reduction of the supply or of its diversity, which is harmful to the collective well-being and constitutes a concern for competition.

Moreover, by retaining a very high share of the profit of the economic chain, distributors could end up in discouraging upstream investment so much that it could impair the proper operation of the sector".

52. In a context in which milk producers are often in a situation of economic dependency relative to their collector, strengthening their market power could help to improve economic efficiency and increase overall surplus.

B. PRICE FLUCTUATIONS

53. Until recently, the EU regulatory framework of the dairy sector partially "insulated" the Community market from the rest of the world and smoothed out fluctuations of prices through quotas and interventions on prices.

54. The progressive lifting of these management instruments has not had any impact on milk production prices: they are increasingly connected to supply and demand fluctuations and are therefore more likely to reflect possible imbalances.

55. These effects are magnified by the peculiarities of the dairy market. As previously noted, demand for dairy products is relatively insensitive to prices and short-term supply is quite rigid. Indeed, no matter how much feed a farmer provides his cows, they will not milk beyond their physiological limits, and the additional milk produced will not necessarily be in line with extra variable costs. When it comes to cope with downward prices, farmers are even less apt to adjust production as animals fed only on grass cannot be made to produce less milk. These asymmetrical limits in the ability of farmers to adjust volumes and sales are further restricted by the nature of the product, which is perishable and cannot be stored.

56. Due to the stickiness of demand and supply for raw milk products, adjustment falls back on surplus products, in particular storable industrial products such as butter and milk powder. Figure 12 shows the fluctuations in price quotations for bulk butter and milk powder in France between 1999 and 2009, and points to the peak in summer 2007.

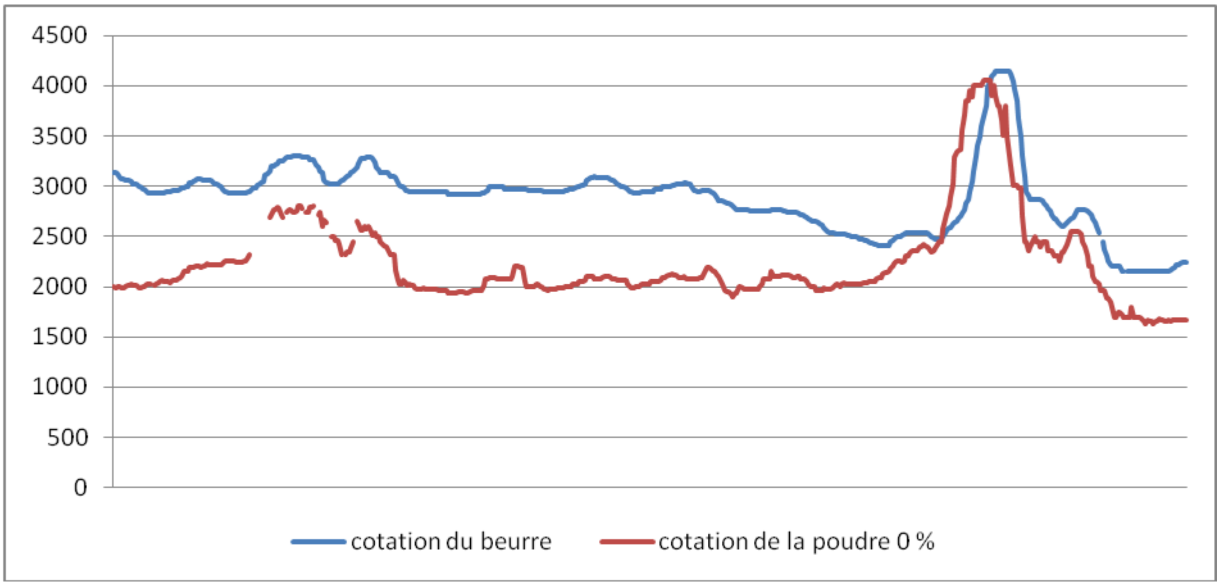


Figure 12- Price quotations for butter and non-fat milk powder in France between 1999 and 2009 (source: *Office de l'élevage*)

57. In the absence of specific contractual mechanisms, fluctuations in prices of industrial products are actually passed on production prices since industrial products are the next level after raw milk in the value chain.

58. Strong price fluctuations harm the competitiveness of the dairy sector. Indeed, the lack of foresight on farmers' revenues and processors' costs discourages investment and challenges their financial viability. It is therefore a question of general economic public order.

59. The effects of price fluctuations are all the more detrimental to farmers as they need to have a long-term perspective given the constraints of a lengthy and rigid production cycle and of burdensome fixed expenditure.

60. These dairy market failures, in particular the imbalance in the bargaining power of farmers and processors and high price fluctuations, need to be addressed by a specific framework. However, price steering mechanisms such as those implemented by the CNIEL until 2008 made sense within a Community framework that was meant to preserve the competitiveness of European food prices vis-à-vis the rest of the world and relied on heavy regulation. Such price recommendations were at any rate clearly at odds with competition law, as the DGCCRF pointed out in 2008.

61. There are nonetheless alternative options such as concentration or contractualization. Such options do not come into conflict with competition rules, and would help steer prices by strengthening the bargaining power of producers and mitigating the effects of price fluctuations.

III. Price recommendations

62. In the *Autorité*'s view, general price recommendations would bring little benefit, which would have to be weighed against strong disadvantages. They would be of

little help to milk producers, while entailing significant legal risks with regard to competition rules. Recommendations focussed on quality initiatives such as branded or labelled products could be contemplated at most, if certain conditions are met.

A. INEFFICIENCY OF PRICE RECOMMENDATIONS IN THE CURRENT REGULATORY FRAMEWORK

63. In the opinion of the various operators that the *Autorité* has consulted, price recommendations disseminated by the CNIEL served two objectives. On the one hand, they allowed both categories of operators, i.e. farmers and processors, to anticipate the evolution of milk production prices, thereby partly correcting information asymmetry and helped farmers to become aware of the evolution of downstream prices. On the other hand, recommendations allowed producers to address the imbalance in bargaining power, since they were issued by the interprofession, within which they are represented through the National Milk Producers Association (*Fédération nationale des producteurs de lait* or FNPL).

64. The DGCCRF's warning admittedly took place at a time when the market was just turning around. But it must be stressed that indulging back to such a mechanism is hardly likely to remedy the malfunctions of the dairy sector. Indeed, the CNIEL's three "families" would probably be hard put to reach a common understanding of their price expectations, as confirmed by the difficulties experienced by mediators in their efforts to bring about a consensus for the preparation of the June 2009 agreement. Moreover, the European context has evolved and has made more way for market mechanisms in the dairy sector.

65. Moreover, price recommendations run up against two difficulties, firstly international competition and secondly the determination of the price level itself.

66. A production price level cannot be set disregarding its effects on potential competitors of producers and processors. A too high price would result in reduced competition and would harm the development of the dairy sector. Indeed, in a sector in which certain industrial products can be exchanged not only between Member States but also with third countries, the efficiency of an indicator price is likely to be low, since processors may well shift their demand to products from third countries if prices are too high in France.

67. Besides, apart from the issue of international competition, price-setting is inherently inefficient in economic terms. Indeed, in a market at the crossroads of very heterogeneous supply and demand, in particular in terms of quality and cost, setting the good level of the indicative price is extremely challenging. If the price is underestimated, farmers will not invest enough, which will eventually result in reduced diversity of supply. If the price is overestimated, producers will, on the contrary, be prompted to over-invest, which will cause imbalances between supply and demand, and will give misleading signals to producers, who will not be encouraged to improve their productivity.

68. Last, price recommendations bear strong legal risk with regard to competition rules.

B. ASSESSMENT OF PRICE RECOMMENDATIONS WITH REGARD TO COMPETITION RULES

69. The assessment of the legality of price recommendations must take into consideration both national law and EU law.

1. NATIONAL LAW

70. The agricultural sector is subject to competition law. As such, when the DGCCRF warned the interprofession regarding the dissemination of prices and related recommendations, it did so on the basis of article L. 420-1 of the Code of commercial law (*code de commerce*). The exception provided by subsection I(2) of article L. 420-4 of that same code does not apply as price recommendations were general, rather than specific to a brand or trade name. The aforementioned provision provides indeed article L. 420-1 do not apply to practices that may consist of organizing under a single brand or trade name, volumes and production quality as well as commercial policy of agricultural products or products of agricultural origin, including by agreeing to a common transfer sale price, but only insofar as these restrictions imposed on competition are indispensable to achieve the aim of economic progress objective. The mechanism implemented by the CNIEL went therefore beyond this exception. Since that time, the 2009 budget law modified the Rural Code [*code rural*] by inserting the following article L. 632-14:

"*The National Interprofessional Centre for the Economics of the Dairy Sector (*Centre national interprofessionnel de l'économie laitière*) can prepare and disseminate trend indices, notably forward-looking ones, relative to the dairy markets, as well as any other piece of information that may enlighten the situation of operators in the dairy sector.*

Regional interprofessional centres for the dairy sector can prepare and inform collectors or processors of valuations that are used in the transfer price of milk, notably on the basis of the indices mentioned in the previous paragraph.

Dairy sector operators can refer to the indices and values mentioned in the first two paragraphs as part of their contractual relations.

These practices are not subject to articles L. 420-1 and L. 420-2 of the French Code of commercial law (code de commerce)".

These new provisions were not submitted for an opinion to the *Conseil de la Concurrence* prior to their adoption.

71. As such, subsection II(1) of article L. 420-4 of the Code of commercial law (*code de commerce*) applies to this system:

"I. The following practices are not subject to the provisions of Articles L.420-1 and L.420-2:

1° Those which result from the implementation of an act or regulation adopted in application thereof"

72. However, such practices will still be subject to Community competition rules.

2. COMMUNITY COMPETITION LAW

a) The effect on trade between Member States

73. Community competition law applies if trade practices have or may have an effect on trade between Member States in an appreciable manner.

74. In the case in point, nationwide price recommendations involving all national operators, including producers and processors, within a country that generates 17% of the Community milk production, would clearly fall within the scope of Community competition law. In its guidelines on the concept of the effect on trade concept as contained in articles 81 and 82 of the EC Treaty (OJEC 2004, C 101, p. 81–96), the European Commission notably stipulates that "*horizontal cartels covering the whole of a Member State are normally capable of affecting trade between Member States*." Recommendations from an interprofession necessarily contain a "horizontal cartel" component.

75. Moreover, even though there are few raw milk intra-Community exchanges given the perishable nature of this product and high transport costs, packaged or processed products such as UHT milk, cheese or milk powder circulate widely within the Community market. Standardization of collection prices on a national level would necessarily have an indirect effect on the downstream markets within which intra-Community exchanges are significant, even if the two markets are separate.

76. The system implemented by the CNIEL confirms that operators are well aware of the interdependency of the French market with those of the other Member States and that they pay much regard to European competition. Indeed, price recommendations included a competitiveness index comparing French performance with that of Germany.

77. It is therefore likely that price recommendations as used until 2008 may have an appreciable effect on trade between Member States, and could therefore be subject to an appraisal with regard to article 81 of the EC Treaty, which notably stipulates that:

"*The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:*

a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(...)"

78. If price recommendations are only issued at a regional level, as envisaged by the interprofession after the DGCCRF warning, and as now foreseen by article L. 634-14 of the Rural Code [*code rural*], a more in-depth analysis of the affectation of intra-Community trade would be required. It might depend on the region in question, and notably take into account the following criteria: the nature of the practices, the identity of the products at hand and the size of the undertakings involved.

79. During the session of the board, the representative of the Government opined that the regional nature of the practices and the high level of transport costs associated with

milk collection pointed to the absence of any appreciable affectation of trade between Member States.

80. However, other features invite to conclude in the opposite direction.

81. Firstly, it would be necessary to check whether price recommendations applied at a regional level are not the mere continuation of practices at national, especially if regional do not set them independently. In that case, price recommendations could be deemed to reflect a national consensus.

82. Secondly, a price recommendation intended for all regional producers and collectors could be considered to have an appreciable effect on trade between Member States in the border regions, either directly, by causing milk deliveries to be redirected to national milk processors rather than to foreign milk processors, or indirectly, on the downstream markets. In this regard, it is likely that the thresholds mentioned in the Commission's communication regarding agreements of minor importance that do not appreciably limit competition for the purposes of article 81, paragraph 1, of the Treaty (OJEC, C 238, p. 13) would be exceeded as it is probable that at least one of the parties will have a turn-over above 40 million euros or a market share beyond 15% or 5% (depending on the case).

b) An unlikely application of the exemption provided by article 81, paragraph 3, of the EC Treaty to general agreements

83. A national competition authority that would come to assess the compatibility of price recommendations with Community law would certainly examine to what extent the exemption provided by article 81, paragraph 3, of the EC Treaty, would apply. This stipulation provides that paragraph 1 of article 81 may be declared inapplicable to any agreement or practice:

"*which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:*

a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

84. The Commission's communication consisting of guidelines for the application of article 81, paragraph 3, of the EC Treaty (OJEU 2004, C101, p.8) stipulates that this provision:

"does not exclude a priori certain types of agreement from its scope. As a matter of principle, all restrictive agreements that fulfil the four conditions of article 81(3) are covered by the exception rule. However, severe restrictions of competition are unlikely to fulfil the conditions of Article 81(3)" (point 46).

85. In the case to point, it would certainly be difficult to prove that the competition restriction consisting of the formulation of price recommendations on the national or regional level is necessary in order to attain the stated objective. The national competition authority would also have to check whether alternative means that would affect less competition and achieve the stated objective are available, which is a question that has already been dealt with in paragraph 103 of the present opinion.

Besides, it must be borne in mind that the European Community itself abandoned price indicators within the milk CMO, which seems to reveal that the European Commission considers that other means can be used in order to ensure the proper operation of the dairy sector.

86. Moreover, an agreement that restricts competition benefits from the exception only if it allows consumers to benefit from a fair share of the economic progress achieved. The notion of "*consumer*" includes all direct or indirect operators using the products covered by the agreement, including processors and distributors, but also, in the case of goods intended for large-scale marketing, end consumers.

87. In most cases, a system for setting or steering the purchase price of raw materials at a higher level than market prices is likely to prompt buyers and distributors to increase the net price of their products in order to maintain their own margins. For example, in decision 75/77/EEC of 8 January 1975, IV/27 039 - Preserved mushrooms (OJEC L 29, p. 26), the European Commission considered that "*concerted price fixing, as in this case, within the common market involving the main firms in this particular branch of the food industry are inappropriate and indeed could not produce the improvements required by Article 85 (3). Nor could they make a valid contribution to promoting technical or economic progress; they can only harm the interests of consumers"* (also see the Commission decision of 2 April 2003, COMP/C.38.279/F3, French beef, OJEU L 209, p. 12, point 130).

88. It should nevertheless be recalled that the *Conseil de la Concurrence* did not express any hostility to possible agreements for setting minimum production prices in exchange for the benefit of special quality if competition between quality sectors remains insufficient and if prices are in no way fixed at consumer level. This approach was outlined in opinion n° 08-A-07 of 7 May 2008 relative to the economic organization of the fruit and vegetable sector:

"*The Competition Authority, in an opinion regarding Cahors wine (Opinion n° 81/14), considered that an agreement within the sector between producers and retailers regarding the minimum price for wine sold in bulk to retailers could escape the prohibition of anticompetitive practices insofar as it served to guarantee and improve the quality of the wines made available to consumers, and provided that it was not accompanied by a suggested or imposed price for resale to consumers. This position was later confirmed by the* Conseil de la Concurrence *on several occasions (see decisions n° 94-D-41 of 5 July 1994 relative to the labelled poultry sector and n° 95-D-15 of 14 February 1995 relative to the storage potato sector).*" (point 67);

89. The *Autorité de la concurrence* has no reasons to reconsider this approach. However, it can offer no insight on the position that the European Commission might adopt if this matter were referred to it.

c) No additional flexibility from the specific exception for the agricultural sector

90. The conditions for implementing competition rules with regard to the objectives of the common agricultural policy were most recently outlined in a Council Regulation (Regulation (EC) n° 1184/2006, of 24 July 2006, OJEU L 214, p.7), the first article of which provides that, in principle, competition rules apply:

"Articles 81 to 86 of the Treaty and provisions made for their implementation shall, subject to Article 2 of this Regulation, apply to all agreements, decisions and

practices referred to in Articles 81(1) and 82 of the Treaty which relate to production of ,or trade in, [agricultural products]."

91. Article 2 includes a specific overriding mechanism for the agricultural sector:

"*Article 81, paragraph 1, of the Treaty shall not apply to such of the agreements, decisions and practices (...) as form an integral part of a national market organization or are necessary for attainment of the objectives [of the common agricultural policy]*.

In particular, it shall not apply to agreements, decisions and practices of farmers, farmers' associations, or associations of such associations belonging to a single Member State which concern the production or sale of agricultural products or the use of joint facilities for the storage, treatment or processing of agricultural products, and under which there is no obligation to charge identical prices, unless the Commission finds that competition is thereby excluded or that the objectives of [the common or cultural policy] are jeopardized.

92. This exception, which in any event excludes price agreements, was nevertheless the subject to a particularly narrow interpretation by the European Commission and by the Court of Justice of the European Communities. Thus, in its ruling of 15 May 1975, Frubo/Commission (71/74, Rec. p. 563, points 24, 25 and 26), the Court decided that in order to satisfy the condition of being necessary for attaining the objectives of the common agricultural policy, the agreement in question should be necessary in order to attain each of the following objectives:

" - to increase agricultural productivity by promoting technical progress, ensuring the rational development of agricultural production as well as the optimal utilization of the factors of production, notably labour;

- to ensure a fair standard of living for those engaged in agriculture, by increasing their individual earnings;

- to stabilize the markets;

- to assure the availability of supplies;

- to ensure reasonable prices for consumers."

93. Similarly, in its ruling of 12 December 1995, H.G. Oude Luttikhuis e. a./Coberco (C-399/93, Rec. p. I-4515, points 26 and 27), the Court adjudicated that agreements for which the benefit of this exception is claimed should not compromise any of the objectives of the common agricultural policy.

94. It would therefore appear that issuing of general price recommendations, whether nationally or regionally, entails a genuine legal risk with regard to competition rules. It would seem preferable to focus on solutions that comply with competition rules and better address the dairy market failures.

IV. Options to be considered to improve the operation of the dairy sector

95. While it is beyond dispute that the most relevant level for giving a proper framework for the dairy sector is the Community level, this does not rule out reflections on mechanisms that are likely to improve the operation of that sector at national level, all the more so since disparities between Member States necessitates an analysis on a country by country basis.

96. In this context, the *Autorité* points out that the analysis of the causes of the crisis in the dairy sector and of its operation indicates that the distribution sector is not responsible for the difficulties experienced by producers. As the recent study from the Observatory of Prices and Margins (*Observatoire des prix et des marges*)[10] shows, the retail sector did not take advantage from the increase of milk production prices to increase its margins (chart 13).

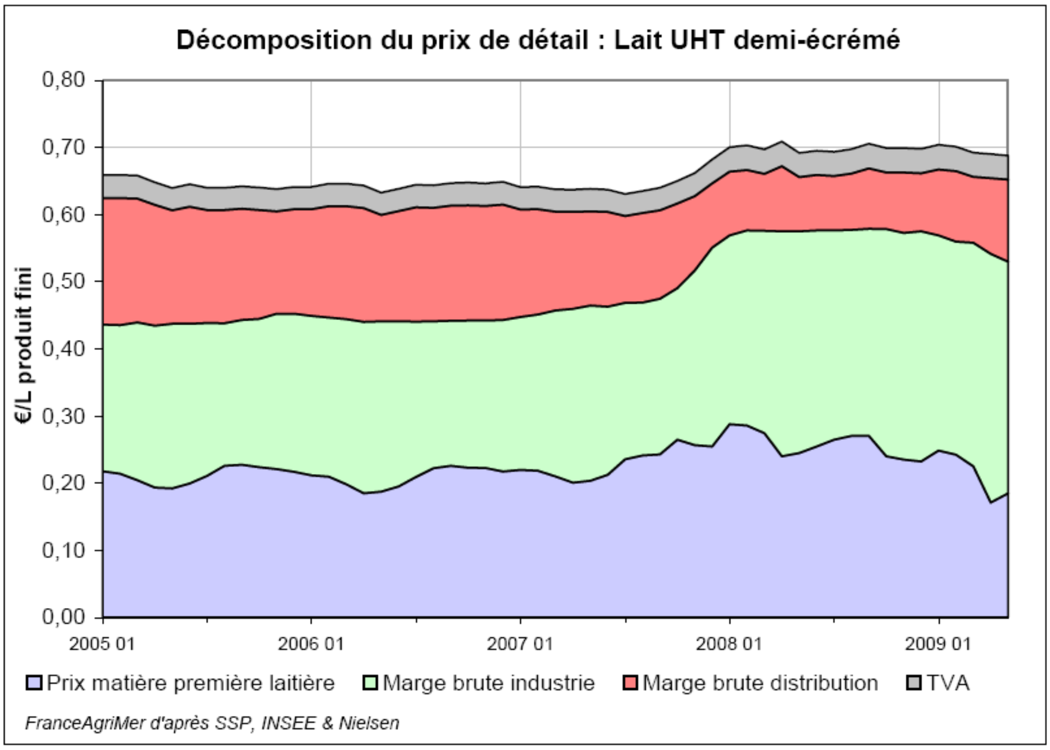


Figure 13- Breakdown of the retail price of half-skimmed UHT milk (source: *Observatoire des prix et des marges*)

97. However, the difficulties experienced by the sector and the dairy market failures previously analysed require to consider classical ways out, such as concentration of the production, but also more innovative and sector-specific options, such as the relaxation of the CMO Regulation and contractualization within a predefined framework. These various solutions should be studied further.

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[10] Price and Margin Observatory (*Observatoire des prix et des marges*), dairy sector, accessible at the address: http://www.dgccrf.bercy.gouv.fr/concurrence/prix/lait_decomposition_prix.pdf

A. THE SET-UP OF A FUTURES MARKET IN ORDER TO ADDRESS PRICE VOLATILITY

98. Classical market solutions could be envisaged in order to remedy the problem of wide fluctuations in production prices.

99. Insurance mechanisms, traditionally used in order to counter price volatility, notably as a result of climatic hazards, would apparently be of little help in the dairy sector. Indeed, price fluctuations affect all farmers, unlike climatic phenomena. As all policy holders are affected by the same events, an insurance company would therefore not be able to pool risks in an efficient way.

100. On the contrary, the development of futures markets would genuinely help address price fluctuations insofar as they would make it possible to pool risks not only amongst producers, but also over time, which cooperatives do not allow. No equivalent to the United States' futures market (Chicago Mercantile Exchange), which offers contracts on milk, butter and milk powder, exists in Europe, although a European Milk Exchange is currently being set up.

B. THE RELAXATION OF THE COMMON MARKET ORGANIZATION

101. The fruit and vegetable sector is governed by a CMO which is more flexible in terms of production organization than that of the dairy sector. Indeed, provided that it is not in a dominant position, an association of organizations of producers can, without a transfer of ownership, be given a mandate by its members to market products; it can also organize information exchanges intended to regularize production prices, i.e. in order to limit the effects of price fluctuations. For more information regarding this CMO, please refer to the aforementioned opinion n° 08-A-07 of the *Conseil de la Concurrence*.

102. As the dairy sector is also typified by a very low bargaining power of farmers towards processors, it may be worthwhile to consider a relaxation of the rules governing this sector following the example of the fruit and vegetable sector.

C. CONCENTRATION OF SUPPLY IN ORDER TO STRENGTHEN THE BARGAINING POWER OF PRODUCERS

103. In general terms, the pursuit of the concentration of supply is necessary to restore the bargaining power of producers, all the more so if contractualization is to be developed. Indeed, first bids appear to vary widely amongst producers, which show that their bargaining power is very heterogeneous.

104. Concentration of dairy production began in the early 1980s, as previously indicated (see § 14), and should be continued in order to maximize its positive effects on the bargaining power of farmers.

105. Beyond bargaining power considerations, concentration may also enhance the competitiveness of the French dairy sector as compared to its European neighbours. Indeed, French dairy farms are generally smaller than those in other countries (Netherlands, Denmark...). Given the significant share of fixed costs within

production costs, increasing the size of the farms could, to some degree, serve to amortize fixed costs over a larger production volume. The grouping of farms, for example within a collective farming grouping (*groupement agricole d'exploitation en commun* or GAEC) or a dairy partnership (*société civile laitière* or SCL) must be encouraged. Concentration of supply may also require the strengthening of collection cooperatives, which are considered as producers' organizations by the Community Regulations. Should the relaxation of the CMO mentioned in paragraphs 101 and 102 be implemented, associations of producers' organizations could themselves, under certain conditions, concentrate supply without entailing the risk for producers taking part in these structures to be reproached with engaging in anticompetitive practices.

106. Vertical concentration should also be developed. Indeed, the perishable nature of milk significantly limits the bargaining power of producers. The effectiveness of concentration, if it is meant to restore bargaining power, may therefore depend on the level of vertical integration of processing operations. In such a case, co-operators would decide on the allocation of resources between the production stage and the processing stage. Processing cooperatives have fully integrated these principles of concentration and vertical integration. They may not have reached yet, however their full potential as, so far, they have mainly relied on butter and milk powder, which yield low added value and were, until recently subject to price intervention by the Community. This explains why many operators have considered that producers are not systematically better compensated by cooperatives than by processors. In the future, processing cooperatives should therefore focus on more high added value and quality outlets.

107. Better compensation for producers would in fact require both an increase of their market power but also a greater valuation of the manufactured products, for example through differentiation. In this regard, collection of organic milk, which is currently insufficient to meet the national demand (30% of the liquid organic milk consumed in France is imported), could allow a certain number of producers to upgrade their earnings, even though this would only involve a minority of them. The development of other types of quality production and processing could bring about, as in Austria and Italy, better compensation for producers and mitigate the effects of world price fluctuations. However, such a reshuffle of production would require the approval of both parties, i.e.producers and processors.

D. NECESSARY CONTRACTUALIZATION BETWEEN PRODUCERS AND PROCESSORS

1. THE PRINCIPLE OF CONTRACTUALIZATION

108. At present, half of the producers sell their milk through cooperatives, with the majority of the latter also involved in processing. Producers are tied to their cooperatives by a contract of variable duration (generally around 5 years), which stipulates that the farmer shall provide all of his production to the cooperative and transfers its ownership. This contract is subject to automatic renewal, except if the cooperative takes the initiative to oppose it and does it on the grounds that the producer has not complied with his duties.

109. The board of directors of the cooperative is required to set a monthly advance payment and can decide to pay bonuses. At the end of the year, when the accounts are closed, the general meeting decides to share out the final earnings.

110. The situation is different for a producer whose milk is collected by a processor. In general, there is no written contract between a producer and "his" private industrial company. It is a relation based on trust, sometimes inherited. It makes no mention of prices, quality or volumes. Traditionally, with quotas, production was limited and the entire volume produced by a farmer was collected by “its” processor. The buyer unilaterally sets a price each month.

111. With quotas, upstream relations in the dairy sector were simpler. Indeed, the quotas kept annual prices relatively stable and producers regained bargaining power due to the deficit in supply (as producers were even less concentrated than processors). Moreover, intervention prices for industrial products (butter, milk powder) enabled to cap the valuation difference between industrial products and consumer goods. As such, the milk price could be the same irrespective of the product "*mix*" of the processing company (relative volume of industrial products and of consumer goods in the company's manufacturing)[11]. With looser and looser quotas and the decrease of intervention prices for industrial products, these balancing mechanisms do not hold any longer.

112. The lifting of quotas by 2015 will require to re-consider producer-processor relations, whether involving cooperatives or private industrial companies. Indeed, none of the parties can afford to commit to collecting the total production of "their" farmers with no limits, as this would lead to overproduction. This would be inefficient in economic terms and harm producers.

113. Contractualization of volumes, prices and quality standards must take up the baton and serve to provide the foresight that producers need. Indeed, dairy production is characterized both by a long and rigid production cycle, and by fixed expenses that are clearly higher than variable expenses. This is a serious limit to the ability of dairy farmers to adjust their production. Moreover, more foresight on the medium term will also benefit processors, as they would have a compass to anticipate better their supply needs and costs. Finally, implementation of contracts with fixed prices over periods of several months could serve to mitigate seasonal variability. Indeed a portion of processed products is subject to negotiations with mass retail distribution, in general on an annual basis.

2. WHAT TYPE OF PROVISIONS SHOULD CONTRACTS CONTAIN?

114. Various provisions could be envisaged in contracts between producers and processors. The CNIEL is currently working on the preparation of a best practices guide, which may in particular set out the content of a typical contract, i.e. the elements that should be found therein. For all that, prices, volumes, and re-evaluation mechanisms should be independently negotiated by each processor with grouped producers. It is imperative that no consensus is reached between processors.

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[11] There are a few special cases where this equalization has not been set up. This primarily involves quality productions such as controlled origin (AOC) or organic cheeses, where the price for milk paid to the producer is clearly higher than the national average.

a) With whom should the processor sign a contract?

115. One of the major difficulties of contractualization is in the very large number of suppliers to whom major private industrial companies they purchase. It is therefore necessary to determine with whom the processor will have to negotiate the content of the contracts. While price negotiations at national level involving all operators would be contrary to competition law, the extreme opposite, i.e. negotiation between each processor and each producer, would inevitably limit the benefits that could be expected from contractualization as regards the bargaining power of producers.

116. Two intermediate solutions are possible. The first one would be to group producers into to which ownership of the merchandise would be legally transferred and which would look after the marketing of the products. The second one would be to entrust POs with functions of commercial agents, so that they are allowed to negotiate with processors on behalf of their members.

117. The first solution doesn't raise any problems with regard to competition rules. Indeed, a cooperative is akin to a mechanism that operates a concentration of suppliers, in which the various producers as owners, as though they were establishing a single company.

118. More questions arise as regards the compatibility of the second solution with competition rules. Indeed, when the producers do not transfer the ownership of their production, they remain in the grips of the market, but via the PO. Thus, in this case, the PO markets the production on behalf of producers, on the basis of a marketing mandate. Sales are carried out by the association structure; the volumes of different producers are therefore grouped, but the sales price definitely remains a customized price between each producer and the downstream side. In legal terms, the nature of the mandate would have to be examined in order to ensure that it cannot be considered as a mechanism that allows autonomous producers to reach a consensus in order to distort competition. The relaxation of the CMO governing the milk sector along the lines mentioned in paragraph 102 would ensure to that this option is legally secure.

b) Duration of the contracts

119. The question of the duration of contracts must be raised. The duration must serve to provide the producer with sufficient foresight so as to plan medium-term investments. As a cow needs to be amortized over contracts concluded for more than two years seem to be necessary.

120. In response to the questions of the *Autorité*, the president of the CNIEL considered that contracts should last between 5 and 10 years. However, the periodic re-evaluation of prices set in contracts entails that parties should concur in the way risk is shared. The longer the contract, the greater the risk and the more difficult to find a formula that suits to both parties. The adequate trade-off would certainly two- to five-year contracts, in order to secure the buy-in of all dairy operators.

121. The duration of all contracts does not necessarily need to be equal. Indeed, contracts may take into account the specificities of each farm or group of farms, such as the fact that a farmer moving into new installations is likely to have a greater need for visibility than other farmers. In this regard, it is worth praising the initiative of the Sodiaal cooperative, which gives a reward to producers who accept to declare their

delivery forecast in advance and to carry out deliveries that are sufficiently close to their forecasts, as this initiative also contributes to establishing greater predictability within the sector.

c) Contractualization of volumes

122. The issue of volumes needs to be handled with relative flexibility. Indeed, a farmer cannot anticipate his milk production accurately. In addition, the cyclical nature of dairy production requires a specific approach. As it was put forward, it may be appropriate to distinguish two kinds of volumes: the "basic" volume (hereinafter "volume A"), for which the price would be set for a term of several months, and a "peak" volume (hereinafter "volume B"), for which the price could be aligned onto the market price connected with quotations at downstream level, as it is currently the case for the overall volume.

123. Fluctuations of milk prices would then be mitigated. Indeed, volume A would be purchased at a price that would escape from monthly variations due to fluctuations in prices of industrial products. To ensure that this expected effect actually takes place, it is necessary that each contract between a producer and a processor stipulates that the ratio of volume A over the overall volume transferred to the processor is at least equal to the volume of sales that the processor is reasonably apt to anticipate, i.e. approximately to the share of consumer goods that it manufactures.

d) Re-evaluation of prices

124. Eventually, contracts should mention exactly how they will be re-evalued on a periodic basis, as prices set for volume A cannot be set for the whole term of the contract.

125. Two questions must then be considered: how often will the price be re-evalued? On the basis of what criteria?

126. To maximize the stabilizing effects of contractualization, it would be preferable for the prices not to be re-evalued as frequently as they currently are (monthly re-evaluation). Quarterly and even half-yearly re-evaluations could be envisaged, which should be possible given that negotiations with mass retail distribution channels take place on an annual basis at the downstream level.

127. Moreover, price re-evaluation formulae contained in contracts correspond to the sharing of risks between producers and processors. Ideally, provided that producers enjoy sufficient bargaining power, both parties should agree with such an item, disregarding what has been done in other contracts binding other parties.

128. However, if grouping of producers proves insufficient to allow a fair sharing of risks, it might be contemplated to provide this re-evaluation with a national framework. One could consider, for example, that the formulae could take into account aggregate indices calculated by an institution, provided that it is independent from market operators. Such a mechanism would help both parties to understand that the commitment to re-evaluate is not contrary to their own interest but can bring mutual benefits in terms of foresight at medium-term.

129. For instance, a composite index that would include downstream variations (prices of industrial products, prices of consumer goods...) as well as upstream costs (cost for

animal feed, for example) could be developed and disseminated, not by the interprofession but rather by a structure in which the State would sit in. This index could be used as the legal basis for increases or decreases in prices of the “basic” volume A. Indeed, in case of a major crisis in the dairy sector, prices should take into account the difficulties encountered by processors trying to sell off their products. Prices could vary depending on the evolution of this index in terms of percentage points, rather than in terms of absolute value. Such a mechanism would otherwise bring about standardization of prices.

130. In this regard, this mechanism is quite similar to that of the road transport sector, in which public authorities have established a mechanism for passing on variations of diesel prices on the invoiced price of transport on the basis of an official index prepared by the National Road Committee, the board of which the Minister for transport sits in.

CONCLUSION

131. Without prejudice to what it might adjudicate on the basis of a complaint or a referral, the *Autorité* considers that interprofessional organizations which issue price recommendations, whether at a national or regional level, bear a genuine legal risk with regard to competition rules.

132. The *Autorité* also remains sceptical towards the alleged efficiency of such price recommendations to overcome structural difficulties in the dairy sector, and claims preference for more relevant solutions such as encouraging contractualization, revamping the dairy sector by relying on producers’ organizations, considering a relaxation of the milk CMO to allow POs to market products on behalf of their members, and setting up a futures markets.

133. Contractualization appears to be a necessary avenue in the context of a de-regulation of the dairy sector. The interprofessional organization would play its role in promoting it while ensuring that market players abide by competition rules, and act as single economic units which determine their commercial strategy in an autonomous manner.

Deliberated after an oral report by Mrs. Constance Valigny and the intervention of Mr. Jean-Marc Belorgey, Deputy General *Rapporteur*, Mr. Bruno Lasserre, President and Chair of the meeting, Mrs. Anne Perrot, Mrs. Elisabeth Flüry-Hérard and Mr. Patrick Spilliaert, vice-presidents.

The secretary of the session,	The president,
Marie-Anselme Lienafa	Bruno Lasserre