



Australian
Competition &
Consumer
Commission

Draft Determination

Applications for authorisation A90992

lodged by

The Australian Nurserymen's Fruit Improvement Company

in relation to its proposed strategic marketing arrangements with various participants in the Australian fruit supply chain

Date: 23 March 2006

Commissioners:

Samuel
Sylvan
King
McNeill
Martin
Willett

Authorisation no. A90992

Public register no. C2005/1862

Executive Summary

The Australian Competition and Consumer Commission proposes to deny authorisation to application A90992 lodged by the Australian Nurserymen's Fruit Improvement Company.

The application

On 14 November 2005, the Australian Nurserymen's Fruit Improvement Company Ltd (ANFIC) lodged application for authorisation A90992 to allow its members to enter into collective agreements with fruit growers and wholesalers to establish a coordinated production and marketing strategy for certain high quality fruit varieties (referred to by ANFIC as *exceptional fruit*). The alliance proposal would allow ANFIC's members to standardise their royalty collections and determine the supply of the nominated fruit varieties.

The authorisation process

A key objective of the *Trade Practices Act 1974* (the TPA) 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 TPA, however, allows the Australian Competition and Consumer Commission (the ACCC) 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 ACCC for what is known as an 'authorisation'.

Broadly, the ACCC 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.

Assessment of the public benefit and anti-competitive detriment

ANFIC has submitted that a number of benefits to the public will result from its proposed arrangement, including providing a co-ordinated approach to marketing and, through changes to royalty arrangements and income streams to nurseries, continued improvements in fruit varieties (for example greater disease resistance, improvements in quality).

In assessing ANFIC's proposed arrangement the ACCC is required to identify the most likely alternative to the alliance proposal (referred to as the *counterfactual*) and compare the benefits to the public and the anti-competitive detriments of the two scenarios. In assessing ANFIC's proposal the ACCC considers that the most likely alternative will be for the individual members of ANFIC to compete against each other to make sales of their differing fruit varieties to growers.

In this environment the ACCC considers that the accurate collection of plant royalties and the production of high quality fruit are equally achievable under the proposed alliance as

under the counterfactual. The ACCC is concerned however that the proposed arrangements may result in some detriments to consumers and a loss of allocative efficiency. To the extent that the proposed arrangements are at risk of dampening innovation incentives and creating a misallocation of resources through artificial price signals, detriments to competition may also arise.

Furthermore, the ACCC is concerned that, without full information as to the varieties to be included under the proposed arrangements, the full extent of any detriment is difficult to assess. The ACCC must assume that the conduct could be broadened to apply to a larger number of exceptional fruit varieties than has been identified by ANFIC to date – this would be consistent with the terms of the authorisation that ANFIC has been sought. As such, the ACCC considers that, where the proposed conduct is broadened to include other varieties of fruit held by ANFIC, the extent of the anti-competitive detriment may be increased.

The ACCC considers intellectual property protection and the promotion of appropriate investment incentives are important for the development and future competitiveness of the Australian fruit industry. However, having considered the information that has been provided to it by ANFIC, the ACCC has concluded that the proposed arrangements are unlikely to achieve any greater benefits than those that are already provided for by the current intellectual property regime.

While the ACCC has concluded that ANFIC's proposal is unlikely to result in additional benefits to the public, this conclusion has been reached after considering the information available to it. Importantly, the ACCC recognises that supply chain arrangements can provide for improvements in intellectual property protection and in the promotion of appropriate investment incentives, thereby providing benefits to the public. However, it is the role of the applicant to satisfy the ACCC, through the demonstration of public benefits, that the proposed arrangements should be authorised.

In addition to the lack of demonstrated public benefits, the ACCC is concerned from a competition perspective that these arrangements, if given effect to, may result in a loss of allocative and dynamic efficiency. However, the ACCC does consider that where the size and scope of the arrangements can be narrowed, or described with greater certainty, the detriment associated with the conduct is likely to be lessened.

Proposed decision

Pursuant to the statutory test outlined in section 90(6) of the TPA, the ACCC proposes to deny authorisation to application A90992.

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1 Introduction

- 1.1 The Australian Competition and Consumer Commission (the ACCC) is the Australian Government agency responsible for administering the *Trade Practices Act 1974* (the TPA). A key objective of the TPA 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 TPA, however, allows the ACCC 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 ACCC for what is known as an ‘authorisation’. Broadly, the ACCC 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.
- 1.3 The ACCC conducts a comprehensive public consultation process before making a decision to grant or deny authorisation. Upon receiving an application for authorisation, the ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.4 The ACCC then issues a draft determination in writing proposing either to grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the ACCC will take into account any submissions received from interested parties.
- 1.5 Once a draft determination is released the applicant, or any interested party, may request that the ACCC hold a conference. A conference is generally called by a party dissatisfied with the ACCC’s decision and provides interested parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite interested parties to lodge written submissions on the draft.
- 1.6 The ACCC then reconsiders the application taking into account the comments made at the conference and any further submissions received and issues a written final determination. Should the public benefit outweigh the public detriment the ACCC may grant authorisation. If not, the authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the public benefits and decrease the detriment.
- 1.7 The ACCC also has the power to grant interim authorisation, at the time the application is lodged or at a later stage. Interim authorisation protects the arrangements for which authorisation is sought from legal action under the TPA while the ACCC considers and evaluates the merits of the application.
- 1.8 This document is the draft determination in relation to authorisation application A90992 lodged with the ACCC by the Australian Nurserymen’s Fruit Improvement Company (ANFIC), on behalf of its 12 member nurseries to establish a coordinated production and marketing strategy for its fruit varieties.

2 Industry background

The supply of fruit in Australia

2.1 The conduct for which ANFIC has sought authorisation is fairly broad, given that it may apply to any number of fruit varieties. Consequently, the information provided in this section is an equally broad assessment of a fairly typical supply chain for fresh fruit. The ACCC understands that the supply chain for fruit is comprised of the following vertical levels:

- plant breeders
- plant nurseries
- fruit growers
- fruit wholesale and
- fruit retail

2.2 Vertical integrated businesses may also be involved in more than one level of the supply chain.

Fruit breeders

2.3 Fruit breeders are responsible for the initial creation of new fruit varieties for supply to the market. These are usually developed through a series of different breeding techniques, the aim of which is to produce fruit with characteristics that will make it attractive to export and retail customers. Development of new fruit varieties can take an extended period of time given the fruit cycles of the plants and the thorough nature of the testing carried out prior to mass production.

Plant nurseries

2.4 Plant nurseries provide plant material to fruit growers for use in the growing of different fruit varieties. This plant material may include young potted trees, vine cuttings or other material which can be used to grow fruit. Generally, nurseries located within a specific geographical area will offer plant material that is suited to the local growing conditions. Nurseries may provide plant material that is protected by intellectual property, provided they have the consent of the intellectual property owner, or plant material which is in the public domain. Plant breeders will generally obtain plant genetics from fruit breeders for duplication and on-sale.

Fruit growers

2.5 Fruit growers provide the service of tending and growing commercial quantities of fruit plants (usually vines or trees). Broadly, fruit growing may involve activities such as planting, irrigating, fertilising, pest reduction and harvesting. The varieties of fruit grown will depend on a number of factors such as climate, geography and

soil conditions. Fruit growing may also involve the use of heavy machinery and a large area of land.

Fruit wholesale

- 2.6 Wholesalers purchase fruit from growers for resale or sell fruit on consignment on behalf of the growers. Businesses operating at this level may include fresh fruit packers, wholesalers, market agents and exporters. Some businesses operating at this level may undertake more than one of these tasks. Businesses involved in fruit wholesale will generally undertake the task of quality assurance and assess whether fruit is acceptable for consumption at the retail level. Fruit wholesalers will largely supply fresh fruit to either fruit retailers or export markets while fruit of lesser quality may be directed to fruit processors for use in products such as canned fruit.

Fruit retail

- 2.7 Retailers include specialist produce markets, fruit stores and supermarkets. Some larger retailers may also operate at the wholesale level or deal directly with fruit growers.

Intellectual property

- 2.8 Plant varieties can be protected in a number of ways under intellectual property laws. The three types of intellectual property law used by plant breeders for the purposes of intellectual property protection and commercialisation are Plant Breeder's Rights (PBR), Patents and Trademarks.

Plant Breeder's Rights

- 2.9 The *Plant Breeder's Rights Act 1994* (the PBR Act) provides intellectual property ownership to the creators of eligible new plant varieties. This intellectual property ownership is referred to as Plant Breeder's Rights (PBR). The purpose of the PBR Act is to provide an incentive to plant breeders to produce new plants with improved characteristics. Breeding a new variety of plant can involve a significant investment on the part of a plant breeder. The PBR Act allows a plant breeder exclusive rights to the production and commercial sale of the variety, allowing them pursue a return on the variety that they have developed. The PBR Act was brought into effect to bring Australia into line with international standards for intellectual property ownership of plant varieties.

Rights conferred on PBR holder

- 2.10 The PBR Act essentially gives holders of the PBR the right to exclude others from certain specified actions with respect to the commercialisation of the variety. Section 11 of the PBR Act outlines the activities to which the PBR holder will have the right to exclude others from participating in and essentially covers all potential forms of commercialisation.

- 2.11 Once granted, a PBR will remain in place, unless it is revoked at an earlier stage, for a period of 25 years on tree and vine varieties and 20 years on all other varieties.

Eligibility requirements for the PBR

- 2.12 To be eligible for ownership of the intellectual property of a plant variety under the PBR Act, the plant variety in question must meet the criteria of being new, stable and unique. If a plant variety is more than a year old, does not maintain its characteristics from generation to generation or is not distinct from currently available varieties, it will not be eligible for protection under the PBR Act.
- 2.13 IP Australia is responsible for granting PBRs and provides information in relation to its assessment on its website at **www.ipaustralia.gov.au**.

Ability of PBR holder to collect royalties and control downstream supply

- 2.14 The PBR Act does not contain any provisions that relate to the way in which a PBR holder may commercially exploit a variety. Rather, the ability to exclude others from commercial use of the variety allows the PBR holder to determine to whom, and on what terms, it sells its product. This is commonly achieved by entering into contracts with downstream market participants (such as the closed loop arrangements described below). The ability of a PBR holder to collect royalties and exhibit some control over downstream supply will depend on the terms and conditions of any contracts that it enters into with the various supply chain participants.

Ability of the Secretary to grant further PBRs

- 2.15 Section 19 of the PBR Act allows the Secretary of the Department of Communications, Information Technology and the Arts (DoCITA) to provide an entity other than the PBR holder the right to commercialise the PBR protected variety if there is currently deemed to be an insufficient supply of the variety to satisfy demand at a reasonable price. The secretary cannot exercise this right within the first two years of the PBR being granted. To date, section 19 of the PBR Act has not been invoked, such that it is difficult to assess when it may be used.

Patents

- 2.16 A patent can also be obtained to provide protection for a fruit variety. Patents are largely used to provide intellectual property protection to the processes used to develop varieties rather than the varieties themselves.

Trademarks

- 2.17 Plant breeders may also register a trademark for use in the retail market. Generally, a trademark will be used by a PBR or patent holder to provide quality assurance and brand recognition at the retail level.

Closed loop marketing of fruit

- 2.18 Closed loop marketing of fruit and vegetable varieties refers to a process where a plant breeder or licensed agent enters into contracts at different levels of the supply chain in order to control distribution. For example, a PBR holder may allow a nursery to sell its PBR protected plant material for harvesting on condition that the nursery only sells to certain growers. In turn, the selected grower may have a contract with the PBR holder directing the sale of harvested material to a particular fruit packer or market agent. Finally, the market agent may have a contract with the PBR holder stating that it can only purchase the PBR protected fruit from a selected grower. In this way, the contracts create a closed loop.
- 2.19 Contracts between the PBR holder and the different participants in the supply chain will differ depending on what the PBR holder is attempting to achieve by implementing such arrangements. These contracts will typically contain non-propagation agreements to protect the PBR holder's exclusive right to sell the plant material as well as quality assurance provisions for the fruit to ensure the integrity of the variety is maintained. Closed loop marketing also allows a PBR holder or licensee to seek royalties from different participants in the supply chain.

3 ANFIC's application and supporting submission

- 3.1 On 14 November 2005, ANFIC lodged an application for authorisation (A90992) with the ACCC on behalf of 12 nursery members that breed different fruit types for supply to growers.
- 3.2 The authorisation applications were made pursuant to section 88(1) of the TPA for an authorisation under that subsection:
- to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or may have the likely effect, of substantially lessening competition within the meaning of section 45 of the TPA and*
- to give effect to a provision of a contract, arrangement or understanding where the provision has, or may have, the effect of substantially lessening competition within the meaning of section 45 of the TPA.*
- 3.3 Copies of the applications and ANFIC's submission in support are available from the public register maintained by the ACCC. The main issues are outlined below.

The proposed arrangements

- 3.4 ANFIC, on behalf of its 12 member nurseries, is seeking authorisation to establish a coordinated production and marketing strategy for certain high quality fruit varieties (referred to by ANFIC as *exceptional fruit*) between various participants in the supply chain.
- 3.5 To this end, ANFIC has proposed to form a new company known as ANFIC Commercial Company Ltd (ComCo), which will enter into contracts with fruit growers and market agents for the purposes of carrying out the proposed arrangements. These contracts may specify production or acreage limits for growers, as well as any royalty arrangements.

Term of authorisation

- 3.6 ANFIC is seeking authorisation for application A90992 for a period of 25 years.

Interim authorisation

- 3.7 ANFIC also requested that the ACCC grant interim authorisation to application A90992 to allow ANFIC to begin negotiations with individual fruit growers in respect of the proposed arrangements. On 21 December 2005, the ACCC denied interim authorisation on the grounds that ANFIC had not suitably demonstrated that interim authorisation was urgent, and that the information provided at the time was not sufficient to allow it to make a preliminary assessment of the application.

ANFIC's submission in support of its application

3.8 ANFIC is a not for profit company, limited by guarantee and comprised of 12 members that operate fruit nurseries. The group's stated aim is to facilitate the greater exchange of information on varieties around the world as well as offering access to varieties. ANFIC currently manages more than 1200 fruit varieties in Australia from 50 breeding programs in 12 countries. Of the 1200 fruit varieties, fewer than 120 are currently produced in commercial quantities.

ANFIC's members

3.9 ANFIC submits that each of its members is a fruit tree nursery business. A list of ANFIC's members is provided at Attachment A of this draft determination. ANFIC notes that each of its members produce in-ground deciduous trees for sale to commercial orchardists. ANFIC also notes that some of its members grow fruit trees in containers for sale to both commercial orchardists and the retail garden trade.

3.10 ANFIC notes that its members are located in strategic areas of the country to suit the many fruit production industries in Australia. As an example, ANFIC notes that its only Queensland nursery produces subtropical and tropical fruit trees, while nurseries in the south produce deciduous fruit trees such as apples, pears and stonefruit.

3.11 ANFIC notes that its members are licensed by them to produce trees for sale to orchardists (i.e. fruit growers) throughout Australia. ANFIC notes that these licence agreements outline the royalty collection requirements for each fruit variety managed by ANFIC in Australia and any other limitations on the sale of a new fruit variety.

Background

3.12 ANFIC submits that it is investigating coordinated marketing and licensing due to the need for growers to join with other growers to gain a mutually larger market share. ANFIC notes that it has not currently approached any growers or marketers with respect to the proposed arrangements.

Plant Breeder Rights

3.13 ANFIC submits that PBR facilitates innovation and the development of better varieties. However, ANFIC submits that the PBR Act does not indicate how commercialisation should occur. ANFIC submits that the PBR Act is silent on commercialisation of new varieties other than that they should be reasonable accessible to the public within 2 years of the grant of rights.

3.14 ANFIC submits that not all new fruit varieties are protected by PBR and that other methods of Intellectual Property protection are in use, for example, non propagation agreements, DNA fingerprinting and the National Licensing Association.

Details of Exceptional fruit varieties

- 3.15 ANFIC submits that the new exceptional fruit varieties to which its application relates are either still in plant quarantine or in the early stages of propagation. ANFIC submits that the details of the exceptional fruit varieties are currently confidential. ANFIC submit that the information is commercially sensitive and cannot be shared at this time due to existing confidentiality agreements in place with many owner/breeders. The ACCC has not been furnished with the information on a confidential basis.
- 3.16 ANFIC submit that they manage more than 1200 fruit varieties in Australia and only 10 new fruit varieties in total may fit the 'exceptional' fruit variety status and show potential to be included in 'Coordinated Marketing' programs.

Details of fruit volume coordination

- 3.17 ANFIC submits that fruit growers, as part of the coordinated marketing program, will be provided with a choice of marketers/market agents/direct sellers/exporters for their fruit marketing. ANFIC notes that their choice may be limited to two market agents in each capital city market. ANFIC submits that coordination of fruit volumes will be required to ensure that each capital city market receives an appropriate volume of fruit for their customers. ANFIC submits that national coordination will greatly assist the buyers of this fruit.
- 3.18 ANFIC submits that this coordination direction for growers is no different to the way in which they currently market their fruit, although a different market agent may be required in a particular capital city market than currently used by the fruit grower. ANFIC submits that there is no requirement for growers to obtain any additional services from the marketers other than fruit marketing directed by ComCo. ANFIC notes that these directions may change each season as some marketers strive to improve the returns for the growers or other marketers have contracts terminated due to poor performance.

Capped production or acreage

- 3.19 ANFIC submits that production or acreage caps can be specified by the owner/breeder as part of a master license with ANFIC or calculated according to the market share that a new exceptional fruit variety may capture. ANFIC submits that the projected market share for a new exceptional fruit variety will not be more than 2 per cent of industry production.

Projected annual royalty fees

- 3.20 ANFIC submits that projected annual royalty fees for exceptional fruit varieties may equate to \$2000 per hectare based on a 4 per cent production royalty. ANFIC notes that total acreage planted of these new varieties will depend on the industry, its size, the potential market (both domestic and export) and acceptance rate of Australian growers. ANFIC notes that every new fruit variety will be developed

with its own unique royalty model dependent on the owner/breeders requirements and the Australian fruit industry involved. ANFIC submits that there is no preset royalty model that applies to every new fruit variety and industry.

- 3.21 ANFIC submits that royalties will be charged to fruit growers only as they are benefiting from the new fruit variety. Royalty collections commonly take the form of tree or fruit production royalties. Tree royalties are collected at the time of tree sale by the ANFIC's member nurseries, while fruit production royalties are collected by authorised marketers or through other methods. ANFIC submits that the nominated market agents will probably be expected to pay a marketing fee for access to the 'exceptional fruit', but that this fee will cover costs and will not be forwarded to the owner/breeder.

Term of authorisation sought

- 3.22 ANFIC submits that, while it originally sought authorisation for a period of 10 years, it is seeking authorisation for a period of 25 years due to the time involved in developing a new variety. ANFIC submits that the quarantine period for a new variety is between three to five years while the initial establishment of plant material for propagation and planting can delay harvest for between three and four years. ANFIC also submits that 25 years is equivalent to the term of plant breeder's rights.

Effect on competition and public benefits

- 3.23 ANFIC submit that the proposal will benefit industry participants as outlined below.
- 3.24 Owners and breeders through:
- the coordination of fruit production and marketing
 - accurate and convenient collection of both tree and fruit production royalties and
 - intellectual property protection
- 3.25 Fruit growers through:
- access to exceptional fruit varieties
 - access to a range of fruit breeding programs
 - voluntary participation in and coordination of committed growers licensed by ANFIC
 - quicker access to the best varieties available through the committed growers licensed by ANFIC
 - access to technical advice through shared information and newsletters
 - capped production levels with grower commitment
 - limited and authorised market agent choice for growers

- coordination of marketing through selected and authorised market agents and/or exporters
- balanced wholesale market/direct selling/export markets
- an annual coordinated marketing plan and
- sustainable returns for grower efforts.

3.26 Marketers, suppliers and direct sellers through:

- access to the best fruit quality from some ‘exceptional’ fruit varieties
- coordination of fruit production volumes from a range of production areas
- coordination of packing facilities with specified fruit quality standards
- capped production levels with grower commitment
- an annual coordinated marketing plan and
- sustainable returns for marketer, supplier and direct seller efforts

3.27 The public through:

- improved fruit quality through ‘exceptional’ varieties grown by committed growers
- capped fruit volumes/acreage to avoid over supply
- coordination of committed growers working as a team with market agents to produce and deliver consistent fruit quality for the consumer
- increased reliability of products
- increased monitoring and assurance of food safety and health
- development of disease resistant fruit varieties and
- an income stream to breeding programs to continue to provide the best varieties

3.28 ANFIC submit that in the absence of the proposed conduct, many of the above public benefits would not be available from the best varieties.

3.29 ANFIC also provided the ACCC with general information as to the benefits of a strategic alliance. ANFIC’s submission in relation to the effects on competition and public benefits of the proposed arrangements will be considered further as a part of the ACCC’s assessment in section 7 of this draft determination.

4 Submissions received in relation to the application

4.1 The ACCC sought submissions from a wide range of interested parties and those received are summarised below. Complete copies of all submissions are available on the ACCC's public register and on its website.

Apple & Pear Australia Limited

4.2 Apple & Pear Australia Limited (APAL) submits that it does not object to ANFIC's application for authorisation, however APAL suggest that the ACCC examine the *Plant Breeders Rights Act 1994* and the *Trade Marks Act 1995* before making a decision.

Western Australian Department of Agriculture

4.3 The Western Australian Department of Agriculture (WADA) submits that production and marketing arrangements for fruit varieties are changing rapidly. WADA states that the key drivers for this are:

- the requirement of breeding organisations to generate longer term returns for their varieties
- the need to provide new varieties to consumers to build market share and
- certainty for producers in terms of variety success.

4.4 WADA states that it does not object to ANFIC's request and notes that it is consistent with current international approaches to the development of new fruit varieties.

New South Wales Department of Primary Industries

4.5 The New South Wales Department of Primary Industries (NDPI) submits that the application by ANFIC does not identify a market failure sufficient to justify authorisation of the proposal.

4.6 NDPI states that it is concerned that, if granted, A90992 may potentially cause a reduction in competition in the rootstock market, an increase in costs to fruit growers and a reduction in industry competitiveness.

4.7 NDPI notes that the case needs to be established as to whether the varieties in question would otherwise be able to be imported in the absence of the arrangement for which authorisation is sought.

Tasmanian Department of Primary Industries, Water and Environment

4.8 The Tasmanian Department of Primary Industries, Water and Environment (DPIWE) submits that ANFIC's proposal falls within the general context of *variety clubs*, which aim to manage supply to consumers. Variety clubs control supply and, as a result, the price by restricting the number of producers and retailers.

- 4.9 DPIWE submits that *variety clubs* benefit specific plant breeders, nurseries, participating producers and selected suppliers retailers. DPIWE submits that variety clubs are currently operating within Australia, often to the detriment of smaller producers, who have insufficient funds to enter into these arrangements.
- 4.10 DPIWE notes that ANFIC's proposed arrangements differ from existing variety clubs in that participation in ANFIC's proposed arrangements is voluntary. However, the proposed arrangements are similar to variety clubs in that supply is capped to control price.

South Australian Department of Primary Industries and Resources

- 4.11 The South Australian Department of Primary Industries and Resources (DPIR) has not stated a position in relation to the application submitted by ANFIC. DPIR has however, submitted a number of comments in relation to the application, including:
- the application is not likely to be favoured by the general orchardists however it does not seem to restrict the supply of fruit to consumers
 - the application is likely to encourage other groups to form similar strategic alliances with breeders and nurseries
 - if the arrangement is carried out well it may result in more orderly marketing that reduces fluctuation in the supply and demand situation and
 - if the arrangement is carried out poorly it may restrict consumer and grower access to germplasm.

The Queensland Farmers' Federation

- 4.12 The Queensland Farmers' Federation states that it has no objection to ANFIC's application and that it supports the application.

ANFIC's Response to the Interested Party Submissions

- 4.13 In response to the interested party submissions ANFIC have submitted, among other things, the following:
- the high production costs and falling prices due to oversupply are reducing the number of small orchardists
 - there are no exorbitant costs of entry
 - tree and production royalties will be more easily paid by virtue of the 'exceptional' fruit varieties commanding a higher return
 - if an 'exceptional' fruit variety cannot achieve returns that sustain reinvestment, the variety will revert to a commodity variety and no royalties will be payable to the owner/breeder
 - ANFIC has no intention of limiting rootstock supply to the industry

- any request for an increase in tree and production royalties can only be met through increased market returns and
- ANFIC does not perceive a market failure but rather, is trying to maximise the returns to all players involved with some new 'exceptional' fruit varieties; owner/breeders, nurseries, fruit growers, marketers and consumers. These varieties will not replace any of the existing industry sectors but compliment marketing at particular times of the harvest season.

5 Statutory provisions

- 5.1 Application A90992 is made under section 88(1) of the TPA to make and give effect to arrangements that might substantially lessen competition within the meaning of section 45 of the TPA.
- 5.2 In assessing an application made under section 88(1) of the TPA to make and give effect to arrangements that might substantially lessen competition within the meaning of section 45 of the TPA, the relevant test that ANFIC must satisfy for authorisation to be granted is outlined in subsection 90(6) of the TPA.
- 5.3 Under subsection 90(6) of the TPA, the ACCC 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.
- 5.4 In deciding whether it should grant authorisation, the ACCC 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 ACCC may grant authorisation.
- 5.5 Public benefit is not defined by the TPA. However, the Australian Competition Tribunal (the Tribunal) has stated that the term should be given its widest possible meaning. In particular, it includes:
- ...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.¹
- 5.6 Similarly, public detriment is not defined in the TPA but the Tribunal has given the concept a wide ambit. It has stated that the detriment to the public includes:
- ...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.²
- 5.7 In weighing up the public benefit and anti-competitive detriment generated by proposed arrangements for which authorisation has been sought the ACCC also applies the ‘future with-and-without test’ established by the Tribunal.

¹ *Re 7-Eleven Stores; Australian Association of Convenience Stores* (1994) ATPR ¶ 41-357 at 42677
The Tribunal recently followed this approach in *Qantas Airways Limited* [2004] ACompT 9, 16 May 2005

² *ibid* at 42683

- 5.8 Under this test, the ACCC 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 ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as ‘the counterfactual’.
- 5.9 Section 88(10) of the TPA provides that an authorisation may be expressed so as to apply to or in relation to another person who becomes a party to the proposed arrangements in the future.
- 5.10 Section 91(1) of the TPA allows the ACCC to grant authorisation for a specific period of time.

6 The relevant markets and the counterfactual

- 6.1 The first step in assessing the public benefits and anti-competitive detriments of the proposed arrangements for which authorisation is sought is to consider the relevant market(s) in which those arrangements occur.
- 6.2 The proposed arrangements seek to bring about the coordination of production of fruit varieties through agreements between various participants in the supply chain. While ANFIC has noted that its members currently control the plant breeding rights of over 1200 fruit varieties, it has not identified those varieties which are to be managed under the proposed strategic alliance. Given this information restriction, the ACCC's analysis of the market features is necessarily broad. It is the ACCC's view however that it is unnecessary in the circumstances presented to definitively identify all markets that may be affected by the proposed arrangements. On balance, the ACCC considers that an appraisal of the likely features of those markets most likely to be affected by ANFIC's proposed arrangement will assist in the identification and balancing of benefits and detriments.
- 6.3 The ACCC considers that the proposed arrangements are likely, to varying degrees, to affect all levels of the Australian fruit supply chain, being:
- plant breeders
 - plant nurseries
 - fruit growers
 - fruit wholesale and
 - fruit retail.
- 6.4 More generally, the ACCC notes that:
- there are a number of well established fruit varieties produced within Australia, these varieties compete with imported varieties for market share
 - considerable time is involved in developing a new variety of fruit (around eight years)
 - intellectual property protected varieties may be owned by a breeder, and can be licensed for commercial exploitation
 - Australia supplies fruit to export markets
 - fruit importers also supply the Australian market but are constrained to some extent by the logistics involved (transport costs, quarantine, et cetera)
 - a large number of businesses supply fruit to consumers, including supermarkets and specialty fruit retailers and
 - the presence and acceptance of high quality fruit varieties that sell at a premium over standard varieties suggests that consumers place value upon high quality fruit varieties.

The future with-and-without test

- 6.5 As stated in section 5, the ACCC applies the ‘future with-and-without test’ established by the 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 ACCC 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 ACCC 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 In relation to application for authorisation A90992, the ACCC considers that the most likely counterfactual is a situation whereby each individual member of ANFIC is likely to compete for the sale to growers of their differing varieties of fruit. In this regard the ACCC considers that some individual nurseries and PBR owners are likely to continue to enter into vertical closed loop arrangements with other members of the supply chain – to the extent that such arrangements do not raise concerns under the exclusive dealing provisions of the TPA³ – but would not otherwise exercise these rights under horizontal supply agreements with the other nurseries where such arrangements would contravene the TPA.

³ section 47

7 The ACCC's assessment

Effect on competition

- 7.1 As discussed in section 5, the ACCC must assess the extent to which the proposed arrangements give rise to any detriment to the public constituted by any lessening of competition that flows from the proposed arrangements.
- 7.2 The ACCC considers that the proposed arrangements are likely to result in a lessening of competition insofar as the 12 members of ANFIC enter into agreements as a group, and collectively form vertical arrangements with various participants in the supply chain, that have the effect of altering market behaviour.

Potential reduction in allocative efficiency

- 7.7 From the outset, it is important to note that individual nurseries or PBR owners may act to restrict supply under the current intellectual property regime. In this respect the ACCC considers that an individual nursery, acting through a closed loop marketing scheme, could choose to restrict the supply of its PBR protected fruit variety to the market. However, the ACCC considers that any decision of a nursery or PBR owner to impose such a restriction would be constrained by the choices made by its competitors.
- 7.8 In particular, any decision by a nursery or PBR owner to restrict supply, thereby reducing the quantity provided at the retail level, is likely to be capitalised on by a competing nursery or PBR owner. Such opportunistic behaviour is a feature of a competitive market. To the extent that the proposed arrangement lessens this behaviour (by providing a collective agreement on matters of production) a detriment to competition will arise. In effect, allocative inefficiencies arise as a result of interference with market signals.
- 7.9 As noted previously, ANFIC proposes to restrict the quantity of its exceptional branded fruit varieties by entering into vertical agreements with growers and market agents to cap production and supply. ANFIC submits that oversupply of fruit occurs in Australia within a short period and that the proposed arrangements will assist in developing high quality fruit varieties by providing greater returns to members of the supply chain.
- 7.10 The ACCC is concerned that the proposed restriction of supply will have the effect of artificially inflating the price of the nominated varieties. This has the potential to result in consumer detriment (discussed below) and to distort price signals.
- 7.11 As a general principle, prices that are set in a competitive market signal to producers the amount that a consumer is willing to expend in order to acquire the product. This enables the producer to determine whether value to the consumer is at least equivalent to the resource of production. If the value placed upon the product by a consumer is lower than the resource cost, then the producer is provided with a price signal which will prompt a reallocation of resources.

7.12 The ACCC is concerned that, by restricting production, the proposed arrangement will distort price signals for high quality fruit. One potential consequence may be the diverting of consumer choice away from the restricted product (due to suppression of supply and artificial inflation of prices) towards an inferior product, leading to the over production of that product. This may cause a distortion in the types of fruit produced, resulting in an inefficient allocation of resources. To the extent that this may arise, the ACCC considers that an anti-competitive detriment is likely to occur.

Potential dynamic inefficiencies

7.13 As noted in section 6, the ACCC considers that consumers are willing to pay a premium for high quality fruit varieties. The ACCC considers that, in the absence of authorisation, individual nurseries and plant breeders will compete to supply fruit varieties with improved characteristics to capture some of this premium. The ACCC considers then, that an incentive exists under the current intellectual property regime for individual nurseries and PBR owners to produce high quality fruit varieties.

7.14 The ACCC is concerned that the proposed arrangements, which amount to collectively determining production, marketing and royalty collection, may dampen this incentive. The ACCC considers that, where competitive tensions are removed from a market, a consequence may be that participants expend less effort in improving their product. To the extent that this occurs, a loss of dynamic efficiency will result.

7.15 While the 12 nurseries affected by the proposed arrangement will still compete with other nurseries and PBR owners for market share, under the arrangement they will no longer be required to compete with each other to the same extent to obtain the high quality fruit premium. In this respect, the ACCC considers that the proposed arrangements may lead to a loss of dynamic efficiency and anti-competitive detriment.

Breadth of the proposed conduct

7.16 The significance of the anti-competitive detriment flowing from ANFIC's proposal to restrict supply of its exceptional fruit varieties will depend, to a large extent, on the scope of the proposed arrangements. The ACCC considers that where the conduct is more widespread, there is greater scope for anti-competitive detriments to arise.

7.17 In this respect, ANFIC has noted that while around 120 of its fruit varieties are currently produced in commercial quantities the proposed arrangements are likely to apply to less than 10 varieties of fruit. ANFIC has not identified the fruit varieties likely to be affected by the proposed arrangement; it has however submitted that in its view the current market share of these varieties is quite small (less than 2%).

- 7.18 While it notes these submissions, ANFIC has not provided the ACCC with any meaningful or contestable information as to the fruit varieties it intends to include under the proposed arrangements. This has significantly affected the ACCC's ability to be satisfied that the scope of the arrangement is restricted as has been contended by ANFIC.
- 7.19 Accordingly the ACCC has assessed the scope of the arrangements based upon the terms of the conduct for which authorisation has been sought. In this respect the ACCC notes that, if the strategic alliance proves successful in increasing returns to supply chain participants, ANFIC would not be prevented from broadening the collective arrangement to apply to other high quality varieties produced by its members and future members.
- 7.20 On balance, the ACCC considers that the potential scope of the proposed arrangements could result in significant anti-competitive detriment.

Voluntary participation

- 7.21 ANFIC submits that the proposed arrangements are voluntary for growers and market agents, such that they will only be entered into if these parties believed that there was a benefit in doing so.
- 7.22 While the ACCC accepts that no grower or market agent would be likely to enter into an arrangement that would be detrimental to their business, it does not consider in the circumstances presented that this feature significantly reduces the potential detriments to competition. In this regard, the ACCC is more concerned with the lessening of competition and the impact of the proposed arrangements on consumers.

Conclusion

- 7.23 The ACCC considers that the proposed arrangements are likely to generate anti-competitive detriment by potentially dampening innovation incentives and by potentially creating a misallocation of resources through artificial price signals. Furthermore, the ACCC is concerned that, without full information as to the varieties included under the proposed arrangements, the full extent of any detriment is difficult to assess. Consequently, the ACCC must assume that the conduct, if successful in raising returns to supply chain participants, may be broadened to other varieties. As such, the ACCC considers that, where the proposed conduct is broadened to include other varieties of fruit held by ANFIC, the extent of the anti-competitive detriment may be significantly increased.

Public benefit

- 7.24 In order to grant authorisation to the proposed arrangements, the ACCC must be satisfied that the arrangements would result in a benefit to the public that outweighs any detriment to the public constituted by a lessening of competition arising from the arrangements.

- 7.25 As noted earlier in this document, under the future with-and-without test, the ACCC assesses the public benefit of an application by measuring the extent to which the likely benefits outweigh those public benefits that are likely to occur in the absence of authorisation. That is, for a public benefit to be given weight in this assessment, it must be demonstrated that the benefit would not arise, or would not arise to the same extent, if the competitive process were allowed to run its course.
- 7.26 ANFIC submits that granting authorisation allowing it to form agreements between its 12 members to establish coordinated production and growing arrangement with growers and market agents will result in a number of benefits to the public. Broadly, ANFIC has claimed that benefits will accrue at several levels of the supply chain, including benefits to:
- intellectual property owners and breeders
 - growers
 - market agents, suppliers, direct sellers and
 - the public
- 7.27 The benefits claimed by ANFIC are outlined from paragraph 3.23 to 3.29 of this draft determination and in ANFIC's supporting submission. The ACCC notes that, for the purposes of its analysis, it will consider whether access to improved fruit varieties, improved royalty collection processes, greater returns to participants in the supply chain and intellectual property protection represent a public benefit under the statutory test. The ACCC considers that other benefits claimed by ANFIC are covered by these topics, such that a separate analysis of each claim is unnecessary.

Access to improved fruit varieties

- 7.28 ANFIC submits that the proposed arrangements will benefit consumers and all members of the supply chain by providing access to high quality fruit with improved characteristics that are targeted towards consumer preferences of novelty, nutrition and convenience.
- 7.29 As noted previously, the use of intellectual property law and licensing arrangements provide a number of incentives promoting innovation in respect of fruit varieties. However, for the reasons outlined above, it is the ACCC's concern that ANFIC's proposal may in fact dampen these incentives. The ACCC is also concerned that the arrangement may distort price signals, prompting a misallocation of resources by the supply chain. In this environment the ACCC can not accept that the arrangement is likely to result in a greater responsiveness to consumer preferences. Accordingly, the ACCC does not propose to accept this claimed public benefit.

Improved royalty collection processes

7.30 ANFIC has also submitted that the proposed arrangements will better allow it to track royalty payments made later in the supply chain. While the ACCC recognises that entering into direct arrangements with market agents is likely to allow ANFIC to track the sale of its fruit to retail and better administer its royalty collection, the ACCC considers that it is likely that ANFIC's members would be as successful if they were to undertake this on an individual basis and absent of the proposed arrangements. As such, the ACCC does not consider that this claimed benefit will result in any increase to those benefits available under the counterfactual, and does not lend weight to ANFIC's claim.

Greater returns for supply chain participants

7.31 ANFIC has submitted that the proposed arrangements will benefit all supply chain participants by offering sustainable returns. It submits that these returns will be achieved by virtue of participants carrying higher value fruit varieties. Presumably, ANFIC anticipates that these fruit varieties will attract a higher retail price than ordinary varieties, which will lead to greater returns up the supply chain.

7.32 As noted in section 6, the ACCC considers that consumers are likely to be willing to pay a premium for high quality fruit varieties, such that, where high quality fruit products are provided, they are likely to attract a higher price at retail than standard fruit varieties. The ACCC considers that, to the extent that high quality products are produced, they are likely to attract customers and provide increased returns throughout the supply chain.

7.33 The ACCC is concerned however that any increase in returns above those made under the counterfactual are likely to result from the potential for the proposed agreement to artificially maintain the price of a variety above the market rate. In this respect the ACCC considers that, as increased returns to ANFIC's members are likely to be made at the expense of consumers and a dead weight loss is likely to arise from a reduction in allocative efficiency, it is difficult to accept this increase in returns as a public benefit.

Intellectual property protection

7.34 ANFIC has submitted that intellectual property protection will be a benefit of the proposed arrangements. In this regard, the ACCC notes that ANFIC members will retain the ability to gain intellectual property protection with or without authorisation such that the ACCC does not consider that the proposed arrangements will increase the scope for such protection.

Conclusion on public benefits

7.35 The ACCC considers that while ANFIC may be able to accurately collect plant royalties and produce high quality fruit under the proposed arrangements, it does not consider that these will be any less achievable under the counterfactual. The ACCC also considers that, while the proposed arrangements may provide greater

returns to supply chain participants, any increase is likely to be at the expense of consumers and allocative efficiency. The ACCC also considers that intellectual property protection is available with or without authorisation. Consequently, the ACCC does not consider that the proposed arrangements, if given effect to, are likely to increase public benefit when compared to the likely counterfactual.

Balance of public benefits and anti-competitive detriments

- 7.36 The ACCC considers intellectual property protection and the promotion of appropriate investment incentives are important for the development and future competitiveness of the Australian fruit industry. However, having considered the information that has been provided to it by ANFIC, the ACCC has concluded that the proposed arrangements are unlikely to achieve any greater benefits than those that are already provided for by the current intellectual property regime.
- 7.37 While the ACCC has concluded that ANFIC's proposal is unlikely to result in additional benefits to the public, this conclusion has been reached after considering the information available to it. Importantly, the ACCC recognises that supply chain arrangements can provide for improvements in intellectual property protection and in the promotion of appropriate investment incentives, thereby providing benefits to the public. However, it is the role of the applicant to satisfy the ACCC, through the demonstration of public benefits, that the proposed arrangements should be authorised.
- 7.38 In addition to the lack of demonstrated public benefits, the ACCC is concerned from a competition perspective that these arrangements, if given effect to, may result in a loss of allocative and dynamic efficiency. However, the ACCC does consider that where the size and scope of the arrangements can be narrowed, or described with greater certainty, the detriment associated with the conduct is likely to be lessened.
- 7.39 On the information available and for reasons set out in this draft determination, the ACCC does not consider that the proposed arrangements give rise to a public benefit sufficient to overcome the anti-competitive detriment identified within this section, and proposes to deny authorisation.

8 The draft determination

The application

- 8.1 On 14 November 2005, ANFIC lodged an application for authorisation pursuant to section 88(1) of the TPA for authorisation A90992.
- 8.2 Application A90992 seeks:
- to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or may have the likely affect, of substantially lessening competition within the meaning of section 45 of the TPA and
 - to give effect to a provision of a contract, arrangement or understanding where the provision has, or may have, the effect of substantially lessening competition within the meaning of section 45 of the TPA.
- 8.3 ANFIC is seeking the authorisation to allow its members to collectively enter into agreements with various supply chain participants for the coordination of the marketing and supply of its 'exceptional fruit' varieties.

Statutory test

- 8.4 For the reasons outlined in this draft determination, the ACCC is not satisfied that in all circumstances the making of contracts and giving effect to the provisions of the proposed collective bargaining arrangements for which authorisation A90992 is sought under section 88(1) of the TPA:
- would be 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 proposed arrangements.

Proposed decision

- 8.5 Pursuant to the statutory test outlined in section 90(6) of the TPA, the ACCC proposes to deny authorisation to application A90992.