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**SUBMISSION OF MCCAIN FOODS (AUST) PTY LTD AND SAFRIES PTY LTD
IN RESPONSE TO
APPLICATION FOR REVOCATION OF AUTHORISATION A91048 AND SUBSTITUTION OF A
NEW AUTHORISATION BY THE VICTORIAN POTATO GROWERS COUNCIL
AND
APPLICATION FOR REVOCATION OF AUTHORISATION A91057 AND SUBSTITUTION OF A
NEW AUTHORISATION BY THE SOUTH EAST POTATO GROWERS ASSOCIATION**

The Victorian Potato Growers Council ("**VPGC**") lodged an application with the Australian Competition and Consumer Commission ("**ACCC**") on 26 June 2012 seeking revocation of authorisation A91048 (due to expire on 31 July 2012) ("**VPGC Authorisation**") and reauthorisation under section 91C of the *Competition and Consumer Act 2010* (Cth) ("**CCA**") to continue to engage in a process of collective bargaining between its members, an arrangement which may otherwise contravene the CCA ("**VPGC Application**"). McCain Foods (Aust) Pty Ltd ("**McCain**") is a potato processor with a processing plant in Ballarat and will be one of the counter-parties to the proposed collective bargaining arrangement described in the VPGC Application. Specifically, McCain is the counter-party to the sub-group defined in the VPGC Application as the "McCain Growers Group".

The South East Potato Growers Association ("**SEPGA**") lodged an application with the ACCC on 23 June 2012 seeking revocation of authorisation A91057 (due to expire on 29 August 2012) ("**SEPGA Authorisation**") and reauthorisation under section 91C of the CCA to continue to engage in a process of collective bargaining between its members, an arrangement which may otherwise contravene the CCA ("**SEPGA Application**"). McCain and Safries Pty Ltd ("**Safries**"), a potato processor which is wholly owned by McCain, are counter-parties to the proposed collective bargaining arrangement described in the SEPGA Application.

Set out below is McCain's and Safries' (together "**McCain**") joint response to the VPGC Application and the SEPGA Application.

1. Summary

Proposed collective negotiation process

McCain opposes both the VPGC Application and the SEPGA Application (together, "**the Applications**").

McCain submits that the Applications do not meet the requirements for the granting of an authorisation set out in s 90 of the CCA, as the proposed conduct will not result in a benefit to the public. To the contrary, the proposed conduct has generated inefficiencies and uncertainty for the parties engaging in collective negotiations in the past and it is most probable that it will do so again in the future.

In contrast, when McCain recently chose not to participate in the collective bargaining processes and negotiated individually with each of its growers, it was able to settle grower contracts quickly and efficiently.

Price recommendation for seed potatoes

These submissions focus on the proposed collective negotiation process between potato growers and processors. However, McCain notes that the Applications are also seeking authorisation to "establish price recommendation for supply of seed potatoes to other potato growers in Australia".

This price recommendation process does not appear to have been the subject of the previous VPGC Authorisation or the SEPGA Authorisation (together, "**the Authorisations**"), and no explanation has been provided in the Applications about how this process would be conducted, or why it would result in any public benefit. Therefore, McCain is not able to make detailed submissions about this element of the proposed conduct. However, McCain:

- is concerned about the conduct given that seed potatoes are an important input into the cost of potatoes; and
- submits that authorisation cannot be granted to this conduct given the lack of explanation in the Applications about the conduct itself, or any public benefit that may result from the conduct.

Dispute resolution

Finally, if authorisation is granted for the collective negotiation processes, which McCain submits it should not be, the ACCC should make it clear that the proposed dispute resolution process is confined in the same manner as set out in the Authorisations.

The remainder of these submissions sets out in detail why authorisation should not be granted to the collective negotiation processes proposed in the Applications.

2. Background to contract negotiation

To assist in understanding McCain's submissions in opposing the Applications, below is a brief background on McCain's operations, the potato industry, and McCain's experience with the collective bargaining processes permitted under the Authorisations.

McCain's operations and the potato industry

McCain, amongst other activities, processes potatoes into a variety of products, principally for sale in the Australian grocery sector and to the food service sector.

McCain has potato processing facilities at Ballarat in Victoria, Penola in South Australia and Smithton in Tasmania. However, no potatoes from the mainland are processed in the Tasmanian processing plant. Each of these processing facilities can only process potatoes.

While McCain processes potatoes throughout the year, potatoes are harvested from January to June, having generally been planted in September and October. McCain stores potatoes for use in processing in the second half of the year.

McCain obtains the potatoes for its Ballarat and Penola facilities predominantly from contracted growers in Victoria and South Australia, with a small proportion sourced from growers who are located near the Murray River in southern New South Wales (and who are not parties to the collective negotiation process). The number of growers with whom McCain has contracts with varies from year to year. Currently, McCain has contracts with 27 Victorian growers, 13 South Australian growers and 2 New South Wales growers.

In order to meet the requirements of its customers, and to enable its plants to be operated efficiently, McCain's arrangements with its growers must ensure that it has a sufficient volume of potatoes spread across the year of the requisite quality and correct variety.

Individual grower capabilities and characteristics vary significantly. There are significant differences between potato growers in terms of land areas and soil types, the varieties of

potatoes they are able to grow and when they want their potatoes harvested. McCain must manage these variables when sourcing potatoes to ensure that the overall supply of potatoes throughout the year meets operational requirements.

McCain engages in careful forward planning to ensure that its contractual arrangements with growers for the coming season:

- will be sufficient to meet the requirements of its customers;
- enable McCain's processing facilities to be operated efficiently over the year ahead; and
- have regard to the characteristics and requirements of the individual growers and their farms.

For such planning to be effectively undertaken and implemented, contractual arrangements with growers should be settled well ahead of planting. This provides certainty for both McCain and the growers on important issues, such as:

- the availability of seed potatoes;
- which potato varieties are to be planted;
- the correct potato volumes to meet demand; and
- planting and harvest timing.

Where negotiations extend past planting time, significant uncertainty for both McCain and the growers is created, and optimal outcomes are less likely to be achieved.

McCain's experience with collective bargaining

Up until this year, McCain has participated in the collective negotiation process authorised by the granting of the VPGC and SEPGA Authorisations in 2007.

In McCain's experience, however, the only substantive matter that has generally been the subject of the collective negotiation processes under the Authorisations has been the price to be paid to growers for the upcoming season. All other non-price terms are negotiated by McCain with the individual growers in each case in each season, in light of the particular circumstances of each grower (such as farm characteristics, preferences as to variety, planting and harvesting, etc). These factors cannot be negotiated collectively as they depend on the individual circumstances of each potato grower.

The base price paid to potato growers for processing potatoes is known as the Russet Burbank Benchmark ("RBB"). There are then adjustments made to the RBB for factors such as delivery time and potato quality. Generally, negotiations have focused solely on the RBB for the upcoming year. However, there was one year when Victorian growers rejected a proposal from McCain for incentive payments (intended to be calculated via a formula of price variation to the RBB) for potato quality.

Prior to commencing negotiations with growers, McCain calculates a proposed RBB price that is based on a cost production model, and that seeks to have regard to the international price of processing potatoes and the conditions in the domestic market for processed potato products. In the absence of a collective negotiation process, a proposed RBB price would be put to individual growers by McCain and then negotiated and settled at the same time as non-price terms.

In the context of collective negotiations, however, McCain is expected to put a proposed RBB price to the negotiating committee of the VPGA or SEPGA ("**Grower Committees**") for consideration.

Where the Grower Committee approves the RBB, it must then seek approval from the growers it represents. If this is not obtained, further rounds of negotiations between the Grower Committee and McCain are necessary, and then further approval must be sought from the growers. As reflected in the description of the process in the Applications, there are often several iterations of this process until a price is settled.

At the same time as participating in collective negotiations on price, McCain must also negotiate individually with each of its growers on all of the other substantive terms of its contracts, including:

- volumes;
- potato varieties;
- planting timeframes;
- delivery timeframes; and
- seed potato requirements for the following season.

McCain's experience has been that the process of collective negotiation with the Growers Committees on price has often been lengthy and difficult. For example, from 2007 to 2009, the negotiation processes for Victoria and South Australia were conducted in parallel, and:

- in 2007, the collective negotiations for the 2008 RBB price commenced in July and concluded in November 2007, after potato planting had occurred;
- in 2008, the collective negotiations for the 2009 RBB price commenced in July and concluded in January 2009, after planting; and
- in 2009, the collective negotiations for the 2010 RBB price commenced in June and concluded in October 2009, after planting commenced.

The collective negotiations in 2010 were particularly fraught. The chronology of those negotiations was as follows:

- negotiations commenced in May 2010;
- agreement was reached with the South Australian growers in September 2010;
- settlement was not reached with the Victorian growers at this time, and negotiations continued unsuccessfully until March 2011;
- on 20 March 2011, a group of growers blockaded McCain's plant in Ballarat, seeking to prevent deliveries into and out of the plant. The blockade remained in place until 24 March 2011;
- to resolve the situation, McCain had to make an increased offer for the 2011 season, and guarantee a price increase for the 2012 season;
- following the offer of the higher price to the Victorian growers, South Australian growers then demanded that McCain also make this offer to them. McCain agreed to this demand; and
- contracts were ultimately finalised on 25 May 2011.

Therefore, in all of the years that McCain has engaged in the collective negotiation process following its authorisation, contracts were not finalised until after planting had commenced, and were not settled until well into the harvesting season in 2011.

The late settlement of contracts caused significant commercial uncertainty and difficulties for McCain, its customers and other participants in the industry.

For example, McCain generally negotiates terms for the upcoming year with its customers in September or October. If grower contracts are not finalised by this time, then McCain is forced to estimate the cost of sourcing potatoes when entering into customer contracts. If McCain has underestimated the price it will pay for its potatoes, as occurred in 2011, then McCain must attempt to re-negotiate a higher price with its customers. This places McCain at significant commercial risk, and creates uncertainty and inefficiencies for its customers.

In addition, protracted collective negotiations create significant uncertainty regarding the expected volume and cost of inputs for the following season. For example, seed potatoes have to be planted for the upcoming season between September and October. Therefore, if McCain's grower contracts have not been settled by this time, this creates significant uncertainty for seed growers about who may acquire their seeds in the following season.

McCain chose not to participate in the collective bargaining process in 2012 as it was seeking a more efficient and effective process for negotiating contracts to assist in improving the competitiveness of its Australian facilities. Instead, in 2012, McCain elected to negotiate its grower contracts with growers individually, on all price and non-price terms. These negotiations commenced with growers in around May and were concluded within that month.

Currently, given the efficiency gains achieved by negotiating individually, McCain would prefer not to negotiate collectively with Growers' Committees in the future.

3. The proposed arrangements will not produce any public benefit

The public benefit claims in the Applications are similar, and can broadly be divided into the following claims:

- collective negotiation addresses an inequality in bargaining power; and
- the collective negotiation processes generates efficiencies.

McCain also notes that, when the ACCC granted the Authorisations, the principal public benefit that the ACCC considered would be likely to result from the collective negotiation processes was that they would promote greater potato grower input into the terms and conditions of contracts with potato processors¹.

However, McCain submits that the public benefits claimed in the Applications:

- are unlikely to arise;
- are not truly public benefits; or
- are unrelated to the conduct being proposed.

Growers are not in a weak bargaining position when compared to the McCain Group

The Applications claim that collective bargaining is needed to address the weak bargaining position of growers. For example, both the applications state:

"...Growers as individuals are in a weak bargaining position against large companies and corporations which desire to buy their potatoes. These companies and corporations often have specialised negotiators, and worldwide company resources to pull from to strengthen their position against individual growers.

Individual growers are not expected to have the skills required to negotiate with multinational and very large companies. And it is neither practical or economical to employ professional negotiators for individual grower businesses..."

¹ A91048, p 14. A91057, p 14.

McCain does not consider there to be any significant inequality of bargaining power, at least to the extent that these assertions apply to McCain.

To a large extent, McCain's interests align with its growers. Further, the parties are at least equally interdependent – if not, growers have fewer penalties/diseconomies from failing to conclude acceptable potato growing contracts: For example:

- McCain is entirely dependent upon growers to supply potatoes (of sufficient quality, at the right time and at acceptable cost etc) – particularly in the context of:
 - the very significant sunk cost investments already made in the McCain plants (which cannot be altered to process other vegetables effectively);
 - the fixed costs incurred in operating from one season to the next;
 - McCain not being able to source potatoes viably for its processing facilities from suppliers other than nearby growers in Victoria and South Australia (apart from a small number of growers in southern NSW); and
 - the need to negotiate contracts with its customers during September and October for the upcoming year.
- once growers have committed to planting a potato crop in a given year, they are likely to be dependent upon McCain or other processors to buy the crop. However, most growers have ready alternative utilisation choices in operating mixed-use farms (although some specialised equipment is required for potato farming), and need not invest in planting a potato crop until a sales contract has been secured with a processor such as McCain.

Collective bargaining has not resulted in greater grower input into contracts

The collective negotiation processes under the previous Authorisations have not resulted in greater grower input into contracts.

Rather, the individual negotiation processes which McCain has undertaken with growers have provided growers with the opportunity to have substantive input into the terms of their contracts.

Specifically:

- as described above, non-price terms have not been the subject of collective negotiations, therefore, collective negotiations have not increased grower input into these terms as compared to individual negotiations;
- the collective bargaining process was generally narrowly focused on the RBB price and did not result in increased input from individual growers into pricing, particularly efficient growers; and
- as described above, quality incentive payments were the subject of a collective negotiation process, with the outcome being that McCain's proposal was rejected in Victoria. McCain considers that this outcome reduced incentives for producing higher quality potatoes, and did not reflect the interests of the more efficient growers.

In some respects the negotiation processes for the RBB price have been similar in collective and individual negotiations, with McCain presenting a proposed RBB price which has then been the subject of negotiations. The difference has been that:

- under the collective process, the negotiations have been between McCain and the Grower Committee, restricting the level of direct involvement that growers have had in negotiations, and have generally been lengthy and inefficient; whereas

- under the individual process, McCain has negotiated directly with growers who have made independent decisions on price (as well as all other non-price terms), enabling the process to be resolved quickly and efficiently.

McCain submits that:

- individual growers have had **more** direct input into the terms of contracts in the individual negotiation processes, than when there has been an additional collective negotiation process; and
- the collective negotiation processes have focussed on the interests of the less efficient growers.

Collective bargaining has not resulted in efficiency gains

The VPGC Application and the SEPGA Application both make statements to the effect that the collective bargaining processes permitted under the Authorisations have been efficient, effective and resulted in costs savings for parties participating in these processes. For example:

- The VPGC Application states, and the SEPGA has a statement to the same effect in the context of South Australia, that:

"...the VPGC considers the collective bargaining approach to be an organized and cost effective means to cover the issue of arranging contract prices and conditions for potato crops grown in Victoria.

Though companies may not support the collective bargaining offer by the different grower groups under the VPGC, growers would like the opportunity to go down this path if the companies decide to change their mind in the future and deal with the growers as a group instead of individually over price, supply and tonnage issues.

The collective bargaining process under Authorisation A91048 has been running smoothly for the last 5 years for those growers and businesses who are using it, and we do not envisage there would be a change in the manner in which the negotiations are undertaken now or in the future..."

- The SEPGA Application also states that: *"...there may be a small cost saving for growers and companies by collective bargaining, and certainly the efficiency of negotiations will be increased on both sides..."*

These submissions are contrary to McCain's experience of collective negotiation. In fact, McCain has found that:

- the collective negotiation processes have been inefficient and time consuming, and there have been several occasions when contracts were not settled prior to planting, and, in 2011, until well after the commencement of harvesting; and
- it has been necessary for McCain to separately undertake individual negotiations with each of its growers on non-price terms in any event – thus the collective negotiation framework has simply added to the cost, complexity and the time required to conclude negotiations.

Other claimed public benefits

There are other public benefits claimed in the Applications.

Both Applications claim that the proposed conduct will provide stability and support the local economy, and assist growers to maintain pace with industry developments and technological progress. That is, the Applications both state that:

- *"...The benefits on the administrative side include a more cost effective method of obtaining a price which will see more stability and added benefits for the local economy...; and*
- *"...Collective bargaining, though sometimes difficult between the negotiating parties, is intended to provide support and industry stability for growers. This transfers to...growers being able to maintain pace with, and continue to adopt relevant technology. There is always a strong desire for growers to continue to adopt suitable technology for industry achievements and process..."*

McCain agrees that local economic development and growers maintaining pace with industry developments and technological changes are desirable outcomes. However, McCain submits that they are unrelated to the proposed collective bargaining processes, and the Applications do not explain how such outcomes will result from collective bargaining.

4. The proposed arrangements will result in anti-competitive public detriment

Given there is no public benefit arising from the proposed arrangements, any anti-competitive detriment resulting from them will be determinative.

Both Applications state that: *"...In the last 5 years of active negotiations under the existing authorization, no public detriment has been observed..."*

McCain submits that this is clearly not the case.

Inefficiency and additional cost

There has been clear public detriment (or dis-benefit) from the collective negotiation process, including:

- the events and outcomes described in the case studies set out above regarding contracts not being settled until after planting, and not until well into the harvesting season in 2011 following a grower blockade of McCain's facility in Ballarat; and
- the additional cost and time involved in having to negotiate collectively with Growers' Committees, while having also to conduct individual negotiations with growers on non-price terms, instead of being able to conclude all terms in the one process.

Impairment to productivity, quality improvements and industry viability

Both Applications state that:

"...we suspect that the raw product price has little or no impact on the price which companies decide to use for their consumers..."

"...the grower share of the retail value of the products range from around 14%, depending on the specific potato crop. This means that any increase to the grower prices will only ever be small, relative to the consumer price..."

"...It could also be argued that there is no immediate need for any price increase to be passed to consumers..."

McCain disagrees with these statements, and particularly the assertion that the cost of potatoes is immaterial to the cost of potato products for consumers.

As explained above, the price McCain pays for its potatoes does affect the cost of its products to its customers (or, at least, the price that McCain seeks to obtain from its customers). In turn, McCain's customers (and other entities in the supply chain affected by the cost of potatoes) are likely to seek to pass these increased costs through to consumers.

It is the case that the price of processed potato products in Australia are to some extent constrained by import competition. However, while import competition in processed potato products may to some extent constrain the price increases for consumers resulting from increased potato costs, such a scenario is likely to compromise the ongoing viability of domestic processors and the potato industry more generally in Australia. That is, if processors are facing ongoing increases in the price of their main input (potatoes account for over half of McCain's costs of producing processed potatoes products in Australia) then:

- they will continue to lose market share if they seek to pass on these costs; or
- if they seek to absorb these costs to remain price competitive with imports, their operations will become unprofitable.

In this regard, McCain notes that the high cost of Australian processing potatoes is adversely affecting the competitiveness of Australian processors, and this is contributing to the increasing volumes of processed potato product imports. More specifically:

- Australian processing potatoes are, in relative terms, among the most expensive in the world. For example, Australian growers receive up to \$100 a tonne more than New Zealand growers (where McCain also has processing facilities).
- Figures from AUSVEG, the peak industry body for Australian vegetable growers which, amongst other activities, monitors imports of vegetable products into Australia show that imports (by value) of processed potato products increased from approximately \$38 million in 2006/07 to approximately \$81 million in 2010/11.

McCain's Australian processing plants are working hard to remain competitive against imports by implementing significant efficiency programs. For example, McCain recently implemented a number of energy and water savings programs in its Ballarat plant, reducing the use of energy by 25% and water usage by 33%

However, unless there are significant productivity improvements across the industry to address the relatively high cost of Australian potatoes, domestic processors will continue to lose market share to imports and the ongoing viability of the industry will be threatened.

There are a range of factors impacting on the cost of Australian potatoes apart from the mechanics of the negotiation process with growers, and McCain is not seeking to submit otherwise. However, McCain's experience since opting out of the collective negotiation process and dealing with growers on an individual basis is that they have been more open to seeking productivity improvements.

Given its previous experience, McCain is concerned that there will be less focus on productivity and quality improvements if the collective negotiation process were to recommence. By way of example, as described above, a proposal from McCain in relation to quality incentives was rejected under the collective negotiation process.

Significance of the proposed arrangements being voluntary

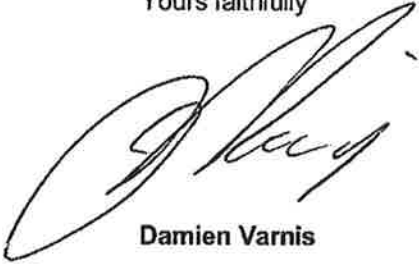
The proposed collective negotiation arrangements are voluntary. Indeed, McCain has chosen this year not to engage in any collective negotiations.

However, this does not fully address the risk that public detriments will materialise. While McCain has been able to negotiate contracts outside of the collective processes, it is concerned that there may be considerable pressure within the industry to move back to collective processes in the future if the VPGC Application and SEPGA Application are authorised.

In this regard, McCain submits that the growers' blockade in 2011 is instructive of the pressure within at least some segments of the industry to act collectively. McCain is concerned that, should the Applications be granted by the ACCC, the presence of the collective process as an alternative to individual negotiations will result in similar pressure

being exerted with a view to forcing the recommencement of collective negotiations in the future.

Yours faithfully

A handwritten signature in black ink, appearing to read 'D. Varnis', written in a cursive style.

Damien Varnis

Company Secretary