

# **Determination**

## **Application for Revocation of A90659 and its Substitution by A90888**

**lodged by**

Inghams Enterprises Pty Ltd on its own behalf and on behalf of  
Tasmanian chicken growers

in relation to the collective negotiation of chicken growers'  
contracts in Tasmania.

Date: 19 May 2004

**Authorisation no.** A90888

**Public Register no.** C2003/1958

**Commissioners:**

Samuel  
Sylvan  
Martin  
Willet  
McNeill

# **Executive Summary**

## **The Application**

On 17 March 1999, authorisation A90659 was granted to Inghams Enterprises Pty Ltd under subsection 88(1) of the Act, for itself and on behalf of its growers, to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition, within the meaning of section 45 of the Act.

The application related primarily to the Broiler Chicken Growing Agreement, the terms and conditions of which were jointly negotiated by the contract growers with Inghams. The Broiler Chicken Growing Agreement provided for a standard fee payable to contract growers for each growing cycle. Authorisation was granted for a period of five years until 31 December 2003.

On 8 December 2003, Inghams Enterprises Pty Ltd on its own behalf and on behalf of Tasmanian chicken meat growers (the Applicants) submitted an application to the Commission for revocation and substitution of authorisation A90659 (the Application).

## **The authorisation process**

A key objective of the *Trade Practices Act 1974* (the Act) is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.

The Act, however, allows the Commission to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the Commission for what is known as an ‘authorisation’.

Broadly, the Commission may ‘authorise’ businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.

Additionally under the Act, the Commission may grant an application to revoke an existing authorisation and grant a substitute authorisation when the benefit from the conduct proposed to be authorised (that is, under the substitute authorisation) outweighs the detriment.

Before the Commission may grant an application to revoke an existing authorisation and grant a substitute authorisation, it conducts the same public consultation process as it would conduct for a new application for authorisation.

## **The proposed arrangements**

The application for revocation and substitution is made by Inghams on its own behalf and on behalf of the seven growers listed in attachment A to this determination.

Essentially, authorisation is sought to continue to engage in the arrangements the subject of authorisation A90659. In the short-term, the Applicants requested interim authorisation to continue to make and give effect to the Broiler Chicken Growing

Agreements until such time as the Commission decided on the merits of the substantive application.

Specifically, Inghams seeks authorisation to negotiate the terms of a chicken growing agreement with the growers. The growers seek authorisation to collectively negotiate the terms of a chicken growing agreement with Inghams. Negotiations will be conducted by the growers collectively through a nominated representative (or representatives).

The resultant agreements will be in a form similar to the indicative Growing Agreement contained in attachment B to this determination and will provide for a common fee to be paid to growers for the growing of chicken meat, and the basis upon which such a fee is to be calculated.

On 17 December 2003, the Commission agreed to suspend the operation of authorisation A90659 and to grant interim authorisation to the substitute arrangements while it considered the merits of the application for revocation and substitution.

### **Assessment of public benefit and anti-competitive detriment**

The Commission considers the combined effect of individual growers' having the option to opt out of collective negotiation and negotiate individual contracts, increasing competition from mainland states, the growing fee constituting only a small percentage of the total retail price and the pressure from downstream purchases mitigates the potential anti-competitive effects of collectively negotiated terms and conditions, including fees. In addition, the Commission considers that the considerable lack of bargaining power of individual growers means competition between them is not vigorous in any event even without the proposed arrangements.

The Commission considers that there are likely to be public benefits arising from the proposed arrangements. In particular, the Commission considers that the arrangements provide a public benefit by facilitating a reduction in transaction costs compared to a situation where growers individually negotiate a contract. The Commission considers that these cost savings are likely to be passed on to consumers, at least, in part, given the competitive pressures to which Inghams and its growers are subject from retailers and fast food chains.

Consequently, following consideration of the arguments advanced by the Applicant and interested parties, the Commission concludes that the public benefits likely to result from the arrangements will outweigh the anti-competitive detriment.

### **Determination**

The Commission therefore grants the revocation of A90659 and its substitution by A90888 for a period of six years.

## Table of Contents

|    |   |    |
|----|---|----|
| 1. | Introduction.....   | 1  |
|    | <i>Authorisations</i> .....   | 1  |
|    | <i>Revocation and substitution of authorisations</i> .....            | 1  |
|    | <i>The current application</i> .....                                  | 1  |
| 2. | Industry Background.....  | 3  |
|    | <i>National Processed Chicken Meat Industry</i> .....                 | 3  |
|    | <i>Chicken Growing Services</i> .....                                 | 4  |
|    | <i>Related Authorisations</i> .....                                   | 5  |
|    | <i>Tasmanian Industry</i> .....                                       | 6  |
|    | <i>Inghams Tasmanian Operation</i> .....                              | 7  |
| 3. | Authorisation A90659.....   | 8  |
| 4. | Application for revocation and substitution.....                      | 9  |
|    | <i>The Application</i> .....  | 9  |
|    | <i>Claimed Adverse Consequences of Non-Authorisation</i> .....        | 10 |
|    | <i>Claimed Public Benefit</i> .....                                   | 10 |
|    | <i>Anti-competitive detriment</i> .....                               | 11 |
|    | <i>Interested Parties Submissions</i> .....                           | 11 |
|    | <i>Draft Determination</i> .....                                      | 12 |
| 5. | Statutory provisions .....  | 13 |
|    | <i>Revocation and Substitution</i> .....                              | 13 |
| 6. | Evaluation .....  | 15 |
|    | <i>The Relevant Markets</i> .....                                     | 15 |
|    | <i>Future with-and-without test</i> .....                             | 16 |
|    | <i>Effect on competition</i> .....                                    | 16 |
|    | <i>Common contract terms and conditions</i> .....                     | 16 |
|    | <i>Scope for New Entry</i> .....                                      | 18 |
|    | <i>Conclusion</i> .....   | 19 |
|    | <i>Public benefit</i> .....   | 19 |
|    | <i>Conclusion</i> .....   | 22 |
|    | <i>Balance of Public Benefit and Anti-Competitive Detriment</i> ..... | 23 |
| 7. | Determination – application for revocation & substitution.....        | 24 |
|    | <i>The Application</i> .....  | 24 |
|    | <i>The Statutory Test</i> .....                                       | 24 |
|    | <i>Conduct Authorised</i> .....                                       | 24 |
|    | <i>The effective date of determination</i> .....                      | 24 |
|    | Attachment A: Consenting Growers.....                                 | 25 |
|    | Attachment B: The Broiler Chicken Growing Agreement.....              | 26 |

# 1. Introduction

## *Authorisations*

- 1.1. The Australian Competition and Consumer Commission (the Commission) is the Commonwealth agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.
- 1.2. The Act, however, allows the Commission to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the Commission for what is known as an ‘authorisation’.
- 1.3. Broadly, the Commission may ‘authorise’ businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.
- 1.4. The Commission conducts a comprehensive public consultation process before making a decision to grant or deny authorisation.

## *Revocation and substitution of authorisations*

- 1.5. Additionally under the Act, the Commission may grant an application to revoke an existing authorisation and grant a substitute authorisation when it is satisfied that the proposed arrangements (that is, under the substitute authorisation) would, or be likely to, result in a benefit to the public; and that the benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed arrangements were made and the provisions concerned were given effect to.
- 1.6. Before the Commission may grant an application to revoke an existing authorisation and grant a substitute authorisation, it conducts the same public consultation process as it would conduct for a new application for authorisation. This process involves informing interested parties about the application for revocation and substitution and inviting submissions in response to it. The Commission then issues a draft determination and invites interested parties to lodge further submissions in response to it and/or call a conference to discuss the draft. The Commission then issues a final determination.

## *The current application*

- 1.7. On 17 March 1999, authorisation A90659 was granted to Inghams Enterprises Pty Ltd under subsection 88(1) of the Act, for itself and on behalf of its growers, to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition, within the meaning of section 45 of the Act.

- 1.8 The application related primarily to the Broiler Chicken Growing Agreement, the terms and conditions of which were jointly negotiated by the contract growers with Inghams. The Broiler Chicken Growing Agreement provided for a standard fee payable to contract growers for each growing cycle. Authorisation was granted for a period of five years until 31 December 2003. The authorisation is described in Chapter 3.
- 1.9 On 8 December 2003, Inghams Enterprises Pty Ltd on its own behalf and on behalf of Tasmanian chicken meat growers (the Applicants) submitted an application to the Commission for revocation and substitution of authorisation A90659 (the Application). The application is described in Chapter 4.
- 1.10 Essentially, authorisation is sought to continue to engage in the arrangements the subject of authorisation A90659. In the short-term, the Applicants requested interim authorisation to continue to make and give effect to the Broiler Chicken Growing Agreements until such time as the Commission decides on the merits of the substantive application.
- 1.11 On 10 December 2003, the Commission wrote to a range of interested parties seeking their views on the application. One submission was received which is summarised in Chapter 4.
- 1.12 On 17 December 2003, the Commission agreed to suspend the operation of authorisation A90659 and to grant interim authorisation to the substitute arrangements while it considers the merits of the application for revocation and substitution.
- 1.13 On 14 April 2004, the Commission issued a draft determination proposing to grant the revocation of A90659 and its substitution with A90888 for a period of five years. No further submissions or requests for a pre-decision conference were received by the Commission, however, shortly prior to the release of this final determination the applicant advised that they did not anticipate that contracts would be finalised for a further six to eight months and that they were seeking authorisation for the period necessary to complete those negotiations and to include the full life of the proposed contract, being a further five years.

## 2. Industry Background

### *National Processed Chicken Meat Industry*

- 2.1 In 2002-03, the Australian processed chicken meat industry produced 723,000 tonnes (35kgs per person) of chicken meat with total retail sales in excess of \$2.8 billion. Exports accounted for a further 21,000 kg<sup>1</sup>. The Applicants claim in their submission to the Commission that the chicken meat industry is Australia's most efficient meat industry – out-performing beef, sheep meat and pork. In terms of absolute size the poultry industry is now second only to the beef industry<sup>2</sup>. The industry is heavily concentrated in outer metropolitan areas and in rural and regional Australia.
- 2.2 Production has increased significantly over the past thirty years with annual growth of approximately 3-4% over the past few years. Similar levels of growth are expected for the next 2-3 years<sup>3</sup>. In previous applications for authorisation Inghams has claimed that, of the states, New South Wales has the largest production of chicken meat followed by Victoria, Queensland and South Australia. Tasmania is the smallest producer<sup>4</sup>.
- 2.3 The Applicants submit that chicken meat is sold predominantly within local state markets although it is gradually moving from this state orientation to a national market as advancements in technology allow processors to move product greater distances with greater safety and economy. However, due mainly to strict quarantine conditions, the processed chicken meat industry has remained primarily contained within Australia's borders with only a small percentage of product either imported or exported.
- 2.4 The Applicants submit that the retailing sector and the fast food industry are the major market outlets for the industry. They state that approximately 75% of chicken meat is sold through retail outlets with the remainder sold through the food service industry. Of the 75% sold through retail outlets approximately 45% is sold through supermarkets, 45% through specialty chicken shops and butchers and the remainder through delicatessens, department stores and other outlets.
- 2.5 The Applicants submit that the majority (85%) of chicken meat sold through retail outlets is fresh rather than frozen product and that a feature of the retail level of the market is the significant buying power exercised by the retail and fast food chains in the purchase of chickens.
- 2.6 The Applicants submit that of the 25 % of product sold through the food service industry, approximately half is sold through fast food chains with the remainder sold through outlets such as restaurants and hotels.

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<sup>1</sup> <http://www.abare.gov.au/australiancommodities/commods/pigpoultry.html>

<sup>2</sup> Ibid

<sup>3</sup> Ibid.

<sup>4</sup> See Attachment A to the application lodged by Inghams Enterprises Pty Ltd on 3 April 2002 in respect of collective negotiations of growing agreements by chicken growers in South Australia.

- 2.7 The Australian processed chicken meat industry is dominated by two large, vertically integrated companies [Inghams and Bartter Enterprises Pty Ltd (Bartter)] who own breeding farmers, multiplication farms, hatcheries, feed mills, some growing farms and processing plants. The Applicants state that Inghams and Bartter account for approximately 70% of chicken meat production in Australia. They claim that each of the companies invests significant funds into in-house research and development, particularly in the areas of product development, processing technologies, quality control procedures, distribution and packaging and market research.
- 2.8 Inghams identifies a number of other significant processors operating in the industry including Baiada Poultry Pty Ltd (NSW) who recently bought out Marven Poultry (in July 2001) and Eatmore Poultry Pty Ltd (in July 2002) to become the third major national processor in the industry.
- 2.9 The processed chicken meat industry is typically vertically integrated due to the importance of having control over costs and the timing of all operations in the supply chain. Integrated processors supply day old chicks and feed to contract growers or company-owned farms, collect the grown chicks, distribute and market the meat.

#### *Chicken Growing Services*

- 2.10 The Applicants describe chicken growing services as an input into the production of chicken meat. Therefore, demand for chicken growing services is a derived demand heavily influenced by; chicken meat demand considerations; technology along the production chain; and the cost of all other inputs.
- 2.11 Growing services are typically outsourced as a way of conserving capital and of ensuring growing efficiency, however, growing farms tend to be located relatively close to the processing plant and associated feed mills to minimize transportation costs and ensure quality of finished birds. Other services such as the provision of breeders, cartage of chicks, live bird pick-up and delivery of product are also often outsourced through contracts by processors.
- 2.12 The contract system of chicken growing has been an intrinsic part of the chicken meat industry for many years. The characteristics of this system are:
- **Processor control of inputs and rearing specifications** – the processors control the genetic material for breeding chickens. They supply contract growers with day old chicks to be reared according to detailed specifications. The processor also provides other important inputs to the growing process including all feed and medications.
  - **Rearing of chickens under contract** – processors and growers enter into contracts, either on a batch to batch basis or on contractual terms of three years. Under these contracts, growers are independent contractors, not employees of the processor. The contract growers never own the chicks they rear.

- **Rearing fee is a small component of product costs** – the cost of contract rearing contributes approximately 10.7% of the wholesale costs and 8.5% of the retail price.
- **Significant equity contributions by growers** – growers contribute approximately 40% of the capital investment in the industry through ownership of farms, shedding and other facilities used in the growing of chickens.
- **Capital investment** – the contract growing of chickens is extremely capital intensive. The average contract farm in Australia consists of three to four growing sheds, each with a floor area of 1200 square metres. The replacement cost of such sheds, with all internal equipment, is approximately \$230 per square metre. Chicken growing sheds are highly specialised and have virtually no alternative use. In addition, they are non-portable. Thus, a reasonable degree of stability and predictability in growing arrangements is required to ensure future investment.
- **Contract terms** – Growers are restricted to working for a single processor at any point in time. They may be engaged on a batch by batch basis, or on contracts.

#### *Related Authorisations*

- 2.13 New South Wales, Victoria, Queensland, Western Australia and South Australia have all (in the past or currently) regulated the commercial relationship between poultry meat producers (growers) and processors. These regulations have generally established an industry committee of grower and processor representatives to negotiate standard contract terms for the supply of chicken meat to processors.
- 2.14 As a result of legislative reviews carried out by these states in accordance with National Competition Policy requirements, a number of states have moved away from regulated commercial relationships between processors and growers to partial, or fully, deregulated industry arrangements. These legislative changes have resulted in a number of applications submitted to the Commission by industry participants in recent years to allow them to collectively negotiate growing and supply contracts.
- 2.15 Authorisations granted by the Commission in recent years to engage in conduct similar to the current application include:
- 9 April 1997- (A90595) Inghams, in South Australia, were granted an authorisation allowing its contracted chicken growers to negotiate collectively amongst themselves and with Inghams. On 22 January 2003, Inghams were granted a revocation and substitution (A90825) of A90595 on the same terms for a further five years.
  - 20 May 1998- (A30183) Steggles Limited (now fully owned by Bartters), also in South Australia, were granted authorisation which allowed its contracted

chicken growers to negotiate collectively amongst themselves and with Steggle's.

- 28 June 2001- (A90750) Marven Poultry Pty Ltd (now fully owned by Baiada), and other Victorian chicken meat processors, were granted authorisation which permitted the contracted growers of each of the states major processors<sup>5</sup> to engage in collective negotiations amongst themselves and with their individual processor. That authorisation was subsequently set aside by the full bench of the Federal Court as of 4 September 2003<sup>6</sup>. Five new applications for authorisation (A90901, A90902, A90903, A90904 and A90905) have been lodged with the Commission by Victorian processors<sup>7</sup> (and growers in the case of some of the applications) and are currently being assessed. In addition, on 5 May 2004 the Commission received a separate application for authorisation from the Victorian Farmers Federation (VFF) on behalf of its member Victorian chicken meat growers (A40093), to engage in collective negotiations amongst themselves and with their individual processors. This application differs from that lodged by the processors primarily in respect of the framework within which it is proposed that collective negotiations will occur and in that the VFF have also sought authorisation to engage in collective boycott activity if negotiations are unsuccessful. This application is also currently being assessed by the Commission.

2.16 On 8 October 2002, an application for authorisation lodged by New South Wales chicken meat processors (A90800) was denied by the Commission primarily due to changes in that states legislation relating to its re-regulation of certain aspects of the chicken industry.

### *Tasmanian Industry*

2.17 The Applicants state that there are two integrated and a number of non-integrated broiler chicken processors in Tasmania. The integrated processors are Inghams, a national firm that grows and processes chickens in all states and the much smaller Nichols Poultry. The non-integrated processors bone or further add value to chicken they obtain from the integrated, or from interstate, processors. The largest non-integrated processors are Farmyard Chickens and Gourmet Fine Foods.

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<sup>5</sup> Inghams Enterprises Pty Ltd, Bartter Enterprises Pty Ltd, Eatmore Poultry Pty Ltd, Hazeldene Chicken Farm Pty Ltd and La Ionica Enterprises Pty Ltd.

<sup>6</sup> On 5 August 2003, the Full Court set aside the Marven authorisation as and from 4 September 2003 on the grounds that:

- the application for authorisation was made by Marven for itself and on behalf of other processors;
- the authorisation sought was directed to permitting growers to engage in collective bargaining;
- in granting authorisation to the application, the Commission had authorised grower conduct to which the processors were not a party; and
- sub-s 88(1) did not empower the Commission to grant an authorisation to the growers where the application was not made by or on behalf of the growers.

*Jones v ACCC [2003] FCAFC 164; (2003) 200 ALR 234*

<sup>7</sup> Same as footnote 5 above save for Eatmore Poultry Pty Ltd replaced by Baiada Poultry Pty Ltd.

- 2.18 The Applicants state that Inghams supplies 75% of the approximately 10,000 tonnes of chicken meat that is consumed in Tasmania each year, with Nichols supplying a further 12% and the remainder being imported from Victoria and South Australia. Overall consumption of chicken meat in Tasmania is claimed by the Applicants to be growing by 5% each year with imports growing by around 10%. Tasmania exports less than 1% of its production.
- 2.19 The Applicants identify the main outlets for chicken meat in Tasmania as being supermarkets (42%), the food service industry (46%), fast food restaurants (6%) and butchers (6%). Pricing and contractual arrangements vary with only a small percentage involving set periods and/or set prices with most sales negotiated on a spot price basis.

#### *Inghams Tasmanian Operation*

- 2.20 Inghams is a fully integrated processor. It has one processing plant, breeding and hatchery farms, and a feedmill in Tasmania. The processing plant is located at Sorell on the outskirts of Hobart. Three company owned farms and nine contract farms, two of which have individual contracts, provide the plant with birds for processing. Inghams' contract growers are located mainly on the Tasman Peninsula and the Applicants submit that no grower has a growing contract alternative to Inghams.
- 2.21 The Applicants submit that there has been some investment in the growing industry in Tasmania over the last five years with three new growers entering the industry and replacing other exiting growers. One grower has built tunnel shedding. Other growers have conventional shedding.
- 2.22 Inghams provides direct employment to approximately 200 people in Tasmania. The Applicants estimate that a further 150 people have contracts with, or a substantial dependence on, Inghams for employment. Inghams claims to have plans for further investment in Tasmania.

### **3. Authorisation A90659**

- 3.1 On 17 March 1999, authorisation A90659 was granted to Inghams Enterprises Pty Ltd under subsection 88(1) of the Act, for itself and on behalf of its growers, to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition, within the meaning of section 45 of the Act.
- 3.2 The application related primarily to a Broiler Chicken Growing Agreement, the terms and conditions of which were jointly negotiated by the contract growers with Inghams. The Broiler Chicken Growing Agreement provided for a standard fee payable to contract growers for each growing cycle.
- 3.3 Attached to the Broiler Chicken Growing Agreement was a Code of Practice for negotiations between Inghams and its contract growers. The Code of Practice governs issues pertaining to the negotiations between Inghams and contract growers and was part of the collective negotiation process for which authorisation was granted.
- 3.4 The Commission found that while the proposed collective arrangements may reduce the scope for competition over rates of payment and other contract terms and conditions between growers, public benefits would flow from the proposed arrangements.
- 3.5 In particular, the Commission found that there was public benefit both in terms of efficiency and equity considerations. The Commission also found that there was likely to be a reduction in costs for both growers and Inghams as a result of collective negotiation. Further, the Commission considered that the competitive pressure provided by chicken retailers was likely to force Inghams and the growers to pass on some of the cost reductions to consumers.
- 3.6 The Commission concluded that the public benefits likely to result from the arrangements would outweigh the anti-competitive detriment. Authorisation was granted for a period of five years until 31 December 2003.

## **4. Application for revocation and substitution**

- 4.1 On 8 December 2003, Inghams, on its own behalf and on behalf of seven consenting chicken growers (listed at attachment A to this determination), lodged an application under section 91C of the Act for a revocation and substitution of authorisation A90659<sup>8</sup>. The Applicants also sought interim authorisation which was granted by the Commission on 17 December 2003.
- 4.2 The proposed substitute authorisation (A90888) is materially the same as A90659. Essentially, authorisation is sought to continue to engage in the arrangements the subject of authorisation A90659. Authorisation is sought for a further six years.
- 4.3 A copy of the application and submission by the Applicants in support of their application is on the public register maintained by the Commission. The main issues raised in the submission are outlined below.

### *The Application*

- 4.4 The application for revocation and substitution is made by Inghams on its own behalf and on behalf of the seven growers listed in attachment A.
- 4.5 Inghams seeks authorisation to negotiate the terms of a chicken growing agreement with the growers. Negotiations will be conducted by Inghams with the growers on a collective basis and through a nominated representative (or representatives) of their growers.
- 4.6 The growers seek authorisation to collectively negotiate the terms of a chicken growing agreement with Inghams. Negotiations will be conducted by the growers collectively through a nominated representative (or representatives).
- 4.7 The agreement will be in a form similar to the indicative Growing Agreement (contained in attachment B to this determination) and will provide for a common fee to be paid to growers for the growing of chicken meat, and the basis upon which such a fee is to be calculated.
- 4.8 The negotiations will be carried out in accordance with a revised ‘Code of Practice for Negotiations between the Processor and the Contract Grower’ (the Code of Practice) a copy of which is attached as Annexure 5 to the indicative Growing Agreement (attachment B). The result will be that the growers will each be bound by a contract of similar terms, including the terms as to the common fee to be paid to growers and the basis upon which that fee is calculated.
- 4.9 Individual growers will retain the right to opt out of collective negotiations and to negotiate specific contracts with Inghams.

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<sup>8</sup> The application has also been considered as an application under the Competition Code.

- 4.10 The Commission notes that whilst the indicative Growing Agreement provided by the Applicants differs in certain respects from the original Broiler Chicken Growing Agreement considered in authorisation A90659, it is framed in substantially similar terms and the variations do not significantly impact on the Commission's consideration of the current application for revocation and substitution. A copy of the original Growers Agreement can be found on the Commission's public register<sup>9</sup>.

*Claimed Adverse Consequences of Non-Authorisation*

- 4.11 The Applicants submit that the public benefits arising from the conduct primarily relate to the avoidance of potential adverse consequences to the industry that may result from non-authorisation. Inghams claim these adverse consequences will include:
- Psychological costs imposed on growers by a perceived imbalance of bargaining power.
  - Search, information gathering, and negotiation (possibly expensive accountants/legal persons) expenses. These costs will involve direct monetary outlays, losses of time away from their direct business and psychic costs associated with worries about the progress of individual negotiations and possible pressures from financing institutions to get an agreement in place.
  - Growers agreeing to sub-optimal contracts that lead to future costs (personal financial, health, safety or environmental).
  - Dissatisfaction of individual outcomes relative to others in similar positions that may affect performance.
  - Processors' costs of negotiating individually with growers including monetary outlays, opportunity costs due to management time being taken up in negotiations rather than on improving and managing the rest of the business.
  - Potential cost to the community due to constraints on the industry's capacity to meet planning and environmental challenges to which it is increasingly subject.
  - A possible threat of strike action that may occur over fees or negotiations which would likely result in adverse outcomes both financially and in relation to animal welfare.
  - Increase potential for disputes due to a lack of a clear resolution process or consistency in contracts of growers in similar situations.
  - Lower efficiencies in operations due to an inability to ensure standardization of business practices.

*Claimed Public Benefit*

- 4.12 The Applicants submit that the public benefits which will flow from growers collectively negotiating with Inghams include:

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<sup>9</sup> <http://www.accc.gov.au/authAndNotif/1998a.htm>

- An improved bargaining position for growers to counter the perception of a power imbalance with processors.<sup>10</sup>
- Reduced transactional costs for growers associated with seeking information, preparing negotiating positions and undertaking negotiations.
- Reduced transactional costs for processors in negotiations.
- A reduction in sources of conflict that could give rise to industrial unrest.
- A mechanism for dealing with disputes which leads to greater industrial harmony and hence to a focus on productivity.
- A more rapid adjustment to safety, environmental, planning and other issues impacting on the industry and hence increased community benefits because of the negotiation of collective agreements as opposed to numerous individual negotiations.
- Improved incentives for capable growers.
- A stronger Tasmanian industry (and hence employment in regional areas) which is better equipped to withstand interstate competition, competition from other products and from overseas imports if they were to be allowed into Australia.
- Increased consumer satisfaction due to an increased ability to adjust Tasmanian production to meet local needs.

#### *Anti-competitive detriment*

4.13 Inghams submits that the major detrimental effects flowing from a collectively negotiated contract as opposed to an individually negotiated contracts include:

- Higher average fees per bird paid to growers.
- Potentially less flexible and therefore more costly contracts.

#### *Interested Parties Submissions*

4.14 The Commission sought submissions from a wide range of interested parties when the application for revocation and substitution was lodged. One submission was received from the Tasmanian Department of Primary Industries, Water and Environment (the Department).

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<sup>10</sup> The Applicants acknowledge that while a change in bargaining power itself may not constitute a public benefit, perceptions of power imbalance appear to be a major rationale for urging restrictive legislation. Therefore addressing this issue removes the pressure for a legislative solution that may arise in a non-authorisation environment and that ultimately may have negative public benefits.

- 4.15 The Department states that it is supportive of the continuing use of the authorisation process to enable growers and Inghams to negotiate the terms and conditions of the growing agreement provided the arrangements ensure both sets of parties are able to determine matters on as equal a basis as possible.
- 4.16 The Department identified that one area of concern was the perceived weakness in dispute resolution mechanisms. The Department acknowledges that the authorisation process does not per se centre on the existence of such arrangements, however, in its view, the contract should provide a suitably strong dispute resolution mechanism. It is noted by the Department that the contract under negotiation specifically provides a dispute resolution clause that does contain clear obligations on both parties with respect to such matters.

*Draft Determination*

- 4.17 On 14 April 2004, the Commission issued a draft determination proposing to grant the revocation of A90659 and its substitution with A90888 for a period of five years. The Commission sought further submissions from interested parties and, in accordance with requirements of section 90A of the Act, provided interested parties with the opportunity to request a pre-decision conference.
- 4.18 No further submissions or requests for a pre-decision conference were received by the Commission, however, shortly prior to the release of this final determination the applicant advised that they did not anticipate that contracts would be finalised for a further six to eight months and that they were seeking authorisation for the period necessary to complete those negotiations and to include the full life of the proposed contract, being a further five years.

## 5. Statutory provisions

### *Revocation and Substitution*

- 5.1. Under section 91C of the Act, the Commission may grant an application to revoke an existing authorisation and grant a substitute authorisation at the request of the party to whom the authorisation has been granted, or another person on behalf of such a party.
- 5.2. In order for the Commission to grant an application to revoke an existing authorisation and grant a substitute authorisation, the Commission must consider the substitute authorisation in the same manner as the standard authorisation process.
- 5.3. As such, the relevant test that the Applicants must satisfy for the substitute authorisation to be granted is outlined in sub-sections 90(6) and 90(7) of the Act.
- 5.4. Under section 90(6) of the Act, the Commission may grant authorisation in respect of a proposed contract, arrangement or understanding that may have the purpose or effect of substantially lessening competition if it is satisfied that:
  - the contract, arrangement or understanding would be likely to result in a benefit to the public; and
  - this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding.
- 5.5. Under section 90(7) of the Act, the Commission may grant authorisation in respect of a contract, arrangement or understanding that may have the purpose or effect of substantially lessening competition if it is satisfied that:
  - the contract, arrangement or understanding would be likely to result in a benefit to the public; and
  - this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding.
- 5.6. In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements or conduct and the public benefits arising from the arrangements or conduct, weighing the two to determine which is greater. Should the public benefits or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation.
- 5.7. This initially involves informing interested parties about the application for revocation and substitution and inviting submissions in response to it. After considering any submissions the Commission prepares a draft determination. It then invites interested parties to call a pre-decision conference and/or lodge further submissions in response to this draft. Finally, the Commission issues a

determination in writing either revoking the authorisation and granting a substitute authorisation or deciding not to revoke the authorisation.

- 5.8 The Commission must not make a determination to revoke and substitute an authorisation unless it is satisfied that the substitute application would be likely to result in a public benefit outweighing the detriment to the public constituted by any lessening of competition that would be likely to result from the substitute authorisation (usually referred to as the anti-competitive detriment). This test is commonly referred to as the ‘public benefit test’.
- 5.9 If this is not the case, the Commission may refuse the Application or, alternatively, in refusing authorisation, indicate to the applicant how the application could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

## 6. Evaluation

### *The Relevant Markets*

- 6.1 As noted in paragraph 2.13, the Commission has considered a number of similar applications for chicken meat growers to collectively bargain in South Australia, New South Wales and Victoria, along with the previous application for authorisation by Inghams in Tasmania. In considering these applications the Commission concluded that the two primary markets of relevance were the state based markets for the provision of grower services to processors and the markets for the retail sale of chicken meat.
- 6.2 The Commission has received no information in respect of the current application which would cause it to change its view of the relevant markets. The Commission does note the information supplied by the industry since the initial authorisation was granted in Tasmania in 1999 that improvements in technology and transport methods have enabled processors to compete more effectively in interstate markets.
- 6.3 In their current application the Applicants contend that ‘imports’ from mainland states account for approximately 15% of Tasmanian sales. Further, the Applicants also contend that these imports are growing by around 10% annually. The capacity to import chicken meat from mainland states may therefore act as a competitive constraint on Inghams and Tasmanian chicken growers.
- 6.4 The Commission also notes the following features of the markets for grower services and the retail sale of chickens in Tasmania and the chicken meat industry generally:
- Inghams is the only major processor in Tasmania, therefore growers are unable to switch to another processor and are locked into dealing with Inghams.
  - The Tasmanian market is small compared to mainland states with approximately 10,000 tonnes of chicken meat sold annually in Tasmania compared to 210,000 in Victoria and 70,000 tonnes in South Australia.
  - The growing fee is a relatively small component (approximately 8.5%) of the total retail price of chicken meat.
  - Downstream purchasers, in particular the large supermarket and fast food chains, have significant buying power when purchasing chicken meat from Inghams.
  - Due to the level of vertical integration within the industry, growers have a limited ability to vertically integrate upwards or downwards making entry into the market at the growing level very difficult without an arrangement with a processor.
  - Chicken growing is capital intensive and growing sheds and equipment are non-portable and virtually impossible to use for other purposes meaning growers are ‘locked’ into the industry.

- Growers are often required to adapt their shedding to meet processors requirements which often results in them investing significant capital in relationship-specific assets.

#### *Future with-and-without test*

- 6.5 The Commission applies the ‘future with-and-without test’ established by the Australian Competition Tribunal to identify and weigh the public benefit and anti-competitive detriment generated by arrangements for which authorisation has been sought.
- 6.6 Under this test, the Commission compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the Commission to make a reasonable forecast about how the relevant markets will react if authorisation is not granted. This forecast is referred to as the counterfactual.
- 6.7 The Commission notes that collective bargaining in the form proposed in the current application has been on-going for a number of years. Indeed, the application for revocation and substitution simply seeks to extend the immunity conferred to the subject conduct of authorisation A90659, on essentially the same terms as previously authorised.
- 6.8 Absent of authorisation, these arrangements would be likely to raise concerns under the Act. Specifically, the Act prohibits, for example, persons in competition with each other negotiating collectively, either directly or by electing a representative to negotiate on their behalf, provisions in contracts that may have an anti-competitive purpose or effect (e.g. a common fee). In this respect, it is likely that growers do compete with each other in the market for the provision of grower services to Inghams.
- 6.9 In this context, the Commission considers that the likely counterfactual if the authorisation is not granted is that each chicken grower will negotiate individually with Inghams the terms and conditions of their individual grower contracts.

### **Effect on competition**

#### *Common contract terms and conditions*

- 6.10 In general terms, collective bargaining agreements which set uniform terms and conditions (including fees) for independent contractors covered by that agreement are likely to lessen competition relative to a situation where each of the contractors individually negotiates their own terms and conditions. However, the extent of the detriment and the impact on competition of the collective agreement will depend upon the specific circumstances involved.
- 6.11 As a consequence of the collective negotiations between Inghams and its contract growers in Tasmania the scope for competition between growers over terms and conditions, and in particular over rates of payment, is likely to be reduced. The

- Applicants submit that this may lead to higher fees paid to the growers and less flexible contracts than would be the case if contracts were negotiated individually with growers.
- 6.12 In addition, the proposed arrangements may place upward pressure on retail prices when compared to a situation where each grower individually negotiates its own contract terms and conditions with Inghams.
- 6.13 However, the Commission considers that there are a number of factors which limit any anti-competitive detriment resulting from collective bargaining in this instance. Contract growers have the option of negotiating individually with Inghams if they do not wish to be party to the collective bargaining process. To the extent that some growers choose to negotiate individually this may increase the scope for competition over rates of payment and other contract terms. However, the very substantial lack of bargaining power by individual growers means their ability to compete in the relevant market is marginal.
- 6.14 Further, the Commission notes the increasing capacity for Inghams to import chicken meat into Tasmania from mainland states which acts as a competitive constraint on Tasmanian growers capacity to negotiate increased growing fees. Additionally the Commission notes that the growing fee constitutes only a small component of the retail price of chicken meat (approximately 8.5%). Finally, the Commission considers that competitive pressures provided by powerful downstream purchasers such as retail chains and fast food outlets should limit chicken processors' ability to pass on any fee increases.
- 6.15 The Commission further notes that any anti-competitive effects from growers seeking to exploit their improved bargaining position as a result of the collective negotiation arrangements are likely to be far less in the chicken growing industry than in other industries where elasticities of supply are much higher. Capital investment in chicken growing, for example in land, shedding and equipment is large and highly specific to the occupation. This limits the ability of growers to supply different goods and services in response to changed market conditions or variations in contract terms offered. Consequently growers' ability to exploit any increase in bargaining power as a result of the proposed arrangements is also limited.
- 6.16 In addition, the Commission considers the inclusion of the Pool Payment System and the Efficiency Rating System in the in proposed Growing Agreement (see attachment B), to a large extent, counteracts any potential anti-competitive detriment of the indicative Growers Agreement. The Commission believes these systems provide significant incentive for growers to continue competing with one another for payments and to continue improving and modernising their businesses. Briefly, the systems will operate in the following manner:

- Pool Payment System: Establishes a system whereby the contract growers are paid relative to the liveweight<sup>11</sup> of all the chickens collected from a grower during the pool period.
- Efficiency Rating System: Requires growers to maintain a minimum standard of their facilities or risk Inghams reducing the number of batches placed with them.

*Scope for New Entry*

- 6.17 The capacity for new entrants to compete for the rights to undertake the business of existing market participants subject to a collective agreement also has implications for how competition in the market is affected.
- 6.18 Difficulties faced by new growers entering the chicken industry include the extent of vertical integration in the industry, the limited ability of growers to vertically integrate either upwards or downwards, the capital investment requirements which are tied once committed, and meeting the start-up requirements of the processors before entering into a growing agreement.
- 6.19 Entry into the market at the processor level also has barriers due to the relatively high start-up costs and the uncertainty of gaining either new growers and/or growers from other processors.
- 6.20 Collective negotiation between growers and their processor resulting in agreed fee levels and entry into long term agreements may further reduce the likelihood of entry into both the chicken growing and chicken processing markets by potential competitors.
- 6.21 However, the Commission notes that the proposed arrangements are voluntary and allow growers (including new entrants) freedom to negotiate rates of payment and other conditions different to those determined under collectively negotiated agreements. This may limit any detrimental effects such agreements may have on the likelihood of new entry into the market at the growing level.
- 6.22 In addition, the Commission notes that the number of growers in Tasmania has declined steadily over the last decade as a result of industry rationalisation. This suggests that there is, absent of the proposed arrangements, limited scope for new entry into the market in any event.
- 6.23 Consequently, the Commission considers that while collective bargaining between growers and Inghams may increase barriers to new participants entering the industry, such barriers are not increased to such an extent as a result of the proposed arrangements to materially impact on new entry to the market.
- 6.24 Further, the Commission notes that to the extent that collective bargaining between growers and Inghams does increase barriers to new participants entering the

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<sup>11</sup> Weight of chickens that are live at the time of collection by Inghams (subject to conditions).

industry in Tasmania, the scope for product to be imported from mainland states limits the extent to which any increase barriers to new entry would generate any anti-competitive detriment.

### *Conclusion*

- 6.25 The Commission considers that any collectively negotiated agreement between Inghams and its contract growers has the potential to result in some small lessening of competition. However, for the reasons outlined above, the Commission considers that the proposed arrangements will not, in practice, result in any significant anti-competitive detriment.
- 6.26 The Commission considers the combined effect of the growers' option to negotiate individual contracts, increasing competition from mainland states, the growing fee constituting only a small percentage of the total retail price and the pressure from downstream purchases mitigates the potential anti-competitive effects of collectively negotiated terms and conditions, including fees. In addition, the Commission considers that the considerable lack of bargaining power of individual growers means competition between them is not vigorous in any event even without the proposed arrangements.

### **Public benefit**

- 6.27 The Applicants claim that continued collective negotiation by growers will result in a number of specific benefits to the public. The Commission's assessment of the public benefit claims made by the Applicants is discussed below.

*A reduction in transaction costs for growers and processors; especially negotiation costs.*

In considering the related South Australian and Victorian applications, and the original Tasmanian application, the Commission noted that there are transaction costs associated with using the market as a mechanism for trade, and that these costs are likely to be lower in negotiating and implementing a collective bargaining agreement involving only a single negotiating process than where a processor must negotiate and implement agreements with each grower.

In considering the original application for authorisation for Tasmanian growers to collectively bargain, the Commission accepted the submissions of Inghams and growers that many growers do not have the expertise, experience or confidence to successfully negotiate equitable contracts individually with Inghams and that collective negotiation would allow growers and Inghams to avoid unnecessary duplication of legal fees, specialist consultant fees and time.

The Commission remains of the view expressed in its determination in relation to the original application for authorisation that the proposed collective bargaining arrangements are likely to reduce transaction costs compared to a situation where each grower individually negotiates a contract with Inghams.

Further, the Commission considers that, given the competitive pressures to which the chicken processors and growers are subjected from retail and fast food chains, they would be likely to be forced to pass on some of the reduction in costs in the form of lower prices. Therefore, the Commission accepts that a public benefit is likely to arise from transaction cost savings in this instance.

*Maintaining a more equitable bargaining position for growers which, inter alia, mitigates the argument for regulation.*

In considering past applications for authorisation, the Commission has recognised that an inequality of bargaining power exists between chicken growers and processors. Factors such as the capital investment required by growers, the significant sunk costs they incur and the limited substitutability of their growing infrastructure mean that they are unable to switch to supplying different services in response to variations in price. Additionally, processors tend to be large national vertically integrated companies who own and control a majority of the inputs to the production process. In Tasmania this inequality is exacerbated by Inghams being the sole processor to whom growers are able to contract.

The Commission considers that the proposed arrangements go some way towards redressing the imbalance in bargaining power between Inghams and its growers.

The Commission also agrees with the argument advanced by the Applicants that redressing this imbalance in bargaining power may mitigate arguments for industry regulation. Such arguments are generally based on the contention that the bargaining power imbalance between processors and growers is so great that regulation, and in particular, regulating growing fees, is necessary to ensure an equitable and sustainable price is paid to growers for their services.

However, it is not the Commission's role to determine whether government regulation of the Tasmanian chicken meat industry, or indeed any other industry, is in the public interest. The Commission's role in this matter is limited by law to considering the application before it.

Whether regulation of the industry is likely to be in the public interest is a matter for the Tasmanian government. Given this, the Commission is not satisfied that mitigating the need for government regulation of the industry in itself constitutes a public benefit.

*A more efficient, effective and timely industry response mechanism to safety, environmental and planning issues that impact the industry.*

The Commission did not receive any submissions on this public benefit during the consultation process of the current application nor was the claim expanded on by the Applicants.

In previous related determinations the Commission has noted that the inclusion of provisions addressing issues such as safety, the environment and planning in grower contracts is not necessarily dependant on the collective bargaining arrangement. Where there is a wish to incorporate such issues into grower

contracts, the Commission considers that this is equally capable of being achieved through individually negotiated contracts.

More generally, to the extent that these issues arise, they are capable of being dealt with through industry dissemination of information via publications, seminars and meetings without the need for the type of collective bargaining arrangement proposed in the current application.

Consequently, the Commission does not accept these as public benefits resulting from the arrangements for which authorisation is sought.

*Greater industrial harmony and productivity due to the existence of an agreed conflict resolution and mediation process.*

The inclusion of a fair and equitable dispute resolution process in any collectively negotiated agreement is likely to be beneficial to all parties to the agreement. However, the same is also true of many of the other, often essential, terms and conditions of any commercially negotiated agreement (for example provisions regarding price and other terms of supply). The mere inclusion of a dispute resolution process in a collectively negotiated agreement does not necessarily in itself generate a public benefit.

Rather, like many other terms and conditions of any commercial agreement, it serves to provide for a workable set of commercial arrangements between the parties to the agreement. Whether such dispute resolution processes are formalised within the terms of the agreement is essentially a commercial matter for the parties to the agreement.

The Commission is not satisfied that the specific dispute resolution mechanism in respect of the proposed arrangements will provide for greater industrial harmony and productivity by formalising an agreed conflict resolution and mediation process. Indeed, the Commission notes the submission of the Tasmanian Department of Primary Industries, Water and Environment that the dispute resolution process does not contain clear obligations on both parties with respect to such matters.

In any event, regardless of the effectiveness or otherwise of the dispute resolution mechanism, the Commission has received no evidence which would suggest to it that there is currently any problems with respect to industrial harmony within the Tasmanian chicken meat industry. In this respect, the Commission notes the following comment of the Australian Competition Tribunal:

...in order...to accept that a public benefit exists, the evidence must clearly establish that the granting of authorisation will lead to significantly greater industrial harmony in the future than a likely alternative<sup>12</sup>.

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<sup>12</sup> Re Lamont (1990) ATPR 41-035 at 52525

Even presuming that the dispute resolution mechanism is an effective means of ensuring industrial harmony, for the Commission to consider this to be a public benefit it would require some evidence of existing industrial problems within the industry, or a realistic potential for such problems to arise in the future, and that the dispute resolution mechanism would contribute to overcoming such problems.

*Providing incentives for more efficient growers which in turn creates a more competitive growing environment.*

Having incentives for efficient growers built into contracts is likely to create a more competitive growing environment than having a flat rate fee for all growers.

As noted at paragraph 6.25, the proposed growing agreements contain provisions, including a Pool Payment System and Efficiency Rating System, which the Commission considers provide significant incentives for growers to compete with one another and to continue improving and modernising their businesses.

However, the Commission does not consider that incorporating such provisions into growing contracts is dependent on growers collectively bargaining with Inghams. Such provisions are equally able, if not more so, to be incorporated into contracts under a system of individually negotiated agreements.

*A more competitive Tasmanian industry which is better able to compete with domestic and foreign competition.*

The Commission notes that the Tasmania industry is subject to increasing competition from, in particular, Victorian and South Australian processors and growers. The Commission considers that the proposed arrangement may generate some, small, improvement in the competitiveness of the Tasmania chicken meat growing industry. Specifically, as noted above, the Commission considers that collective bargaining by growers with Inghams will generate some transaction cost savings compared to a situation where each grower individually negotiates their own contract.

The Commission considers that any improvement in the competitiveness of the Tasmanian industry, which would be likely to be reflected in lower prices and higher quality of service, would be a public benefit. However, as noted above, the Commission does not consider that the proposed arrangements are likely to impact significantly on the competitiveness of the Tasmanian industry. Therefore, the Commission accepts, but does not place great weight, on improving the competitiveness of the industry as a public benefit stemming from the proposed arrangements.

### *Conclusion*

- 6.28 For the reason outlined above, the Commission considers that there are likely to be public benefits arising from the proposed arrangements. In particular, the Commission considers that the arrangements provide a public benefit by facilitating a reduction in transaction costs compared to a situation where growers individually negotiate a contract. The Commission considers that these cost savings

are likely to be passed on to consumers, at least, in part, given the competitive pressures to which Inghams and its growers are subject from retailers and fast food chains.

### **Balance of Public Benefit and Anti-Competitive Detriment**

- 6.29 The Commission considers the potential anti-competitive detriment of the arrangements to be negligible.
- 6.30 The Commission considers the combined effect of the growers option to negotiate individual contracts, increasing competition from mainland states, the growing fee constituting only a small percentage of the total retail price and the pressure from downstream purchases mitigates the potential anti-competitive effects of collectively negotiated terms and conditions, including fees.
- 6.31 The Commission accepts there are likely to be public benefits arising from the proposed arrangements, most significantly, the reduction in transaction costs compared to a situation where growers individually negotiate contracts. The Commission considers that savings from this reduction are likely to be passed on in the form of lower prices due to competitive pressures from, in particular, large retailers and fast food chains.
- 6.32 On balance, after considering the submissions made by Inghams and interested parties and other relevant information, the Commission considers that the public benefits likely to result from the arrangements will outweigh the anti-competitive detriment.
- 6.33 Subsequent to the Commission issuing the draft determination, the applicants indicated that there would need to be a period during which there was sufficient time for negotiations between the growers and Inghams prior to a contract (likely to be five years) being entered in to.
- 6.34 The Commission considers that by authorising for a period of six years, this provides sufficient time for the making of the arrangements and the giving effect to them (in the form of contracts between Inghams and the growers) for a period of five years.
- 6.35 The Commission therefore proposes to grant authorisation for a period of six years. Authorising arrangements for a limited period allows the Commission an opportunity to assess whether the public benefits upon which its decision was based actually eventuate in practice and the appropriateness of the authorisation in the market environment as it exist at the time authorisation expires.
- 6.36 In addition, the Commission may review the authorisation, prior to the expiry of the authorisation, if there has been a material change of circumstances since the authorisation was granted.

## **7. Determination – application for revocation & substitution**

### *The Application*

- 7.1 On 17 March 1999, Authorisation A90659 was granted to Inghams Enterprises Pty Ltd under subsection 88(1) of the Act, for itself and on behalf of its growers, to make and give effect to a contract, arrangement or understanding which may have the purpose or effect of substantially lessening competition, within the meaning of section 45 of the Act.
- 7.2 The application related primarily to the Broiler Chicken Growing Agreement (the Growing Agreement), the terms and conditions of which were to be jointly negotiated by the contract growers with Inghams.
- 7.3 On 8 December 2003, Inghams lodged an application under section 91C of the *Trade Practices Act 1974* for a revocation and substitution with authorisation A90888. The substituted authorisation sought is essentially the same as A90659 except for its expiry date.
- 7.4 Interim authorisation was granted to the application on 17 December 2003, pending Commission consideration of the application.

### *The Statutory Test*

- 7.5 Pursuant to section 91C (7) of the Act, and for the reasons outlined in Part 6 of this determination, the Commission is satisfied that the proposed revocation and substitution of Authorisation A90888 is likely to result in public benefits that outweigh the public detriment constituted by any lessening of competition that would be likely to result from the arrangements.

### *Conduct Authorised*

- 7.6 Accordingly, the Commission grants the revocation of A90659 and its substitution by A90888 under the Act and the Competition Code for a period of six years.

### *The effective date of determination*

- 7.7 This decision is subject to any application to the Australian Competition Tribunal for its review.
- 7.8 This determination is made on 19 May 2004. If no application for review of the determination is made to the Australian Competition Tribunal, it will come into force on 9 June 2004. If an application is made to the Tribunal, the determination will come into force:
- (a) where the application is not withdrawn – on the day on which the Tribunal makes a determination on the review; or
  - (b) where the application is withdrawn – on the day on which the application is withdrawn.

## **Attachment A:        Consenting Growers**

Jim and Lorraine Sharman

Lindsay and Sabine Kingston (Barlou Pty Ltd)

Noel and Patrica White (Ellen Bank Enterprises Pty Ltd)

John and Meryle Heycock

Kaye Triffet and Michael Bevan (K&M Holdings (TAS) Pty Ltd)

William and Faylene Jones

Steven and Karen Saunders

**Attachment B:           The Broiler Chicken Growing Agreement**