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**Australian
Competition &
Consumer
Commission**

Determination

Application for Authorisation

lodged by

Inghams Enterprises Pty Limited

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

Date: 17 March 1999

Authorisation No: A90659

Commissioners:

File No: CA98/9

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Summary

On 28 May 1998, Inghams Enterprises Pty Limited (Inghams), for itself and on behalf of its contract growers in Tasmania, lodged an application for authorisation (A90659) with the Australian Competition and Consumer Commission. Authorisation was sought 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 Trade Practices Act.

In particular, the application relates to a proposed Broiler Chicken Growing Agreement (the Growing Agreement), the terms and conditions of which will be jointly negotiated by the contract growers with Inghams. The Growing Agreement provides for a standard fee payable to contract growers each growing cycle. This fee is based on the concept of a 'model farm', where the actual fee paid to each grower depends on their efficiency relative to other contract growers. The Growing Agreement provides that the standard fee will be reviewed by Inghams and representatives of the growers every six months. Contract growers will have the option of negotiating individually with Inghams if they do not wish to be part of the collective negotiation process.

A code of practice for negotiations between Inghams and its contract growers is attached to the Growing Agreement. The code of practice governs issues pertaining to the negotiations between Inghams and its contract growers and is part of the collective negotiation process for which authorisation is sought.

While the Commission found that the proposed collective arrangements may reduce the scope for competition over rates of payment and other contract terms and conditions between growers, the Commission also found that public benefits would flow from the proposed arrangements. In particular, the Commission found that there is public benefit both in terms of efficiency and equity considerations in providing growers with greater equality in the bargaining process. There is also likely to be a reduction in costs for both growers and Inghams as a result of collective negotiation. The competitive pressure provided by chicken retailers is likely to force Inghams to pass on some of the reduction in costs to consumers.

The Commission concluded that the public benefits likely to result from the arrangements would outweigh the anti-competitive detriment.

On 10 February 1999 the Commission issued a draft determination proposing, subject to any pre-decision conference that may be requested, to grant authorisation until 31 December 2002. The Tasmanian Chicken Growers Association initially requested a pre-decision conference, however, it later withdrew its request and sought to rely on a further submission made in relation to the draft determination.

Inghams also lodged a further submission requesting the Commission to extend the authorisation period to 31 December 2003 as contracts had not yet been signed and would be backdated to commence on 1 January 1999 for a five year period.

Consequently, the Commission grants authorisation to the arrangements the subject of application A90659 until 31 December 2003.

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1. Introduction

- 1.1 On 28 May 1998, Inghams Enterprises Pty Limited (Inghams), for itself and on behalf of its contract growers in Tasmania, lodged an application for authorisation (A90659) with the Australian Competition and Consumer Commission (the Commission). The application was made under subsection 88(1) of the Trade Practices Act (the Act) for authorisation 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 has not been made in relation to conduct which may constitute an exclusionary provision within the meaning of section 45 of the Act.
- 1.2 The application relates to a proposed Broiler Chicken Growing Agreement (the Growing Agreement), the terms and conditions of which will be jointly negotiated by the contract growers with Inghams. The Growing Agreement provides for a standard fee payable to contract growers each growing cycle. This fee is based upon the concept of a 'model farm' where the fee received by a particular grower is determined by the efficiency of that grower, measured by conversion of feed (the most expensive input) to chicken meat, compared with the efficiency of other growers in the pool. The determination of the standard fee is agreed between Inghams and its contract growers. Inghams proposes to meet representatives of the contract growers every six months to review the standard fee.
- 1.3 A code of practice for negotiations between Inghams and the contract growers is attached to the Growing Agreement. The code of practice governs issues pertaining to negotiations between Inghams and its contract growers. Specifically, it covers the appointment and election of grower representatives, the procedures for meetings between grower representatives and Inghams, the duties of elected representatives, mechanisms for dispute resolution and the handling of recommendations made by representatives. The code of practice is part of the collective negotiation process for which authorisation is sought.
- 1.4 Inghams initially requested that the Commission grant interim authorisation to its application to enable it and its growers to continue negotiations on contract terms and conditions including model and standard fees and efficiency and pooling systems which were to take effect from 1 July 1998. This request was subsequently withdrawn and the Commission understands that Inghams has been dealing with its contract growers on an individual basis and the standard fee has not been negotiated.
- 1.5 On 10 February 1999, the Commission issued a draft determination proposing to grant authorisation until 31 December 2002 to apply to the current term of the proposed Growing Agreement. Authorisation does not apply to any new Agreement entered into and/or given effect to beyond 31 December 2002. The authorisation the Commission proposed to grant was subject to any pre-decision conference requested pursuant to section 90A of the Act.
- 1.6 The Tasmanian Chicken Growers Association (TCGA) initially requested the Commission to hold a pre-decision conference, however, this request was

subsequently withdrawn. An outline of the submission made by the TCGA in response to the Commission's draft determination is at section 6 of this determination.

Related authorisations

- 1.7 The application lodged by Inghams to apply to its contract growers in Tasmania is in substantially the same form as application A90595 lodged by Inghams in relation to collective negotiations of chicken growers' contracts and a company code of practice to apply in South Australia. The Commission granted authorisation to Inghams in respect of application A90595 on 9 April 1997.
- 1.8 On 20 May 1998, the Commission also granted authorisation (A30183) to Steggles Limited (Steggles) in relation to the collective negotiations involving chicken growers contracted with Steggles in South Australia.
- 1.9 These applications by Inghams and Steggles in respect of their South Australian operations arose following the decision by the South Australian Government to deregulate the poultry meat industry in that state. In both applications the parties argued that authorisation of the collective negotiations would, among other things, provide a smooth transition from a regulated to a deregulated environment.
- 1.10 Although there are similarities between these earlier applications relating to South Australia and the application by Inghams to apply in Tasmania, many of the issues raised in the current application involve different considerations.

2. The chicken meat industry

Processing

- 2.1 The Australian chicken meat industry has grown rapidly over the last 30 years with the per capita consumption of chicken meat now only exceeded by consumption of beef. In 1996/97 production of chicken meat was estimated to reach approximately 475,000 tonnes from 332 million birds, at an average dressed weight of 1.45 kg each.¹ Retail sales of poultry products are currently estimated to reach \$2 billion annually.
- 2.2 The poultry meat industry is predominantly geared to the domestic market with only 1.9% of dressed poultry (or approximately 9,800 tonnes) currently exported.²
- 2.3 The major processors in Australia are Inghams and Steggles (a subsidiary of Goodman Fielder Ltd) who together process approximately 70% of all broiler chickens marketed in Australia. Inghams and Steggles are vertically integrated companies operating in all States except Tasmania where Inghams is the only major processor.
- 2.4 The balance of production is shared among several smaller processors including Bartter Enterprises and Baiada operating in NSW; Eatmore, Marven and Hazeldine in Victoria; Golden Cockerel in Queensland; and Joe's Poultry in SA.
- 2.5 Production of chicken meat is a year-round activity. The major costs involved in producing a live broiler chicken are the cost of producing the day old chick (22% of the total cost), the growing fee (17% - incorporating farm labour, energy, return on capital and bedding costs) and feed costs (54%).³
- 2.6 Broiler production (growing and processing) is located relatively close to the areas of consumption. Besides the main areas around the capital cities, there is substantial production near Tamworth and Newcastle in NSW, Geelong and Bendigo in Victoria, and Murray Bridge in South Australia.

Growing

- 2.7 Chicken growing occupies relatively small areas in comparison to conventional farming. Broiler chickens are raised from hatchling to broiler stage (over a period of seven to eight weeks) in shed buildings designed to house approximately 20,000 broiler chickens. The usual shedding arrangement allows for an initial area at one end of the shed to house the chick hatchlings in one dense mass, confined by a curtain and heated from overhead. As the chickens grow the curtain is moved gradually further

¹ National Farmers' Federation, 'Australian Agriculture', Sixth Edition 1997/98, page 150

² Ibid.

³ Ibid.

down the shed and less heating is required as the growing chickens generate more of their own body heat.

2.8 Farm techniques (as with chicken processing) have undergone a continuous process of rationalisation, re-structuring and concentration into larger and more efficient operational units. In particular, specialisation and improvements in technology have increased farm throughput yielding large efficiency gains to the industry and consumers.

2.9 Throughout Australia approximately 850 growers produce about 80% of chickens under contract to processing companies. The balance is produced by a small number of large company-owned farms. The contract system of chicken growing has been an intrinsic part of the chicken meat industry for 25 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 between one and five 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 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 totally non-portable. Thus, a reasonable degree of stability and predictability in growing arrangements is required to ensure future investment.

2.10 The grower's position has changed in the past 25 years from that of an independent farmer with a commodity to sell, to a relatively powerless player in a vertically integrated industry where processors maintain control of breeding stock, processing and marketing of chicken meat.

Retail

- 2.11 Chicken is marketed throughout Australia by Inghams and Steggles under various brand names. Smaller processors also use their own particular brand or in some cases without any brand identification. Generally, the chicken industry has not undertaken generic promotion of its products through the media. However, individual processors are endeavouring to promote chicken consumption with the introduction of more varied packaging and processing methods and specific brand promotion.
- 2.12 Despite the dominance of Inghams and Steggles, the real retail price of chicken has declined on average by 4.7% per year over the last 15 years, largely due to efficiency gains in the industry⁴. This compares with declines of 2.4% for pork, 1.6% for lamb, and 1.3% for beef.
- 2.13 Approximately 75% of chicken meat is sold through retail outlets. The remainder is sold through the food service industry. Of the chicken sold through retail outlets approximately 45% is through supermarkets, 45% through speciality chicken shops and butchers and the remainder by delicatessens, department stores and other outlets. The majority (85%) of chicken meat sold through retail outlets is fresh rather than frozen product.
- 2.14 Of the 25% of the chicken meat sold through the food service industry, approximately half is sold through fast food chains with the remainder through outlets such as restaurants and hotels.

The Tasmanian chicken meat industry

- 2.15 Inghams is the only major chicken meat processor operating in Tasmania. Inghams estimate that it produces between 80% – 90% of chicken consumed in Tasmania. There is also one other small processor operating in Tasmania – Nichols Poultry. The balance is supplied from time to time by processors operating mainly in Victoria, including Steggles, Marven Poultry Pty Limited and Eatmore Poultry Pty Limited.
- 2.16 At the time of lodging this application, Inghams had 15 contract growers. Inghams advised that negotiations were underway with growers to increase farm sizes and upgrade shedding and facilities, which will result in a decrease in the number of its contracted growers over time. Inghams advised that of its 15 contracted growers only 4 farms met its standards as set out in the Growing Agreement. Inghams estimated that some of its growers would need to spend up to \$250,000 to meet the minimum standards it required. In addition to this amount contract growers are required to continually maintain their farms and shedding to at least the minimum standard.
- 2.17 Inghams advise that as a result of this rationalisation process it currently has 11 contract growers.

⁴ The Australian Chicken Meat Industry International Benchmarking Study' May 1997, page 3

- 2.18 Inghams estimate that its contract growers produce approximately 59 per cent of its live birds with the balance grown on company-owned farms.
- 2.19 There is no specific legislation covering the chicken meat industry in Tasmania. In the past, negotiations of contract growers' terms and conditions (including fees) have been conducted between representatives of the growers through the Tasmanian Chicken Growers Association and Inghams. Inghams advise that this position is similar to that which has been operating in all states for many years although the mainland states have operated under legislation

3. The Growing Agreement

- 3.1 Inghams' application for authorisation relates to the Broiler Chicken Growing Agreement which it proposes to enter into which each of its contracted growers in Tasmania. The contract growers will negotiate jointly with Inghams on terms and conditions, including fees, that will be contained in the Growing Agreement. A copy of the proposed Growing Agreement is on the Commission's public register. An outline of the main features of the Growing Agreement is set out below.
- 3.2 The Growing Agreement shall expire on 31 December 2002 subject to provisions providing for early termination. The parties are able to enter into a new Agreement within a minimum of 12 months prior to the date of expiration of the Growing Agreement.

Inghams' obligations

- 3.3 The Growing Agreement provides, among other things, that Inghams shall:
- Supply and deliver broiler chickens to the grower for raising to a stage determined by Inghams to be marketable;
 - Provide the grower with all feed, medication and vaccines necessary for the proper raising by the grower of the chickens supplied and delivered by Inghams;
 - Provide at its own expense advice to the grower in the raising of broiler chickens supplied by Inghams;
 - Provide at its own expense all transport required for delivery to the grower of all the goods and chickens supplied by Inghams;
 - Provide at its own expense all transport necessary for the collection of broiler chickens from the grower's premises when such broiler chickens have reached a stage of development determined by Inghams to be marketable and catch and load the broiler chickens onto the transport;
 - Other than when it is beyond the control of Inghams, give the grower reasonable notice of both the time and date of delivery and collection of the broiler chickens supplied; and
 - Render to the grower all reasonable assistance for the disposal of dead birds following a catastrophe that is outside the grower's control or when ongoing disease mortality of the flock exceeds 10%.

Growers obligations

3.4 The Growing Agreement provides, among other things, that the grower shall:

- Provide, make available, and where necessary install, facilities, services and management in accordance with the minimum standards as shall be commensurate with the model or as advised from time to time by Inghams as discussed with Grower Delegates including:
 - land with suitable drainage, all weather roads and vehicle access to shedding;
 - sheds suitable for the raising of broiler chickens together with such structures and fittings;
 - the necessary quantity and quality of water for the proper and efficient rearing of broiler chickens;
 - the necessary electric power and gas or other heating fuel for the proper and efficient rearing of broiler chickens; and
 - such labour, materials and management as are necessary for the proper and efficient care of broiler chickens.
- Prepare the sheds and have them in readiness of the reception of broiler chickens delivered by Inghams and be present at the time of such deliveries and place them in the prepared brooding areas;
- Comply with the reasonable advice of Inghams or its representative in general shed preparation, litter replacement, culling and in the raising, general husbandry, disease prevention practices and management in relation to the broiler chickens provided by Inghams;
- Provide progressive information, including flock weights and mortality rates, during the growing period as may reasonably be requested by Inghams;
- Not permit or allow in the grower's building(s) housing the broiler chickens any other poultry nor allow other livestock to be or remain within the vicinity of such building(s), nor allow persons access to the broiler sheds unaccompanied and without approval from Inghams;
- Effect and maintain policies of insurance providing statutory and common law cover in respect of employees; cover against fire damage to the grower's buildings and equipment at current replacement value; and public liability policies to the amount of not less than \$5 million; and
- Comply with the reasonable advice of Inghams in relation to shedding and equipment maintenance and/or replacement. Demonstrate at all times a high standard of external housekeeping in the immediate vicinity of shedding, control rooms, silos, water tanks, etc in line with Inghams required farming standards which shall be discussed with Grower Delegates.

Terms of payment

- 3.5 Under the Growing Agreement Inghams will pay contract growers a standard fee at the end of the growing cycle. The standard fee is to be determined by negotiation based on a model farm concept with cost criteria based upon the farm meeting minimum standards and operating on the most efficient basis. The Growing Agreement provides for the model to be reviewed taking into account such factors as the capital values for land and improvements, return on investment, and grower costs including wages, fuel and repairs and maintenance.
- 3.6 The final payment received by growers is determined under a pool system that ranks growers and allocates differential payments between growers in the pool on the basis of the relative performance and/or cost of each batch. The pool consists of all Inghams' contract growers supplying chickens in a particular batch, subject to the ability to terminate arrangements with growers who persistently fall below a minimum efficiency level. The fee received by a particular grower in the pool is based on the efficiency of that grower, measured by the conversion of feed to chicken meat, compared with the efficiency of other growers in the pool. As a consequence the more efficient growers receive a higher payment than the less efficient growers.
- 3.7 If a grower's efficiency over five batches averages less than those specified the contract with the grower may be terminated by Inghams by giving 7 days written notice. A grower receiving a notice of termination may, subject to the agreement of Inghams, assign his rights and obligations under the Growing Agreement. Inghams will not unreasonably withhold such approval notwithstanding that Inghams may request improvements to the premises or property prior to granting approval of assignment.
- 3.8 The Agreement provides for the standard fee to be reviewed every 6 months. If the parties are unable to agree on a revised standard fee within 90 working days of either party commencing the review process, either party may regard the matter as in dispute to be dealt with in accordance with disputes/mediation procedures set out in the Growing Agreement.

Disputes/mediation procedures

- 3.9 Disputes arising under the Growing Agreement, other than in respect of the rate of remuneration payable, are to be settled by discussion and conciliation through the appointed Growers Delegates in accordance with the code of practice. Failing agreement the dispute can be referred to the Australian Commercial Disputes Centre (ACDC) for mediation.
- 3.10 If a dispute arises out of or relates to the rate of remuneration payable the parties agree to first endeavour to settle the dispute by discussion and conciliation through the appointed Grower Delegates and failing agreement by mediation administered by the ACDC. In the event that the dispute has not been settled after the appointment of the mediator the dispute shall be submitted to expert determination administered by the ACDC. The determination of the expert is to be final and binding.

3.11 The costs incurred by the parties involved in mediation and/or expert determination are to be decided by the mediator or expert as applicable.

Code of practice

3.12 Annexed to the Growing Agreement is a code of practice governing negotiations between Inghams and its contract growers. The code of practice governs the election process and duties of three Grower Delegates who have the role of negotiating with Inghams' representative on the terms and conditions of the Growing Agreement and any matters arising therefrom, on behalf of all participating contract growers.

3.13 The functions of the Grower Delegates and Inghams' representative (the Committee) are to:

- negotiate the average price to be paid to growers and the procedures for the regular updating of such prices;
- negotiate change to operational procedures desired by either the growers or Inghams;
- act as mediator for the resolution of disputes between individual growers and Inghams; and
- make determinations or take action on any other matters the Committee agree is in the best interest of the grower group.

3.14 Recommendations of the Committee are accepted by a simple majority vote of growers. A contract grower who does not wish to be bound by the majority decision is entitled to terminate their representation and negotiate directly with Inghams.

3.15 A contract grower who has withdrawn from the collective arrangements provided by the Code becomes a non-participating grower and is able to negotiate directly with Inghams on any matters covered by the Code. A non-participating grower does not participate in pooling or other collective payments and their fee will be adjusted for performance on a basis negotiated separately with Inghams. A non-participating grower may apply to the Committee at any time to be re-instated as a participating grower. Such an application may be approved or rejected by the Committee.

4. The statutory test

- 4.1 Application A90659 was made under sub-section 88(1) of the Act in respect of arrangements which may substantially lessen competition. The Act provides that the Commission shall only grant authorisation if the applicant satisfies the relevant test in sub-section 90(6) and 90(7) of the Act.
- 4.2 Relevantly, sub-sections 90(6) and 90(7) provide that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:
- the provisions of the subject arrangements have resulted, or are likely to result, in a benefit to the public; and
 - that benefit would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from the arrangements.
- 4.3 In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements, the public benefits arising from the arrangements, and then weigh the two to determine which is the greater. Should the public benefits or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation or grant authorisation subject to conditions.
- 4.4 If this is not the case, the Commission may refuse authorisation 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.

5. Submissions

Submission by Inghams

- 5.1 A copy of the submission by Inghams in support of its application is on the public register maintained by the Commission. The main issues raised in the submission are outlined below.
- 5.2 Currently in Tasmania there is no specific legislation covering the chicken meat industry. Negotiations of contracts with growers have in the past been conducted by representatives of the growers through the Tasmanian Chicken Growers Association (TCGA) and Inghams. This is a position which is similar to that operating in all States for many years, although collective negotiations in the mainland states operated largely under legislation. Inghams and its growers have since become aware that the joint negotiation through delegates may constitute a breach of the Trade Practices Act and have hence lodged this application for authorisation.
- 5.3 Inghams submit that it is in the best interest of the industry to have in place a procedure for the joint negotiation of contract terms and conditions. Inghams believe that although there is no legislation in Tasmania, it and its growers should not have to operate under different procedures to those on the mainland.
- 5.4 Inghams believe that a collective negotiation system will, at the present time, provide the most efficient results and seeks the same system on the same basis as that authorised by the Commission to apply in South Australia.
- 5.5 Inghams advise that its contract growers support collective negotiations for the following reasons:
- they are uncomfortable dealing individually with a large processor for such reasons as lack of negotiating expertise, expense of using advisers, and their concern that they will feel overpowered by the processor; and
 - they also believe the continued operation of a pooling system and the ability to have delegates able to handle day to day operational issues pertaining to the contract will be the most efficient system.
- 5.6 Inghams submit that the public benefits identified in respect of its application for authorisation in South Australia also apply in relation to Tasmania. The public benefits claimed by Inghams in respect of its application for South Australia were as follows:
- the arrangements provide mechanisms that maintain efficiency and competitiveness between growers;
 - collective negotiations will be far cheaper for contract growers than negotiating individually. If growers have to negotiate individually, their legal

costs will increase;

- the ability to negotiate collectively will ensure industry environmental and occupational health and safety issues are quickly and readily understood. This protects growers and their employees and is in the public's best interests; and
- growers do not have the resources or expertise to negotiate with Inghams individually in the same capacity as they would have acting jointly. Acting jointly will ensure a more equitable and harmonious system that can drive efficient and long term growth for the industry.

5.7 Inghams also claimed that the collective arrangements in South Australia would provide additional public benefits in that they would facilitate a smooth transition from a regulated to a deregulated environment. However, this claim is not applicable in respect of Tasmania as there is currently no legislation.

5.8 Inghams submit that the benefits of enabling collective negotiation with its contract growers in Tasmania are particularly evident given Inghams market share in that state and the inability of growers to readily transfer to other processors. As such the countervailing bargaining power justification is substantially stronger in Tasmania.

5.9 Inghams submit that the potential anti-competitive detriment identified in respect of South Australia is also applicable in relation to the proposed arrangements in Tasmania, namely, that collective negotiations may result in a higher average fee paid to growers than that which would arise from individual negotiations with growers. However, Inghams argue that the detrimental impact of the proposed arrangements on the consumer is very low.

5.10 Inghams believe that the public benefits from the conduct will outweigh the public detriments particularly given:

- that joint negotiation is a means of balancing the power between the growers and Inghams;
- the small component the contract growing fee bears to the total cost of production (and therefore retail prices);
- the purchasing/countervailing power of the large buyers such as Woolworths and KFC; and
- the ability for chicken meat to come into Tasmania from Victoria.

Submissions by interested parties

5.11 The Commission sought submissions from a wide range of interested parties in relation to the application for authorisation by Inghams. Set out below is a summary of the issues raised in the submissions received from interested parties. Copies of the non-confidential submissions are on the Commission's public register.

Contract growers – in favour of authorisation

5.12 The majority of submissions received from individual contract growers (5 out of 7) were in favour of the authorisation application lodged by Inghams. The main points raised by growers in support of Inghams' application are:

- Growers will compete in a pool system and the Tasmanian growers pool is one of the more competitive in Australia and has helped make Tasmanian growers the most efficient in Australia.
- Collective negotiation is a cheaper and more equitable means for growers than negotiating individually.
- Many individual growers do not have the expertise to negotiate with Inghams and would have to hire professional assistance for many issues that are normally negotiated for them by association leaders.
- Collective negotiation will help growers as the Tasmanian growers group is small with limited resources or expertise, therefore any professional help can be jointly funded by all growers.
- Many growers are not confident enough to pursue a price review on an individual basis and it has been very difficult not having a price review for the last 4 or 5 years.
- Collective negotiations can assist environmental and safety issues as individual growers will be pressured from Inghams and grower groups to meet standards agreed to by both groups.
- Collective negotiations allow environmental, occupational and safety issues to be addressed more readily.
- It has been very difficult operating without a formal contract particularly in relation to obtaining finance as most lending bodies will not lend money without a written contract.
- It is unlikely authorisation would effect chicken prices in Tasmania or Australia as the growing fee only makes up a small portion of the retail price of a chicken. History has shown that the growing fee in real terms has declined over the past years.
- The capacity for interstate processors to supply the Tasmanian market is a real threat to the Tasmanian industry. As transport facilities improve it is unlikely that Inghams will have a monopoly in Tasmania and therefore they will have to stay competitive to maintain market share.
- Interstate processing companies have the capacity to supply retailers in Tasmania.

Contract growers – against authorisation

5.13 Two growers lodged submissions opposing Inghams application for authorisation. The main points raised in these submissions are outlined below:

- There are six growers affected by Inghams termination of contracts
- Inghams informed the growers that their contract to grow chickens would be terminated but they could continue to grow birds on a batch to batch basis. Once the other farms had built new sheds and expanded capacity Inghams ceased placing any birds with the uncontracted growers. Inghams have used the sacked growers in this way because if they were closed down before the other growers built their new sheds Inghams would have been short of chickens and unable to supply their orders.
- One grower was informed that he must build two new sheds at a cost of \$500,000 otherwise he would only grow for Inghams on a batch to batch basis.
- No meaningful negotiations or concern or consideration was shown by Inghams to growers facing termination of contract.
- The remaining farms that expand will benefit financially from the closure of the six farms, however there has been no equitable compensation to the sacked growers either from the remaining growers by way of purchasing their quotas or from Inghams.
- Inghams' actions have devalued or destroyed the value of their property.
- The Tasmanian Chicken Growers Association did not fight for the growers who were sacked.

Tasmanian Chicken Growers Association

5.14 The Tasmanian Chicken Growers Association (TCGA) is an industry organisation representing growers in Tasmania and it lodged a submission supporting Inghams application.

5.15 The TCGA claim that the structure of the collective arrangements and the pool system will maintain efficiency and competitiveness between growers. It claims that growers do not possess the resources or expertise to effectively negotiate individually with Inghams and the costs involved in individual negotiations are considerable given the unnecessary duplication of legal fees, specialist consultant fees and time.

5.16 The TCGA submit that collective negotiation has no bearing on occupational health, safety and environmental concerns. These areas are dealt with via industry and association dissemination of information via publications and at organised seminars and regular meetings of members and between growers and processor representatives, the structures of which are not affected by the type of contract negotiations.

5.17 The TCGA claim that they do not know without actually engaging in collective

negotiation and the associated price review what affect the authorisation is likely to have on prices for chicken meat in Tasmania. The TCGA advise that the last fee review was in 1993 and grower costs and farm model parameters have changed in that period of time. Some of these factors may individually lead to a fee reduction or a fee increase. Whatever the outcome the growers have suffered with a frozen fee for the last 5 years and a fee that is in reality only a small component of the cost of production of chicken meat. The cost of placing a day old meat chicken on a grower's farm is about 50 cents with the current growing fee being 46.5 cents.

- 5.18 The TCGA considers that the effect of the authorisation on chicken meat prices interstate would be small given that Tasmania's production is a small proportion of national production and that most Tasmanian production is geared to meeting the demands of a local fresh market.
- 5.19 The TCGA submit that difficulties caused by managerial and sales planning together with transport difficulties would prevent interstate based processors from being able to supply with as equal success as local producers the day to day fluctuating demands of the market for fresh cut product. Currently such fluctuations are met by afternoon alterations to livehaul schedules for subsequent morning processing and marketing that day – a response time of less than 24 hours.
- 5.20 The TCGA is supportive of legally enforceable housekeeping rules for the relationship between Inghams and its growers in Tasmania. The TCGA applaud Inghams willingness and good sense in maintaining a view that collective negotiation is the desirable solution to the current conundrum although a solution is only to be had if Inghams continue to display good grace. If they choose to be obtuse prior to entering into a collectively negotiated contract or post contract terms or post the period of currency of any authorisation then there would be little chance growers would be able to achieve anything approaching an equitable solution. In preference the TCGA supports the introduction of State or Federal legislation which forces parties to negotiate and provides for dispute mediation.

Eatmore Poultry Pty Ltd

- 5.21 Eatmore Poultry is a chicken processor based in Victoria. It believes that the arrangements will not result in a lessening of competitiveness between growers. Further, Eatmore Poultry does not consider that the arrangements will have any direct effect on the markets in other states in terms of supply and pricing issues.
- 5.22 Interstate suppliers have supplied, and continue to supply, fresh and frozen chicken meat into Tasmania although, the transport barrier to daily deliveries may constitute an impediment to increasing the competitive level in Tasmania.
- 5.23 Eatmore Poultry see benefits in the arrangements particularly as some growers have poor negotiating skills and are likely to be better served by an elected committee. It will also enable common issues between Inghams and growers to be addressed and acted upon more readily.

6. Draft determination and further submissions

- 6.1 On 10 February 1999 the Commission issued a draft determination proposing, subject to any pre-decision conference requested pursuant to section 90A of the Act, to grant authorisation to Inghams in respect of the proposed Growing Agreement. The authorisation the Commission proposed to grant will apply to other contract growers who become a party to the collective arrangements at a time after the proposed Growing Agreement is made. The Commission also proposed to grant authorisation until 31 December 2002 to apply to the current term of the proposed Growing Agreement. The draft determination proposed that authorisation would not apply to any new Agreement entered into and/or given effect to beyond 31 December 2002.
- 6.2 On 23 February 1999 the TCGA requested the Commission to hold a pre-decision conference in relation to the draft determination. On 4 March 1999 the TCGA withdrew its request for a conference and sought to rely on the points raised in its further submission made in relation to the draft determination. An overview of the points raised by the TCGA is set out at paragraphs 6.4 – 6.6 below.

Further submission by Inghams

- 6.3 Following the Commission's draft determination, Inghams lodged a further submission requesting the Commission to extend the authorisation period to 31 December 2003. Inghams advise that this request is made because contracts have not yet been signed and will be backdated to commence on 1 January 1999 for a five year period. Inghams submit that it is important that the authorisation period be the same as that for the contract.

Further submission by TCGA

- 6.4 The main concern of the TCGA is that the Commission has reached an incorrect assumption that chicken growers will be in a better position to negotiate collectively once the current Growing Agreement expires.
- 6.5 The TCGA claim that the draft determination states that growers, with time, will become more adept at negotiation, however, the TCGA submit that this expectation can not be met without an increase in funds and time available to growers to enable participation in individual negotiations.
- 6.5 The TCGA submit that this is an unreal expectation given the reduced grower numbers, free capital and time – all a result of the forced rationalisation process currently underway.
- 6.6 The TCGA submit that the balance of power between grower and processor will be further weighted in favour of the processor and the opposite should not be placed in the public forum as established fact.

Submission by Tasmanian Minister for Primary Industries, Water and Environment

- 6.7 The Minister indicated that the authorisation will allow both the growers and Inghams to capture efficiencies in the negotiation process and to allow for the continuation of the pool system that encourages competition based on efficient production.
- 6.8 The Minister also indicated that it was his understanding that Inghams intended to lodge a further application for authorisation at the end of the proposed current authorisation period to gain immunity for a further 5 years.

7. Commission consideration

- 7.1 The Commission's consideration of the application is made in accordance with the statutory test outlined in section 4 of this determination.
- 7.2 As required by the test, it is necessary for the Commission to assess the likely benefit and detriment including the effects on competition, resulting from the proposed arrangements.

The relevant market and its features

- 7.3 As noted, the Commission has considered two similar applications for authorisation one lodged by Inghams (A90595) in respect of collective negotiations with its contract growers in South Australia and the other lodged by Steggles (A30183) also in relation to the collective negotiation of its chicken growers' contracts in South Australia.
- 7.4 In considering these applications the Commission concluded that the relevant market was a state based market for the acquisition of broiler chickens from growers by processors and/or the service of growing chickens for processors by growers. In assessing the current application the Commission did not receive any information that would cause it to change this view of the market.
- 7.5 It is relevant to note some of the main features of the market in Tasmania:
- Inghams is the only major processor in Tasmania, therefore growers are unable to switch to another processor and are locked into dealing with Inghams.
 - Inghams' contract growers produce approximately 59% of its live birds with the balance grown on company owned farms.
 - Contract growers, once committed to chicken growing, are unable to use their sheds and farm equipment for other purposes such that substitution is unlikely to include production or growing services relating to other types of poultry or meat.
 - The capital investment of growers in land and shedding is large.
 - Inghams is a large vertically integrated company that maintains control over all stages of the production process namely breeding, egg laying, egg hatching, chicken growing and chicken processing.
 - Given the level of vertical integration within the market 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 the processor.

- The cost of the growing stage of production for chickens accounts for approximately 8.5% of the retail price of a chicken.
- The major buyers of processed chicken in Tasmania are Woolworths (Vos/Puirty) stores and KFC.
- Processed chicken from the mainland states currently constitutes a small percentage of retail sales in Tasmania.

Effect on competition

- 7.6 In general terms, collective bargaining agreements which set uniform rates of pay to the independent contractors covered by the agreement are likely to lessen competition relative to a situation where each of the contractors individually negotiates their own rates of payment. However, the extent of the detriment and the impact on competition will depend upon the specific circumstances involved.
- 7.7 As a consequence of the collective negotiations between Inghams and its contract growers in Tasmania the scope for competition over rates of payment (and other terms and conditions) between growers is reduced.
- 7.8 Inghams has submitted that this may lead to higher fees paid to growers than would be the case if rates were negotiated individually with growers. While this may place upward pressure on retail prices for chicken meat the Commission notes that the growing fee constitutes a small percentage of the total cost of producing the final product. The Commission considers that this is likely to limit any anti-competitive consequences resulting from the collective negotiations on the scope for price competition in the retail market. Further, the competitive pressure provided by chicken retailers, some of which are national operations with significant buying power (such as Woolworths and KFC), should limit Inghams' ability to generate abnormal profits by passing on such price increases.
- 7.9 The reduction in competition arising from the uniform rates of payment to growers is also likely to be minimised by the terms for payment provided under the Growing Agreement itself. As outlined in paragraphs 3.5 to 3.8 above the Growing Agreement includes a variable productivity based fee designed to encourage efficiency amongst contract growers and the ability to terminate arrangements with growers who consistently fall below a minimum efficiency level. Fees are adjusted so that the total amount paid to the grower is the standard fee multiplied by the number of birds with the more efficient growers receiving a higher fee at the expense of those who are less efficient. Inghams advise that the operation of a standard fee based on an efficient costed model farm and a pooling system is a key element towards achieving minimum costs and maintaining competitive efficiency and encourages 'best practice' farming.
- 7.10 The Commission considers that the use of such relative performance standards for the basis of determining growers' fees can provide an incentive to growers that may generate the same efficient outcomes as where growers compete on the basis of price and performance.

- 7.11 The Commission notes it is difficult to enter the chicken industry at the grower level due to the extent of vertical integration; the limited ability of growers to vertically integrate upwards or downwards; capital investment requirements which are tied once committed; and satisfying processor start-up requirements before entering into a growing agreement. These difficulties can be mitigated if a grower enters into an arrangement with a processor. However, entry into the market at the processing level is also difficult, particularly due to the relatively high start-up costs and the uncertainty of gaining both new growers and growers from other processors.
- 7.12 In addition, the Commission is not convinced as to the extent to which interstate processors could supply chicken to the Tasmanian market on a large enough scale so as to provide a competitive force to Inghams in Tasmania. However, the Commission notes that mainland processors currently and consistently supply retailers in Tasmania on a small scale. Indeed the submission from Eatmore Poultry, a Victorian processor, indicates that it and other processors have supplied fresh and frozen chicken meat to Tasmania. Further, as storage and transport facilities continue to improve the barrier faced by mainland processors to supply chicken meat on a greater level may be reduced.
- 7.13 Collective negotiation between Inghams and its growers resulting in agreed fee levels and entry by them into four or five year growing agreements may further reduce the likelihood of new entry or expansion by competing processors in the Tasmanian market.
- 7.14 The Commission notes, however, that the growers have the option of opting out of the collective process to negotiate individually with Inghams or a new entrant. Such termination arrangements may decrease the detrimental effect collective arrangements may have on the likelihood of new entry to the market at the growing and processing level.

Public benefits

- 7.15 Inghams claim that collective negotiations with its contract growers will result in benefits to the public, in particular:
- the arrangements provide mechanisms that maintain efficiency and competitiveness between growers;
 - collective negotiations will be far cheaper for contract growers than negotiating individually. If growers have to negotiate individually, their legal costs will increase;
 - the ability to negotiate collectively will ensure industry environmental and occupational health and safety issues are quickly and readily understood. This protects growers and their employees and is in the public's best interests; and
 - growers do not have the resources or expertise to negotiate with Inghams

individually, in the same capacity as they would have acting jointly. Acting jointly will ensure a more equitable and harmonious system that can drive efficient and long term growth for the industry.

- 7.16 As already noted, the majority of the growers who lodged submissions supported Inghams' application and its public benefit claims. The growers who did not support the application raised their concerns over the effects of the rationalisation process and the lack of consultation and negotiation by Inghams in implementing its strategy. These issues fall outside the scope of the Commission's consideration of the application for authorisation.
- 7.17 The Commission notes that while many similarities exist between Inghams' operations in South Australia and those in Tasmania, there are also a number of factors that are specific to Tasmania which raise different issues for consideration.
- 7.18 The Commission understands that historically there has been no formal contractual agreement for the relationship between Inghams and its growers in Tasmania. Traditionally, this relationship has been subject to a 'gentleman's agreement', albeit collectively negotiated, rather than a formal written agreement.
- 7.19 The proposed Growing Agreement for which authorisation is sought will for the first time reduce the terms and conditions under which growers are contracted by Inghams to a formal written contract. In particular, the Growing Agreement and Code of Conduct identify the cost factors and minimum standards used in the calculation of fees to growers and provides a formal procedure for the review of the standard fee and model farm costings. Where no agreement can be reached there is provision for independent dispute mediation.
- 7.20 The Commission also understands that as part of the rationalisation process and the imposition of minimum standards some farms are required to replace or upgrade their old facilities with new and larger chicken growing sheds which may involve expenditure of up to half a million dollars. The Commission notes the concerns of growers that it is difficult to obtain finance without a formal contract and the guarantee of a continued commercial relationship between the growers and Inghams.
- 7.21 While the benefits of a formal written contract can be achieved without collective negotiation, the Commission notes that since Inghams started dealing with its growers in Tasmania on an individual basis (just prior to this application for authorisation being lodged with the Commission) no contracts or agreements have been negotiated with individual growers. Inghams advise that the reason for this is that most growers are reluctant to negotiate on an individual basis due to a lack of experience, confidence or expertise and as such nothing has happened.
- 7.22 The Commission considers that a number of public benefits are likely to arise from the collective bargaining process involving Inghams and its contract growers in Tasmania.

Inequality in the negotiating process

- 7.23 In considering the related South Australian applications the Commission recognised that an inequality of bargaining power existed between the chicken growers and the processors. A number of factors result in chicken growers being disadvantaged in the negotiating process compared to the chicken processors. For example, the capital investment by growers in land and specialised shedding is large which can necessitate high borrowings and lead to high sunk costs. On the other hand, processors tend to be large vertically integrated companies that own and control virtually all inputs in the production process. This inequality is heightened in Tasmania where Inghams is the dominant processor and growers are not able to switch to another company.
- 7.24 In the past the Commission has recognised that where primary producers sell their products to one (or a few) powerful processing or marketing corporations the bargaining power of the primary producers will be reasonably enhanced if they come together to negotiate relevant terms and conditions with the corporation which they supply. Further, the Commission recognises that a market in which there is the potential for some participants to be treated inequitably, or to be exploited, is likely to operate less efficiently than one in which there is equality among participants. In particular, some balance in bargaining power between parties to a transaction is necessary to ensure that both parties have incentives to make optimal investments in capital and resources that are specific to the relationship.
- 7.25 The Commission accepts that the proposed arrangements for which authorisation is sought have the potential to redress the inequality in the bargaining process for growers and considers this constitutes a public benefit both in terms of equity and efficiency objectives. Given the buying power of the large chicken retailers it is unlikely that the market conditions will enable Inghams and its contract growers to jointly exercise market power.

Reduced transaction costs

- 7.26 The Commission also accepts that a reduction in costs would arise for both Inghams and its growers as a result of the collective negotiation of contracts. Transaction costs from negotiating and implementing a collective bargaining agreement involving only a single negotiation process are likely to be lower than where Inghams must negotiate and implement a different agreement with each grower.
- 7.27 Submissions by both Inghams and the growers claim that many growers do not have the expertise, experience or confidence to successfully negotiate equitable contracts individually with Inghams and collective negotiation allows them to avoid the unnecessary duplication of legal fees, specialist consultant fees and time.
- 7.28 In considering the related South Australian applications the Commission noted that the savings in transaction costs primarily constitute a private benefit to the processor and its growers. However, the Commission considered that the retail pressure to which the chicken processors are subjected are likely to force them to pass on some of the reduction in costs to consumers in the form of lower retail prices. Therefore the Commission accepted that a public benefit arises from a reduction in transaction costs.

Environmental and occupational health and safety issues

- 7.29 Inghams submit that collective negotiation will ensure that industry environmental and occupational health and safety issues are quickly and readily understood. Inghams claim that this protects growers and their employees and is in the public's best interests.
- 7.30 Submissions received by growers and the TCGA were mixed on this point. The Commission tends to agree with the comments made by the TCGA namely, that collective negotiation has no bearing on occupational health, safety and environmental concerns. These issues are considered to be important but are dealt with via industry and association dissemination of information via publications, seminars and meetings rather than the type of contract negotiations conducted. In these circumstances, the Commission does not accept this public benefit claim.

Balance of public benefit and public detriment

- 7.31 The Commission considers that although the collective negotiation of growers contracts, including the setting of fees, may result in a lessening of competition relative to a situation where contracts are individually negotiated, there are a number of factors which limit the detrimental effect on competition, including the use of a productivity based growing fee and the fact that the growing fee constitutes a small proportion of the total cost of producing chicken.
- 7.32 The Commission accepts that there are several public benefits arising from the proposed arrangements. In particular, the Commission considers there is public benefit both in terms of efficiency and equity considerations in providing growers with greater equality in the bargaining process. There is also likely to be a reduction in costs for both growers and Inghams as a result of collective negotiation. The competitive pressure provided by chicken retailers is likely to force Inghams to pass on some of the reduction in costs to consumers.
- 7.33 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.
- 7.34 The Commission notes that the proposed Growing Agreement covers issues that were not part of the previous 'gentleman's agreement', including provisions for a formal review process and dispute resolution mechanisms. It is likely that both Inghams and its growers will need time to gain experience in operating under these new expanded arrangements. In addition, the Commission notes that the current rationalisation process in Tasmania may result in fewer but larger growers.
- 7.35 In these circumstances the Commission considers that an authorisation granted until 31 December 2003, to cover the current term of the Growing Agreement, would be appropriate. It is noted that the Growing Agreement includes provision for the parties to enter into a new Agreement within a minimum of 12 months prior to the date of the expiration of the Growing Agreement (see paragraph 3.2 above). Should Inghams and the growers wish to retain the benefits of authorisation (ie immunity from Court

action under the Act) in respect of entering into and giving effect to a new Agreement, a fresh application for authorisation would need to be considered by the Commission. Any new application would be assessed by the Commission in terms of the circumstances at the time.

8. Determination

8.1 For the reasons outlined in section 7 of this determination, the Commission concludes that in all the circumstances the arrangements for which Inghams has sought authorisation:

- are likely to result in a benefit to the public; and that benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the arrangements.

8.2 The Commission therefore grants authorisation to Inghams in respect of the arrangements the subject of application for authorisation A90659.

8.3 The authorisation the Commission grants to Inghams will apply to other contract growers who become a party to the collective arrangements at a time after the proposed Growing Agreement is made.

8.4 The Commission grants authorisation until 31 December 2003 to apply to the current term of the proposed Growing Agreement. Authorisation does not apply to any new Agreement entered into and/or given effect to beyond 31 December 2003.

8.5 This determination is made on 17 March 1999. If no application for a review of this determination is made to the Australian Competition Tribunal, it will come into force on 8 April 1999. If an application for review is made to the Tribunal, the determination will come into force:

- where the application is not withdrawn – on the day on which the Tribunal makes a determination on the review; or
- where the application is withdrawn – on the day on which the application is withdrawn.