PRIMARY INDUSTRIES AND RESOURCES SA

NATIONAL COMPETITION POLICY

LEGISLATION REVIEW

Chicken Meat Industry Bill, 2002

FINAL REPORT

(Second Draft)

November 2002

The views expressed in this Report are the views of the Review Panel and do not necessarily represent the views of the South Australian Government. Any action taken in anticipation of the outcomes of the review process is at the risk of persons taking such action.

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Part 1. Introduction

1.1 Obligation to Review New Legislation

This Final Report concerns the legislation review of the *Chicken Meat Industry Bill, 2002* ("**the Bill**"). The review is conducted in compliance with an obligation upon the South Australian Government under clause 5 of the Competition Principles Agreement ("**the CPA**"). The obligation contained in clause 5(5) of the CPA is to review proposed legislation to assess any restrictions to competition contained therein. The 'guiding principle' in undertaking this review is that legislation should not restrict competition unless:

(a) the benefits of the restriction to the community as a whole outweigh the costs; and

(b) the objectives of the legislation can only be achieved by restricting competition.

1.2 Probity

It is a fundamental principal in the undertaking of legislation review that members of the public who wish to provide submissions are able to do so without threats or intimidation of a commercial nature or otherwise.

The Review Panel has been informed by a number of individuals, at different times and regarding different incidents, that they fear, or have been subject to, commercial threats and intimidation directed at their participation in this review process. Whilst the Review Panel makes no comment as to the validity or otherwise of these allegations, the Review Panel has undertaken to take particular care to ensure that, where it has been requested, submissions will remain confidential.

1.3 The Review Process

The process for reviewing legislation is set out in clause 5 of the CPA. This process must be followed to satisfy the obligation to review and, where appropriate, reform legislation which restricts competition. The South Australian Department of Premier and Cabinet ("**DPC**") has also released a paper that provides a model for the review of proposed legislation entitled "*Proposals for New Legislation - National Competition Policy Review Obligations*" ("**the DPC model**").

The Review of the Bill has been undertaken to meet South Australia's clause 5 obligations and has adhered to the DPC model. Once the policy decision to develop the Bill was made, the following steps in the review process were taken:

- Cabinet approved the drafting of the Bill and the Terms of Reference ("**ToR**") for the legislation review of the proposed Act (See Appendix 1);
- Cabinet approved the release of a ***Consultation Draft*** of the Bill as part of the public consultation process for this review;
- the Review Panel was formed;

- a Consultation Paper was drafted and released which attached the Consultation Draft of the Bill;

- the consultation period commenced on the 28th of June 2002 and closed on 13 September 2002, with over sixty submissions received from industry participants; and

- the Final Report of the Review Panel has been drafted and recommendations made (see Part 7: Recommendations).

The Review Panel notes that the processors' submission argues that consultation should have occurred prior to the drafting of the Bill and that the review process was therefore not consistent with the DPC model for conducting legislation reviews of proposed legislation.

The process conducted by the Review Panel is consistent with the DPC model. Cabinet approval to draft a ***final version of the Bill*** has not, as yet, occurred. Further, during the 11-week consultation period the processors have been given ample opportunity to provide comments to the Review Panel.

The release of the ***Consultation Draft of the Bill*** gave industry participants an opportunity not only to consider the Consultation Paper but also the details of the proposed legislation. This is a reflection of the SA Governments' commitment to full consultation.

1.4 The Final Report

This Final Report is to be read in conjunction with the Consultation Paper that was released to the public on Friday 28 June 2002.

The Final Report **does not re-iterate information provided in the Consultation Paper** unless such information is necessary for the logical flow of arguments in this Report.

1.5 Summary of Outcomes from the Bill

Standing back from the detail, the Panel considers that once the Bill is in operation, it will have the following major outcomes:

- The system of regulation proposed by the Bill is entirely voluntary on the part of growers. A grower who elects not to participate in a Processor Negotiating Group ("**PNG**") will not be subject to the regulatory scheme set in place by the Bill.

- The greatest adjustment that processors may have to make is that they will have to engage in genuine negotiations with growers (if genuine negotiations are not already occurring). Growing agreements and the relationship between growers and processors will exhibit a greater degree of fairness and equity.

- The Bill may result in some small gains and losses between growers and processors at their functional level of the supply chain. However, the economics of the chicken meat industry are such that there is little or no scope for any such adjustments to be passed onto end-consumers. The countervailing factors include:

- import competition into South Australia of frozen or chilled product (particularly by Bartters who have maintained their share of the wholesale market);

- the Bill does not impact at all on competition between processors in South Australia; and

- there is significant competition to chicken meat products from substitutable products (fish and other white and red meats) at the retail level.

- The Bill will aid in achieving an improvement in the long-term competitive position of the chicken meat industry by:

    - providing a better balance between:

        - allowing processors to select, and to enter into long-term relationships with, the more efficient growers; and,

        - providing efficient growers with a reasonable degree of financial certainty and security; and,

    - supporting a consultative approach to the sharing of the risk of major infrastructure investment; and,

    - encouraging the development of harmonious working relationships between growers and processors.

Part 2. Background

2.1 The Present State of the Industry

The following is a discussion of the present state of the South Australian chicken meat industry.

2.1.1 Economic Contribution

PIRSA Food Scorecard Team estimates that the economic contribution of South Australia's chicken meat industry in 2001/02 was approximately $280 million; an increase of about $40 million from 2000/01. The chicken meat industry accounts for about 13 percent of meat industry Gross Food Revenue.

South Australia produced 40 million chickens (an increase of two million from 2000/01); equivalent to 10 percent of Australia's annual chicken production. The farm gate value of these chickens is estimated to be $70 million (an increase of $10 million from 2000/01). The volume of chicken meat processed in South Australia has increased from 55,000 tonnes in 2000/01 to 58,000 tonnes in 2001/02. The value of South Australian processed chicken meat has increased from $165 million to $174 million in the same period.

Net interstate export of chicken meat appears to have increased by about 2,500 tonnes, from 7,500 tonnes in 2000/01 to 10,000 tonnes in 2001/02. The value of interstate exports has increased from about $22 million in 2000/01 to $66 million in 2001/02. Imports of chicken meat in 2001/02 are estimated at $36 million. Thus, South Australia is a net exporter of chicken meat. In addition, South Australia exported about 1000 tonnes of chicken meat overseas, valued at about $1 million, in 2001/02. The Australian Quarantine and Inspection Service (AQIS) do not permit importation of chicken meat into Australia for reasons of biosecurity.

2.1.2 Current Market Situation

According to industry sources, in terms of the provision of growing services, the South Australian chicken meat industry is presently oversupplied. In autumn 2002, Bartters (a major processor) ceased to contract for chicken meat growing services and to process in South Australia.

Between them, the other processors, Adelaide Poultry, Joe's Poultry and Inghams Enterprises, took on all but one of the twenty-six Bartter growers with the objective of expanding market share in the wake of Bartters' exodus.

The number and basis on which the Bartter growers were taken on by the remaining local processors varied. Adelaide Poultry took only one grower; the contractual detail of which is not known. Joe's Poultry offered three batches without written contract and without promise beyond three batches. Inghams took growers in with the intention of contracting on the same basis as with other growers, pursuant to a new national agreement. Inghams have advised the Panel that the new contract has not been progressed with growers because of the draft

Chicken Meat Industry Bill. That leaves the new Inghams' growers without a written contract at this stage.

Bartter's have continued to service their SA wholesale customers by road freighting processed chicken meat from their Victorian plant at Geelong. The Panel is advised that during recent months the situation in the South Australian industry has included:

- increased pressure to achieve interstate markets;
- downward pressure on wholesale prices; and
- ex-Bartters growers left without security of written contract for batch or longer period of supply.

2.1.3 Study of South Australian Growers' Financial Position

The Review Panel is aware that financial data on the commercial operations of chicken growing is difficult to attain. The Australian Bureau of Statistics ("**ABS**") ceased publication of financial statistics for the chicken meat industry in 1994. The ABS stated reason was that because of the vertically integrated nature of the industry, statistics at the farm level could not reasonably be separated from the upstream side of the industry.

To assist the Review Panel, an economist from the South Australian Research and Development Institute ("**SARDI**") undertook an economic analysis of the costs of chicken farming and the relative returns received, from a small sample of South Australian growers.

The results of this study are represented in table form at Appendix 2 to this Report. The following is a summary of the conclusions reached by the SARDI economist who conducted the study, based on his investigations and the results shown at Appendix 2:

- The sample growers' contracts were designed to maintain the growers incomes. The fee per bird is a result of a complex formula that reflects:
    - the cost of inputs, adjusted over time using an index of prices paid, and
    - the intensity of use of the growers facilities, adjusted over time.

    That is, growing fee increases according to the index but drops if the growing sheds are used more intensively - for example, if the processor puts more batches of chickens through the shed, the fee drops because growers receive more payments over time.

- In monetary terms, the problem is that the "national prices paid index" does not reflect the rapid rise in power bills in South Australia.

- In terms of quality of life, the increased intensity of shed use now means that the family farm owner / operator works considerably longer hours for the same reward and no longer gets sufficient break to take a family holiday.

The Review Panel notes that the income level has remained relatively static since effective deregulation in 1997. **However**, the costs of growing chickens in terms of inputs (e.g. electricity or gas) have substantially increased, there has been a more intensive use of facilities and the time which chicks are agisted with growers has been lengthened. These are all additional costs, which have not been reflected in the growing fee and as a result there has been an erosion of the growers' margin. This reduction in growers' margin is reflected in the table at Appendix 2 to this Report, which shows a reduction, in real terms, of growers' fees over the last 5 years.

2.1.4 An Effective Chicken Meat Industry Bill

In response to the draft Chicken Meat Industry Bill processors have indicated their dissatisfaction with the content of the Bill and their intention to circumvent it.

Processor dissatisfaction relates to several aspects of the Bill, but especially access by either party to compulsory mediation and arbitration. Compulsory mediation and arbitration is one of the main features of the Bill. It is intended to achieve a better balance of bargaining power between the two parties without the need for centralised regulation by a committee.

The Panel believes that the principal weakness of ACCC authorised collective negotiation is that, in South Australia at least, it has failed to inject real meaning into the word **'negotiation'** in contractual negotiations and dispute resolution. The Panel is of the opinion that collective negotiation needs to be assessed on several criteria. Authorisation to 'negotiate collectively' on the basis of its trivial impact on competition has little merit if it fails to foster genuine negotiation. Individual grower submissions to the Panel characterise the relationship with their processor as one-way communication. Growers submit that their experience of collective negotiation with their processor has included:

- manipulation of a suspect pricing model to achieve preconceived outcomes;
- frequent changes to preferred shedding and ventilation systems without grounding in science or account for specific circumstance; and,
- absence of fair process for resolution of contractual issues and indifference to financial impacts of policies and decisions.

The Bill will be of little benefit if it can be circumvented with ease, leaving a majority or a sizable minority of the industry not included, not advantaged or worse, disadvantaged.

That outcome is possible if a processor is able to achieve exclusive access to growers' infrastructure and skilled management, and routinely place batches of chicks ***without offering the grower a notice of exclusive contract***. That outcome is possible by reason of the lack of competition, with a small number of processors with territories based on transport economics and biosecurity realities. [1] The Panel is concerned that extra-contractual pressures from a processor could be applied to sign up key growers on individual contracts and then not sign up, but still gain exclusive services from, other growers.

[1] "Biosecurity realities": It is the Review Panel's understanding that due to the inherent risk of cross infection, processors are unlikely to place chicks with a Grower who has already received a batch from another processor.

To address these concerns a significant criminal penalty of up to $100,000 has been inserted into the Bill (new clause 15) for the offence of attempting to make an exclusive arrangement with a grower (whether by words or conduct) without first sending the grower the statutory notice. The definition of "tied growing agreement" includes an agreement that has the ***effect*** of tying the grower to the processor.

Further, the Bill now provides that all growing agreements entered into after the commencement of the Act must be in writing. This follows the scheme in section 20 of the *Chicken Meat Industry Committee Act, Queensland (1976)*.

The Panel is of the view that allowing processors to place a ***small percentage*** of their demand in short term (batch-by-batch) non-exclusive agreements with some growers may be of benefit to industry participants as it may keep a few marginal growers in business who would otherwise have to exit the industry. Further, it may help provide for extraordinary fluctuations in demand for grower services, in addition to the demand management arrangements provided for in long-term contract arrangements.

However, if in the future it is shown that this option is exploited by processors to circumvent the operation of the Act, then the Review Panel recommends that the legislation should be amended so as **to make the entering into all growing agreements, exclusive or otherwise, contingent on the processor issuing the prescribed notice**.

2.2 The Amended Scheme

On page 8, the Consultation Paper provides an overview of the regulatory scheme in the Consultation Draft of the Bill released on 28 June 2002. In response to the submissions received during the consultation period and in response to comments provided to the Review Panel at a meeting with both processors and growers on 29 October 2002, a number of amendments have been made to the scheme.

The amended scheme remains substantially the same as that outlined in the Consultation Paper. The main differences are that the Chicken Meat Industry Committee ("**the CMIC**") has been replaced with an appointed Registrar, and that the Registrar will no longer prescribe a mandatory Code of Practice.

1. **The Registrar:** the Chicken Meat Industry Committee ("**the CMIC**") has been replaced with a Registrar, who will be a public servant appointed by the Minister.

    - The industry liaison functions of the CMIC are to be performed administratively using existing representational bodies.
    - The industry strategic planning role of the CMIC is to be facilitated by PIRSA.
    - The Registrar will be responsible for the remaining functions of the CMIC that include overseeing the setting up of PNGs, maintaining the register and referring disputes for mediation and arbitration.
    - The activities of the Registrar will be paid for on a fee for service basis with the money sourced from a fee charged to all processors and growers.

2. **Arbitration:** clause 5 of the Bill includes an additional objective to require that arbitration under Parts 5, 7 and 8 take into account the need to promote best practice standards and fair and equitable conditions in the chicken meat industry and the need for the industry to be dynamic and commercially viable.

3. **The Code of Practice:** The Code of Practice has been removed from the Bill.

4. **Term of Contacts:** clause 25.(2) of the Bill (as released for consultation) has been amended to allow contracts to be extended for up to an additional 5 years.

5. **TPA:** Trade Practices Act exemption has been expanded to include exclusive contracts for shed maintenance services, transport and harvesting services.

6. **Exclusive growing agreements:** A criminal penalty of up to $100,000 has been inserted into the Bill (new clause 15) for the offence of attempting to make an exclusive arrangement with a grower (whether by words or conduct) without first sending the grower the statutory notice.

7. **Written growing agreements:** All growing agreements entered into after the commencement of the Act will be required to be in writing.

8. **Definition of growing agreement:** To avoid doubt, the transition provisions will deem a growing agreement to include agreements evidenced partly in writing, parole agreements and agreements evidenced only by a course of dealing, as well as variants of these types of arrangements.

9. **Processor access to mediation and arbitration:** During the collective negotiation of tied growing agreements, processors have been granted the power to call a meeting of their negotiating group and to also request that a failure of the group to accept an offered agreement be referred to mediation and arbitration.

10. **Grower representatives:** The factors that an arbitrator must take into account when considering whether a grower has been "unreasonably excluded" from the next round of growing agreements has been expanded to include whether or not the grower has been acting as a grower representative.

11. **Drafting changes:** It is noted that the most recent draft of the Bill has altered the order of some of the clauses in the Consultation Draft, and has refined and improved the way in which the scheme is drafted. Parliamentary Counsel has initiated these changes, which are of a technical drafting nature and do not represent any substantive change to the scheme.

2.3 Entering into an Exclusive Growing Agreement

The following is a description of how the proposed scheme operates during a period of contract negotiation.

1. If a Processor wants an exclusive arrangement with a Grower/Growers (meaning, the Grower is 'tied' to a particular Processor and cannot grow chickens for another Processor for the term of the contract, except with the consent of the first Processor), then the Processor must **COMPLY** with the Act.

2. If an exclusive arrangement is not required, the contractual relationship between Processor and Grower is **UNREGULATED** - thus, all references hereafter to a "growing agreement" mean an "exclusive growing agreement".

3. Processor **CHOOSES** Growers it requires for a growing agreement.

4. Processor **SENDS** chosen Growers a **NOTICE** [s16].

5. The Notice informs Growers that they have the option to negotiate either individually or collectively with the Processor [s16.(b)].

6. Grower **CHOOSES** whether it wishes to negotiate individually or collectively and **INFORMS** the Processor [s16.(b)].

7. If Grower choses to negotiate collectively - then - Grower is part of the Processor's Collective Negotiating Group ("**PNG**") [s11.(2)].

8. If Grower choses NOT to negotiate collectively - then - Grower negotiates directly with Processor, **OUTSIDE THE OPERATION OF THE ACT**.

9. Processor **INFORMS** the Registrar that the Grower is part of its PNG [s13.(5)].

10. Registrar **RECORDS** on register that the Grower is part of the PNG [s 12.(1)(b)(i)].

11. Processor commences **COLLECTIVE NEGOTIATIONS** for a growing agreement with members of the PNG or their representatives [Part 5, Division 3].

12. Grower members of the PNG **AGREE** to the terms of the collectively negotiated growing agreement [s19].

13. Processor **INFORMS** Registrar that an agreement has been entered into, the names of the Growers and the term of the agreement [s13] - **NO FURTHER INFORMATION REQUIRED**.

14. **Mediation / Arbitration:**

    a. Either the processor or the growers in a PNG may require mediation / arbitration if ***negotiations*** reach an impasse.

b. Further, during the ***term of a growing agreement***, either the processor or a grower may require mediation / arbitration as to:

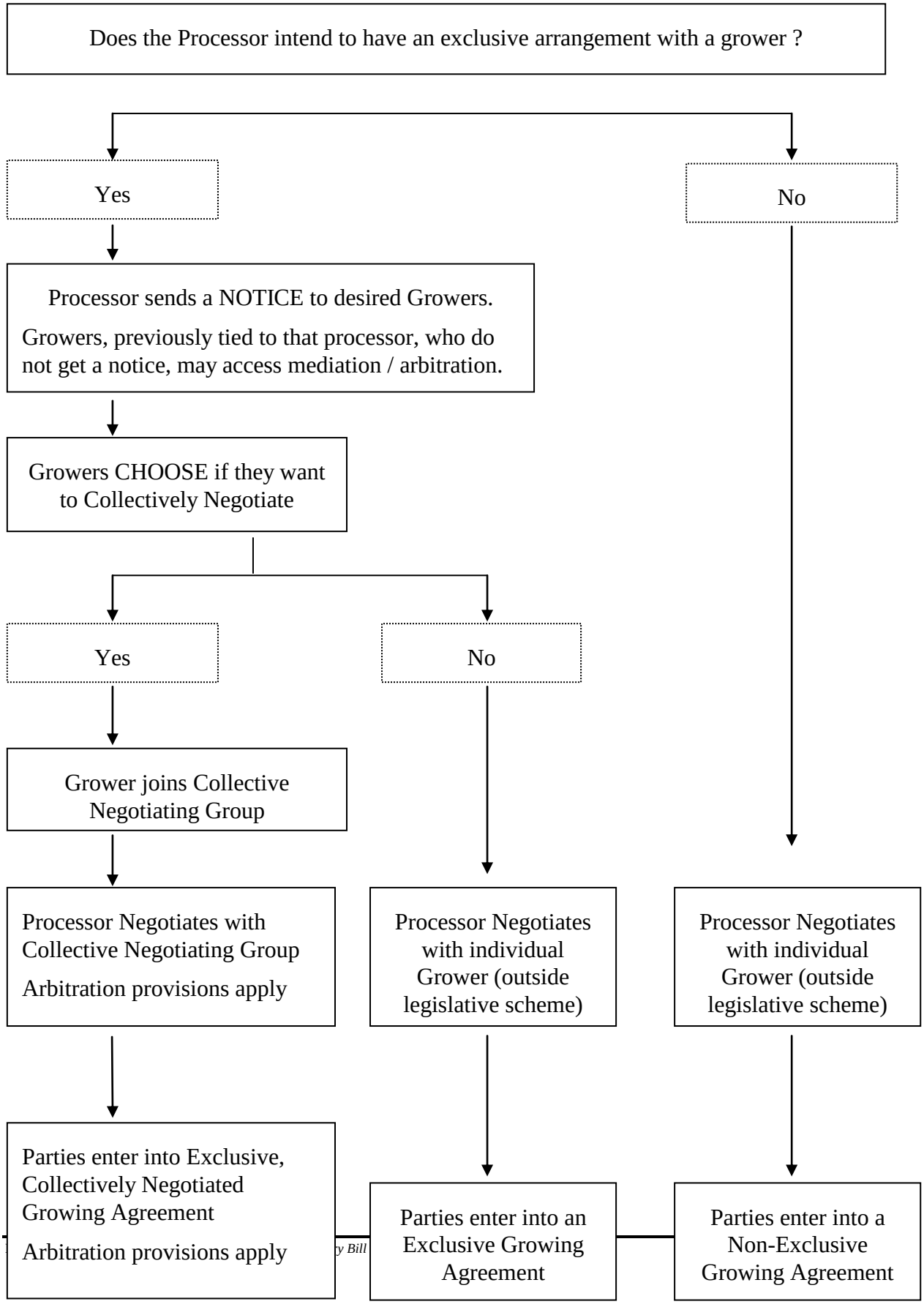
- the proper interpretation and meaning of the agreement; and,
- factual issues that relate to the operation of the agreement.

c. Finally, a grower may require mediation / arbitration if the grower receives notice that it is ***excluded*** from ***the next round of negotiations*** for a contract with that same processor [s. 11.(3)(b)(ii)]. There are a number of factors that the arbitrator ***must*** take into account [s. 28.(3)]:

- to the processor's advantage:
  - any change in the level of growing services that the processor requires;
  - the grower's level of efficiency as a grower;
  - the grower's level of compliance with the grower's obligations;
  - the grower's conduct in relation to the processor, including activities causing commercial detriment to the processor; and,
- to the grower's advantage:
  - the need to redress the imbalance in negotiating power between processors and growers; and
  - the grower's conduct in relation to the processor, including the grower's activities as a grower negotiator or grower representative.

The arbitrator must also consider the interests of the chicken meat industry as a whole.

2.4 Entering into an Exclusive Growing Agreement - Process Map



2.5 The Transition Arrangements

As a result of questions posed by Adelaide Poultry, the attention of the Review Panel was drawn to the fact that the transitional arrangements in the Consultation draft of the Bill were incomplete. This has prompted further consideration of the transitional arrangements in the Bill, and the Review Panel has since decided they required further elaboration. To this end, the following is a brief overview of the amended transition scheme.

2.5.1 The Policy

The policy behind the proposed additions to the transition arrangements is that the scheme of the Bill, once it has come into operation, should reflect the realities of the existing contracts or arrangements in the South Australian chicken meat industry. Thus, a "snap shot" will be taken of the arrangements presently in place between processors and growers, and they will be deemed to have been negotiated as if the proposed Act had been in force.

2.5.2 The Proposed Transitional Arrangements

It is proposed that:

- At the commencement of the Bill all tied growing agreements will be taken to be tied growing agreements collectively negotiated under Part 5 (subject to the point below). Growers who are party to these agreements will be formed into PNGs.

- A tied growing agreement will ***not*** be taken to be a growing agreement collectively negotiated under Part 5 if the Registrar is satisfied, on application from either a processor or a grower, that the agreement is an "individual" agreement or a "probationary" agreement.

- An "individual agreement" is one where there are significant differences between the agreement and ***all other*** tied growing agreements with the processor, in relation to its principal terms and conditions (this assumes that there may be several different types of growing agreements negotiated in a PNG, but "individual agreements" would be unlike ***the other agreements***).

- An agreement is "probationary" if it:

    - operates from batch to batch; and,

    - does not follow on from a previous fixed-term tied growing agreement between the same processor and the grower party to the "probationary" agreement.

2.5.3 Consultation

On the 11th of October a letter was sent to industry participants outlining the proposed transitional arrangements for the new Bill.

The only response received was from Dr Timothy Ryan and Associates Pty Ltd, on behalf of the SA processors: Adelaide Poultry, Joes Poultry and Inghams Enterprises. Dr Ryan indicated objections to the proposed transition provisions that, while expressed in terms of the transition provisions, were to the same effect as the processors' general objections to the Bill.

The following points were forwarded for the consideration of the Review Panel:

- Agreements which are standard amongst the processors' growers will be subject to compulsory mediation and arbitration under Part 7 and Part 8;
- Existing mediation and arbitration provisions in those agreements will be overridden;
- The Act will operate retrospectively, altering the terms and conditions of existing contracts;
- The proposed arrangements do not respect "sanctity of contract"; and
- The proposed arrangements will make existing contracts subject to compulsory mediation and arbitration under Part 8, resulting in "continuous contracts".

2.5.4 The Review Panels' response:

- The benefits that the Bill makes available to growers, including access to the dispute resolution provisions in Parts 7 and 8, should not be delayed until the next contracting period (possibly 5 years hence). The commencement of the Bill has already been delayed 12 months because of the SA election period (no progress was able to be made between September 01 and April 02), and thus the Bill will now be introduced well after the last major contract period has expired (Inghams' last 5 year contract expired in April 02).
- The transitional arrangements do not override any of the terms and conditions of existing agreements (whether formal contracts or informal arrangements) between growers and processors - growers and processors are simply granted access to a statutory dispute resolution process ***in addition*** to any rights to arbitration in the existing contracts. The Panel notes that there is a distinction between contractual rights and obligations and rights and obligations imposed by a statutory scheme.
- The proposed transitional arrangements are not retrospective. The provisions of the Bill will only apply once it has been enacted. The fact that the law applies to circumstances within the community that exist at the time of commencement is not retrospectivity but is the expected result of the application of the new law.

  It is an everyday occurrence, relevant to all new legislation that the rights and obligations introduced by new legislation apply to existing arrangements in the community - that is ***not*** retrospectivity, it is simply standard legislative practice.
- Contractual terms and conditions are not affected by the transitional arrangements - sanctity of contract is respected. In fact, it is a fundamental proposition of the Bill that it is not concerned at all with the content of the contracts that growers and processors enter into. Unless requested to do so, the Registrar does not even get to see the contracts.

- The application of Part 8 does not lead to "perpetual" or "continuous" contracts. In particular, the arbitrator must take into account the factors described at paragraph 2.3, 14.(c) of this Report, which have a focus on efficiency and commerciality.

Part 3. Consultation

3.1 Consultation Process

More than sixty submissions were received in response to an invitation to industry and other interested persons to comment on the Bill (by the closing date of Friday 13th September, 2002). Most submissions were from South Australian growers and grower groups (South Australian Farmers' Federation ("**SAFF**")). Several were from South Australian based processors, with whom there have also been exchanges of letters. One was from the Victorian Farmers' Federation.

There is national interest in the South Australian Government Bill. Livestock Industries' Glenside Office was contacted by the Australian Competition and Consumer Commission ("**ACCC**"). Other States have also shown interest. The National Competition Policy Implementation Unit of the SA Department of Premier and Cabinet has been kept briefed on progress.

In addition to submissions, there have been several public meetings with contract chicken growers, organised by SAFF. The draft Bill was launched for public comment on Friday 28th June 2002 by The Hon. Paul Holloway, the Minister of Agriculture, Food and Fisheries, at the SAFF Chicken Meat Section Annual General Meeting, held in Adelaide and attended by about thirty growers.

An evening meeting at Hahndorf on Friday 26th July was attended by about fifty growers [Speakers: Mr Greg Cox and Mr Simon Howlett, (Attorney General's Department ("**AGD**") and Mr Glenn Ronan, Primary Industries and Resources SA ("**PIRSA**")]. An evening meeting in Adelaide on Friday 30th August was attended by about a dozen growers (Speaker: Mr Glenn Ronan).

Each of the three processors also escorted officers to chicken farming areas with visits to about a dozen chicken meat farms:

1. Inghams, Monday 29th July: Mr Des Hindson, General Manager; Mr Paul Cox, Farm Manager and Mr Glenn Ronan, PIRSA.

2. Adelaide Poultry, Wednesday 31st July: Mr Jake Centenera, Director; Mr Paul Rymer, Farming Manager and Mr Glenn Ronan, PIRSA.

3. Joe's Poultry, Tuesday 10th September: Mr Charles Rikard-Bell, Farming Manager, Mr Greg Cox and Mr Simon Howlett, AGD; Mr Glenn Ronan, PIRSA.

On 29 October 2002, the Hon. Paul Holloway, Minister for Agriculture, Food and Fisheries and the Review Panel met with the representatives of both SA growers and processors.

The Joint Processor submission and the Inghams submission opposed the Bill. Grower submissions supported the Bill. The SAFF submission supported a more regulated situation than represented by the Bill. The SAFF submission and the Joint Processors submission have

been lodged on the PIRSA Livestock Industries website, along with the Bill and the Consultation Paper:

http://www.pir.sa.gov.au/dhtml/ss/section.php?sectID=401&tempID=7

3.2 Grower Submissions

Most grower submissions were signatories to a SAFF proforma letter, supporting all aspects of the Bill. Initially, growers indicated they feared to make submissions if their names were made public. AGD officers advised that the consultation process was able to accommodate requests for confidentiality. All growers have labelled their letters: "In Confidence".

Significantly, more than forty growers attached letters outlining their experience in the industry. Some of these growers had been in the industry for decades; a few were entrants in the past three to five years. None of the growers submissions expressed that they were satisfied with the period of ACCC authorisation after the Poultry Meat Industry Committee ceased to function (*ie*, the past six years). This is in stark contrast to the processors' submission where the authorisation experience is regarded as a satisfactory and preferred basis of industry operation into the future.

The following sections summarise several aspects of *Grower* submissions that are central to the Bill.

3.2.1 Exclusive Contracts, Collective Negotiation and Dispute Resolution:

Most grower submissions said that there had been no genuine negotiation, individual or collective. A number of submissions referred to the manner of negotiating with their processor as **"take it or leave it."** The processor retort is that they (growers) always want a higher growing fee. Growers submit that the growing fee has decreased nominally during the past five years.

Contrary to processor perception, the fee is not the only grievance referred to in submissions. Significant issues in regard to the interpretation and management of contracts were raised, particularly the practice of the smaller processors not having written contracts [2].

Other grower grievances included biased adjudication on liability for chicken deaths, variable feed quality without relief from performance penalty, poor quality chicks, frequent changes to shedding standards and unscientific justifications for ventilation technology specifications. Quite a few of these matters are of serious financial impact, including the potential for the termination of contracts.

The Panel is concerned at the apparent lack of satisfactory resolution that accompanies this frequent reference to contractual conflicts. Unresolved conflicts appear to linger and affect the business relationship. Not wishing to **"bite the hand that feeds them"**, and fearing retribution, the grower does not carry the issue beyond the initial contact with the processor. In a number of cases submissions tell of contracts being terminated and growers placed on

[2] Only one company, Inghams Enterprises Pty Ltd, appears to have a written contract. Inghams is also the only company with ACCC authorisation to negotiate collectively with its growers

batch-to-batch supply. The submissions provide an impression of disproportionate punishment when a contract is breached; contract security is lost and chickens are placed in the sheds on batch-to-batch supply after a stand-off period and rectification of problems. The shedding system may be satisfactory but the contract may not be renewed.

3.2.2 Financial Models ('Model Farm') and Contract 'Negotiation'

In the absence of an auction market for chicken meat, a mathematical model has been used as an aid to objectivity and consistency during collective negotiation of the contract. Inghams and NSW growers each have their own model ("model farm"). With different assumptions and input data, the models apparently produce quite different costs of production (a difference of about 20 percent). According to grower submissions, processors cost assumptions are lower than grower actual costs.

Further, the model is based on a four-shed farm; most South Australian growers have less than four sheds. Processors regard the model as fair and the prices offered as generous, enabling good profits for efficient producers with adequate scale. Obviously no single cost calculating/price generating model could satisfy all growers. However, grower submissions indicate that growers are suspicious of manipulation by processors to achieve processor-desired outcomes. Growers submit that the model:

- lacks transparency;
- is arbitrarily changed and omits critical enterprise costs (eg depreciation);
- is based on an atypical farm size (four sheds).

Growers submit that the contract involves a basis of payment (per bird rather than per kilogram), which leads to extensions of bird management without grower remuneration (norm was 50 days, now being extended to 55 days). Again, the grower view is that this is a crucial contractual clause where the weaker negotiating party has no option but to sign up to an unsatisfactory contract in fear of the alternative (no contract). Arbitration on all issues is not an option in the contract unless ***both*** parties agree. There has ***not*** been a case of mediation/arbitration over the past five years.

The results of the study conducted by SARDI support the growers' position, in that the study indicated a reduction, in real terms, of growing fees over the last 5 years. The Review Panel recognises that the SARDI report is based on a small sample of growers and relies on the results of the study as merely an indicator of the financial position of growers over the last 5 years since effective deregulation. [3]

3.3 Processor Submissions

The following section provides a summary of several main aspects of processor submissions relating to the Bill.

[3] Please refer to the discussion of the SARDI economist's findings under 2.1.3 "Study of South Australian Growers' Financial Position" and the table of the studies results at Appendix 2 to this Report.

3.2.3 Government Intervention is Not Required

Processors emphasise that there has been no operative legislation in effect in South Australia since 1996. Further, that during this time major changes have occurred leading to both development and growth within the South Australian chicken meat industry. Processors highlight the following as characteristics of the positive impact an absence of State-based regulation has had on the local chicken meat industry:

- Essentially two new integrated processors have entered the market (Joe's Poultry had only a small presence in 1996, but has dramatically expanded).
- The three current integrated processors have invested an additional $50 million.
- Total employment (direct and contractors) by those three processors has increased from an estimated 475 to 1,120 over the 5 years.
- Inghams employment (plus contractors) has increased from around 380 to 740.
- Grower numbers have remained static (80 in 1996 and 81 at present; includes Joe's Poultry and Adelaide Poultry company growers).
- Inghams growers have gone from 41 to 44 with no expansion in company farms over that time.
- Grower investment for expansion has continued.
- Chicken meat production has increased by 30 per cent, despite the closure of Bartters.
- In late 2001, estimates of production were for a 47 per cent increase [4].
- Strong growth in exports from very little in 1996, to 30 per cent of total now, and 42 per cent of the largest processor's production. [5]

Processors also put forward a positive view of the commercial position of growers in South Australia since effective deregulation in 1996. Processor submissions say:

- that no grower has gone out of business;
- that except for one of the 25 growers displaced by Bartters exiting the growing market, all have been picked up by the remaining processors;
- that growers are continuing to invest in the industry, with processors noting that they have no problems in getting growers to invest in further expansion of their facilities;
- that new growers are entering the market;
- that all growers have written agreements except some Bartter growers who are still on a probationary period with Joes' Poultry; [6] and

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4 The Panel assumes that this prediction was for a whole of State increase on the assumption that Bartters was processing in SA. Of course, Bartters is no longer processing in SA and import some 25% - 30% of SA's chicken meat consumption.

5 There has been minor amendment of the dot points as presented in the submission so as to avoid repetition within the Final Report.

- that despite early concerns that a lack of legislation would cause growing fees to be severely pressured, they have held and throughput has increased.

Processors submit that the evidence forwarded by them shows that State-based legislation is not necessary for the industry to expand. Participants in the South Australian chicken meat industry are able to negotiate, arrange and manage their own affairs. Further, that there is no *prima facie* evidence that there are large social costs emanating from the current arrangements, or gross inequities, due to any imbalance of bargaining power.

It is also suggested that insufficient consideration has been given to available alternatives. Specifically, processors point out that the ACCC authorisation has, in their view, been a success in providing growers with adequate protection through collective negotiation. Processors assert that State-based legislation is not necessary as growers are at liberty to seek their own ACCC authorisation and may rely on the unconscionability provisions in the *Trade Practices Act* to ensure that they are not unfairly dealt with.

3.2.4 Natural Tension Between Suppliers and Buyers

Processors point out that due to the high level of vertical integration in the chicken meat industry, merely considering the growing fees in isolation does not encompass the breadth of costs that the growers impose on processors. Processors suggest that, in terms of losses in production and quality, they will incur additional flow-on costs where growers' facilities are not up to their required standard. Processors suggest that their dependence on the grower to provide facilities to a standard required by the processor leads to a natural friction between the processor and grower.

Processors point out that tension between suppliers and buyers is a natural occurrence in the market place, that this tension is healthy and forces all parties along a supply chain to seek efficiencies and greater productivity. Processors assert that this natural tension between processors and growers does not in of itself justify intervention by the South Australian Government.

3.2.5 No Market Failure

Processors declare that the situation in the chicken meat industry does not constitute a market failure **in an efficiency sense**. The processor submission states that the situation in the industry is a "monopsony", where a number of suppliers (growers) are selling to a single purchaser (processor). However, processors submit that a monopsony does not result in market failure because the purchaser will bargain down the suppliers to the least amount they are willing to accept: an efficient outcome. Processors claim in regard to prices:

> "*Anything lower will lead to growers leaving the industry or not coming into the industry. This outcome is essentially the same outcome as that which would prevail in a competitive market.*"

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6 This is in ***direct contrast to submissions received from growers***, the Review Panel notes, however, that the processor submissions were drafted prior to certain recent changes in the industry leading to a greater number of unwritten, batch-by-batch contracts.

This appears to the Panel to be an argument by analogy with Ramsey pricing. [7] The Panel has addressed this later in the Report but, in brief, considers that the "monopsony" argument does not provide a true efficiency paradigm.

Processors assert that, as there is no market failure to be addressed, the decision to provide for South Australian legislation is one of equity not of market efficiency. Further, that the equity case is unproven:

> *"...no prima facie evidence that there are large social costs emanating from the current arrangements or gross inequities due to any imbalance of bargaining power."*

3.2.6 The Proposed Legislative Scheme

Processors put forward that the proposed South Australian Government approach, taken in its entirety, constitutes a shift back in structure to a centralised system. Processors claim:

- that the proposal will result in higher costs in the industry and that it will act as an impediment to grower investment in infrastructure;
- that the establishment of the Chicken Meat Industry Committee will take the focus away from supply chain relationships, reinforcing an "us and them" approach;
- that availability of mediation and arbitration will take the pressure off parties to come to negotiated outcomes; and
- that the scheme will result in outcomes that are "compromises" and divorced from economic efficiency considerations.

The Panel disagrees with this view as discussed later in the Report and as summarised in paragraph 1.5 above.

Processors have also taken particular exception to the proposed Part 8 of the Bill. Part 8 provides for growers who are party to a collectively negotiated tied growing agreement to seek mediation and arbitration when a processor gives such a grower notice in writing that they will not be included in the next round of contracts [clause 11.(3)(b)(ii)]. Processors argue that this Part challenges the right of the processor to terminate an agreement at the end of the contract, creating "***perpetual contracts***". Processors assert that this is a violation of "***property rights***" and that it will severely inhibit industry restructuring.

In summary, processors propose that the scheme will result in higher growing fees and slower productivity growth, raising contract growing production costs in South Australia relative to other sources. That this will lead to the following adjustments and cost burdens:

- imports from other States will increase;
- exports to other States will decrease;
- processors will process less chickens in South Australia;
- integrated processors will turn towards company production;

[7] Please refer to heading 4.3.2 "No Market Failure", which includes a comprehensive discussion of the concept of "Ramsay Pricing".

- national processors will shift production to other States;
- employment associated with processing activities will fall;
- it is likely that local South Australia-based processors (Adelaide and Joe's) will experience a greater contraction because they may be less able to adjust to higher costs;
- contract grower numbers / throughput will decline; and
- growers who have older, high-cost facilities or who are less efficient will go out of the industry more quickly than otherwise.

Part 4. Objectives of the Bill

4.1 The stated objectives of the Bill

Clause 5 sets out the intention of the Bill:

> ***"****(a) that equity between processors and tied growers be promoted -*
>
> *(i) by allowing for collective negotiations and arbitration of disputes; and*
>
> *(ii) by the appointment of a Registrar with functions including the facilitation of collective negotiations between processors and growers; and*
>
> *(b) that arbitration under Parts 5, 7 and 8 take into account the need to promote best practice standards and fair and equitable conditions in the chicken meat industry and the need for the industry to be dynamic and commercially viable.****"***

None of the submissions received suggested that the Bill, as proposed, had any other objectives.

While there was disagreement between processors and growers as to whether the benefits of this objective outweighed the cost, there appeared to be no misunderstanding that the stated objective is to promote equity between processors and tied growers.

A submission from a grower suggested that an additional objective should be to protect growers from exploitation. This implied a greater degree of regulatory intervention than proposed by the Bill.

It is not an objective of the Bill to ***guarantee*** that growers be protected from exploitation. The proposed Bill provides growers - through collective negotiation, supported by compulsory mediation and arbitration, and with the "comfort" provided by a State-based regulatory scheme with a Registrar tasked to facilitate the structuring of collective negotiations - with the tools to protect their own interests.

The Panel acknowledges that while the Bill will provide for some re-balancing of the relationship between processors and growers, it will not however be able to place the parties on a 'level playing field'. The imbalance in market power between the parties cannot be wholly overcome by legislative measures such as those proposed by the Bill. To do so would require a much more interventionist scheme.

The Terms of Reference for this legislation review require that the Review Panel not only clarify the objectives of the new legislation but also identify the issues the Bill seeks to address. Part 4 of the Consultation Paper identified:

- the imbalance in bargaining power between growers and processors and the resultant market failure;
- the need to provide for collective negotiation; and

- the promotion of harmony and equitable dealing in the South Australian chicken meat industry,

as the issues which the Bill seeks to address.

Please refer to pages 15 to 17 of the Consultation Paper for a detailed discussion of these issues.

4.2 Discussion of Grower Submissions

Grower submissions confirmed that the issues identified in the Consultation Paper (pages 15 - 17) are those that the objectives of the Bill are intended to address. Growers supported the premise in Part 4 of the Consultation Paper that the processors obtained a whole-of-chain efficiency by vertical integration. On the other hand, growers also suggested that there were inefficiencies resulting from the imbalance of market power between growers and processors.

Growers acknowledged and provided evidence that this imbalance was the result of the combination of three facts:

- the efficient scale for the growing-out operation was small relative to that for processing, so each processor requires numerous growers;
- once the growing-out sheds were built, they had few or no alternative uses, that is, their cost was "sunk" in a "specific asset"; and
- the growers had little intellectual property ownership from which to improve their bargaining position.

As a result of farm visits, it became very apparent to the Panel that a 'best practice' growing situation required a high degree of micro-management by the grower. For example:

- a variation of a few degrees in shed temperature (particularly on extreme temperature days) could cause a die-off of up to 150,000 birds;
- sudden variations in lighting and noise can cause bird panic and the loss of tens of thousands of birds in a shed;
- too high a moisture level can cause disease; and
- bio-security must, of course, always be at a high level or else hundreds of thousands of birds could be lost.

These factors, even if they do not cause significant bird deaths, can interfere with the industry critical factor of the conversion of feed to chicken weight. Interestingly, the requirement for efficient and knowledgeable micro-management by owner-growers gives them a factor of competitive advantage over large "home farms".

The Panel acknowledges that the proposed scheme does not go as far as some of the grower submissions would desire and that the scheme does not fully address the extent of the bargaining power imbalance suffered by growers. The Panel acknowledges that growers will still be exposed because processors are still able to build their own growing facilities or to support new grower entrants.

However, the Panel believes that the Bill's objective of promoting equity between processors and tied growers by addressing the imbalance in bargaining power and in consequence assisting to provide for the long-term security for the majority of growers, is best guaranteed by allowing for a dynamic industry, where competitive pressure from new entrants is not excluded, where mediation and arbitration must take account of commercial and efficiency factors, and where it is anticipated that some industry restructuring will occur. For that reason, a more restrictive scheme is not being proposed.

In summary, the Panel considers that the following proposition best describes the grower position:

- Growers would prefer a more highly regulated scheme such as that in the existing *Poultry Meat Industry Act*, so as to guarantee existing growers industrial security and to impose an external oversight of contracts by a statutory Committee;

- Some growers are now becoming aware that even a statutory Committee (such as in New South Wales) may not be able to give them the security and equal bargaining position that they desire;

- However, ***if*** the existing *Poultry Meat Industry Act* were to be repealed, growers ***without exception*** would prefer the proposed Bill to having no State-based regulatory scheme.

4.3 Discussion of Processor Submissions

Processor submissions also confirmed that the issues identified in the Consultation Paper (pages 15 to 17) are those that the objectives of the Bill are intended to address. However, processor submissions forwarded a number of arguments to suggest that;

- South Australian Government intervention is not required;
- the imbalance in bargaining power does not exist, or if it does, there is no adverse impact on the industry; and
- State legislation would have an adverse impact on the industry.

Those arguments were based on:

- evidence of rapid growth in production since effective deregulation in 1996; and
- disagreement as to there being any negative impacts of processor monopsony.

The following is a discussion of the arguments raised by the Processors.

4.3.1 "Growth in the South Australian Chicken Meat Industry"

Processor submissions provide an impressive list of the advancements in the South Australian chicken meat industry since effective deregulation in 1996. They also list the positive aspects of the growing industry since 1996. Processor submissions suggest that these advancements show that the proposed State scheme is not necessary to allow for the SA industry to expand. (Please refer to Part 3 of this Report for a detailed summary of the Processors' submission).

The Review Panel recognises that the SA chicken meat industry has expanded since the Poultry Meat Industry Committee ("**the PMIC**") and *the Poultry Meat Industry Act* ceased to operate. The PMIC set prices centrally, approved growing agreements, and did not allow new growers into the industry where sufficient growing services were already available to meet demand. It is understandable that a reduction in these constraints ***may*** have been a factor in the industry expansion over the last 5 years. The Review Panel understands the processors' concerns regarding a return to the centralised scheme.

However, while some growth may be attributed to effective deregulation since 1996, the processor argument ignores the retail end of the supply chain, and the increase in consumer demand for "oven ready" and "fancy" chicken products. In response to this demand at the retail level, there has been a large expansion in further processing since the mid-1990s. This has occurred not just in SA, but has been typical of all States as well as of countries like the UK.

The processor submission asserts that the proposed Bill will impose costs on the industry, primarily in terms of acting to restrict commercial flexibility and operating as an impediment to rationalisation.

The Review Panel notes that the scheme does not operate to interfere with the negotiations between the processors and growers. The Bill does not restrict or impede the commercial operations of the processors.

The only instance where a third party may become involved in the negotiation process is as a result of a dispute being decided by arbitration. The costs imposed by arbitration are confined to the parties and furthermore any arbitration conducted pursuant to the Bill must take into account, by law, factors that are pro-competitive and support a dynamic industry. [8]

The compulsory mediation and arbitration provisions do not restrict the commerciality of the processors' business operations. The compulsory mediation and arbitration provisions may impose some additional transaction costs to industry participants. However, these costs should operate as a discipline both to encourage genuine negotiations and as a disincentive for the commencement of nuisance disputes.

The proposed scheme may impose additional transaction costs on the industry. These costs include the administrative cost of sending a notice and of keeping the Registrar informed of the contractual arrangements entered into by the processor. In addition, industry participants will be required to pay a fee for the services provided by the Registrar. These costs are marginal and necessary for the operation of the Bill and are therefore outweighed by the public benefits derived from the scheme.

In any event, the Review Panel notes that there is limited capacity for any additional costs to the industry to be passed down to the end consumers of chicken meat. At the retail functional level of the market there is fierce competition between processors including Bartters, and between chicken and other substitutable products. Further, the relationship between growers and processors is essentially symbiotic - they are mutually dependent upon each other. Growers will not rationally allow a processor to lose market share, much less to fail.

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8 Please refer to the discussion of the compulsory mediation and arbitration provisions under heading 4.4.2 "The Costs" and heading 5.4 "Compulsory Mediation and Arbitration".

Grower submissions provide a stark contrast to the processors assessment of the advancements in the SA chicken meat industry since effective deregulation. Growers express deep dissatisfaction with the industry and request that the old scheme be reactivated. Grower submissions report:

- a reduction in growing fees, in real terms;
- a reduction in the value of their assets;
- an inability to exit the industry due to purchaser disinterest; and
- an increase in the obligations under growing agreements for which they are financially liable. [9] (Please refer to Part 3 of this Report for a detailed summary of the grower submissions.)

The results of the study conducted by SARDI indicate support for the growers' position, suggesting, that in real terms, growing fees have reduced over the last five years.[10]

It is not disputed that the deregulation of the SA chicken meat industry may have been of benefit to the processors. The issue is whether that benefit has been shared with the growers.

The efficiency gains of the processors' vertical integration are only sustainable if they are shared by the whole industry. Short-term gains by processors do not necessarily correlate to long-term sustainability within the industry. The proposed scheme, by promoting equity between processors and tied growers and addressing the bargaining power imbalance, is intended to ensure that the advancements of the SA industry in the last 5 years are sustained into the future.

4.3.2 "No market failure"

Processors correctly point out that in a vertically integrated industry, participants are interdependent and that this leads to a natural tension between suppliers and purchasers. Processors argue that this tension is healthy as it provides incentive for industry participants to find efficiencies and to invest in market innovation. Processors warn that this tension should not be mistaken for an imbalance in marketing power.

The Review Panel agrees that there is a tension between suppliers and purchasers, but believes that it is only ***healthy*** if, in the end, both parties can objectively be said to have reached a satisfactory bargain. That will only occur if there are genuine negotiations which in the chicken meat industry requires the discipline of compulsory objective, unbiased mediation/arbitration.

The processors' joint submission identifies the South Australian chicken meat industry as a "monopsony". That is, a market where a number of suppliers are required to deal with only one purchaser. Processors argue that a monopsony is not of itself a market failure and that it

9 A submission from an independent real estate agent confirming that the value of growing farms had dropped significantly over the 5 years since effective deregulation and further stating that it was very difficult for growers to now sell their farms and therefore exit the industry.

10 Please refer to the discussion of the SARDI economist's findings under 2.1.3 "Study of South Australian Growers' Financial Position" and the table of the studies results at Appendix 2 to this Report.

may lead to efficient outcomes. Processors also stress that if the purchaser demands from his captive suppliers conditions which they are unable to sustain, the suppliers will exit the industry and no further suppliers will enter the industry.

This appears to be an argument by analogy with (the corollary of) Ramsey pricing (that is, it is efficient for a monopolist controlling a scarce commodity to sell at a price that reflects the customer's own assessment of the value he assigns to the particular commodity, thus the scarce commodity is sold to higher-value users rather than to lower-value users.) However, in the present case:

- unlike the Ramsey pricing model, growers do not engage in price differentiated negotiations with their processor - there is a common price or pricing formula for all growers tied to their particular processor (there is even a move to an Australia-wide standard contract by Inghams);

- at present there is no genuine price negotiation at all, and, as discussed at paragraph 3.2.2 ("Financial models and contract negotiation"), growers do not have sufficient information to be able to negotiate fairly, or are presented with financial models that they believe are unsound;

- accepting that, under the processors' monopsonist argument, growers will inevitably be forced to accept a price that is the lowest that they can sustain, that outcome is only efficient if the savings are passed onto consumers, and if the price really does sustain an efficient growing sector over the long run. It assumes that the processor is not pocketing some of this monopsonist 'rent', rather than passing it all on to consumers; and,

- to the extent that there is a surplus generated between growers and processors and **not passed onto consumers**, it is more beneficial to the SA economy as a whole if that surplus is shared equitably (in accordance with factors such as investment and risk) between growers and processors;

- finally, price negotiation is ***not the only issue*** for growers. As described in chapter 3, there are significant other issues that are of genuine concern to growers (such as: issues arising from the industry culture, biased adjudication on liability for chicken deaths, variable feed quality without relief from performance penalty, poor quality chicks, frequent changes to shedding standards and unscientific justifications for ventilation technology specifications).

The Panel agrees that processors have a degree of monopsony power (each with its own 'tied' growers, but ***not*** with growers generally), but disagrees with the processor argument that such power causes no detriment. Standard economic analysis of monopsony suggests that the equilibrium level of production will be lower than in a competitive market and that the price paid to input suppliers (in this case, growers) would be lower. In some cases, depending on the monopsonist's share of the relevant market, the price charged to consumers may even be higher. The impacts identified by growers (a reduction in growing fees in real terms; a reduction in the value of their assets; an inability to exit the industry due to purchaser disinterest; and an increase in the obligations under growing agreements for which they are

financially liable) are as consistent with this analysis as it is with the processor's deregulatory argument.

The processors counter this argument by pointing to continued supply of growing-out services and, indeed, continued investment in shed improvement. However, continued provision of services (and investment) is rational for growers with large sunk costs in the form of sheds and plant, if the prices offered make *some* contribution towards amortising the debts associated with those sunk costs. That is, having built the sheds, they will continue as growers, and will even invest in improvements such as tunnel ventilation, if the loss they make is less than their amortisation costs.

The Panel has received evidence that growers are not receiving full compensation for the depreciation on the sheds. It therefore considers the current situation of grower disquiet to be a combination of the application of the processors' monopsony power and the necessary industry adjustment associated with removal of the earlier unduly restrictive legislation (the present inoperative Act).

The Panel considers that the public consultation has confirmed that, since the present Act has been inoperative (1996), the balance of power has swung too far back towards the processors. It is the objective of the Bill to promote equity between processors and tied growers by allowing for some rebalancing of bargaining power toward the growers so as to foster genuine negotiations between tied growers and processors. At the same time, maintaining the advantages of a light-handed regulatory approach that has efficiency, best practice and commerciality as its standards. This requires a balance between:

- when new contracts need to be made, allowing processors to select growers who:
    - can demonstrate an ability to perform well against contract specifications; and
    - have the appropriate scale and location to minimise the total costs of the arrangement, including growing, delivery and negotiation costs; and,
- providing a mechanism that allows existing and potential investors in growing sheds to have sufficient confidence in their ability to negotiate terms that will provide a reasonable prospect of a market rate of return on their investment.

Given that state-of-the-art growing-out operations are quite capital intensive, lowering the risk margin required by investors will have a significant impact on growing costs over the long-term.

It is the successful combination of these two requirements that is most likely to ensure that the competitiveness and prosperity of the industry is sustainable. Moreover, since the chicken meat industry is competitive at the processing and retailing level, it is expected that much of the productivity benefit from a viable and competitive growing-out sector will be passed on to consumers. That is a public benefit that will flow from the Bill.

The Panel considers it possible that, in the future, a non-legislative solution to the bargaining problem may be possible. This will probably depend on the capacity of the industry to negotiate and honour long-term contracts of the kind referred to in modern management

literature as "strategic alliance" contracts. The proposed Bill may be an intermediate step towards that eventuality.

A Review of the Bill (once enacted) after 6 years will identify the degree to which it may be possible to move to a de-regulated environment. Traditionally growing agreements between processors and growers have been for a term of 5 years. Conducting a review of the Act after 6 years is appropriate as it will allow for the negotiation and completion of a round of growing agreements.

4.3.3 "Legislation to have an adverse impact on SA chicken meat industry"

Processors claim that the proposed scheme represents a return to a centralised scheme and make assertions as to the negative repercussions of such a move. (See Part 3 of this Report).

The Panel is keen to emphasise that the proposed scheme is not a return to the *Poultry Meat Industry Act*. The scheme proposed by the Bill (while appearing complex in its drafting) has a very light-handed approach and, in the Review Panels' view, is the least restrictive alternative that will achieve the objectives of the Bill. The proposed scheme:

- allows for processors to negotiate agreements, including growing fees, with growers;
- the agreements negotiated between the processor and growers are not approved by a central committee; and
- there is no restriction on entry into the market.

After examining all the submissions, and after considering the points raised therein (including the matters raised at the public meetings), the Panel considers, in response to the negative impacts asserted by the processors (summarised in Part 3 of this Report), that:

- the proposed scheme does ***not*** result in substantial additional costs to the industry;
- the scheme will not act as an impediment to grower investment in infrastructure;
- the scheme, by allowing processors to negotiate directly with their growers (rather than a centralised approach), fosters a supply chain management approach;
- the mere availability of compulsory mediation and arbitration does not take the pressure off parties to come to a negotiated arrangement - mediation and arbitration (while less expensive than litigation) is not cheap. In any event, the Registrar can only refer a dispute to mediation or arbitration, once sufficient efforts to reach a negotiated outcome have been made; and,
- negotiation always involves "compromise" or optimally a position of mutual benefit. Simply because an outcome may not conform to the processors' view of "efficiency", that does not mean that it is not commercially sound.

The processors' submission asserts that growers will become obstructionist once the Bill has been introduced.

The Panel considers that while the Bill allows for some re-balancing of the bargaining power between growers and processors, it will not provide growers with sufficient power to become

obstructionist. Growers' submissions have indicated that they are aware that industry participants must work together to provide for an efficient and competitive industry. As stated within this Report, the grower/processor relationship is mutually dependent and growers will not rationally allow a processor to lose market share, much less to fail.

Issue of mediation / arbitration being an interference with contractual rights

It is implied in the processor arguments that compulsory mediation and arbitration is an interference with their contractual rights. However, as has been stressed in the section of this report dealing with Transitional issues (paragraph 2.5, *et seq.*), the statutory right to mediation and arbitration is ***in addition*** to any contractual rights.

There are any number of legislative examples where statutes have provided rights (and obligations) in addition to those that may been provided by contract. Further, the imposition of statutory rights and obligations precludes a party from contracting out of those rights or obligations (otherwise the statutory provision would be to no effect).

For example, the *Trade Practices Act, 1974 (C/wth)* provides for statutory warranties and conditions in Division 2, Part 5, which operate ***in addition*** to any contractual warranties and conditions granted by manufacturers and retailers of consumer goods.

Further, the **Franchise Code of Conduct** (under Industry Codes, Part IVB of the *Trade Practices Act*), specifically requires that both parties to a franchise agreement ***must*** attend the mediation and try to resolve the dispute (clause 29.(6) of the Franchise Code). There are many structural similarities between the franchise industry and the grower/processor relationship.

Also, it is a standard concept in ***all*** access schemes and in some regulated industries that arbitration is compulsory, and that the arbitrator's decision is binding on the parties. Whether it is Part 3A of the *Trade Practices Act*, mediation and arbitration under the SA Electricity Ombudsman Scheme, or access to rail, ports or other infrastructure, there is nothing unique or surprising about statutory requirements for compulsory mediation and/or arbitration.

Further, the *Land Acquisition Act, 1969* provides for compulsory arbitration of price where there is no agreement on the price of land to be compulsorily acquired.

4.3.4 Conclusion

The Review Panel is not persuaded by the arguments presented by the processors that the Bill will either tilt the balance too far towards growers or that it will impose such costs that there will be a negative impact on the industry, end-consumers, or on the economy of the State as a whole.

Indeed, the processors' response is considered to be disproportionate, and the Review Panel is concerned that processors may have misunderstood the operation of the proposed Bill, interpreting it as a return to a scheme similar to that, which operated under the *Poultry Meat Industry Act*.

When the Act comes into operation, the Panel believes that PIRSA should make available an explanatory pamphlet for industry participants.

Grower submissions do not support the processors' claim that there is merely a natural tension between suppliers and purchaser with no real imbalance in bargaining power within the industry. Growers have expressed a desire for, at the very least, a scheme that allows them to negotiate with the processors, in contrast to what they perceive as the present practice of "take it or leave it" offers.

The Panel considers that there is a need for the discipline of mediation/arbitration, required at the instance of either party (or else it is meaningless), to support the process of collective negotiation. Without that discipline, the Bill simply replicates a collective negotiation and *Trade Practices Act* exemption process that would have the same outcomes as the present ACCC authorisations. That is, grower perception of "take it or leave it" negotiations on the part of the processors.

However, the Panel also considers that the Bill needs to institutionalise economic, commercial, and best practice factors that will ensure that arbitration does not produce simply 'palm tree' justice in favour of the growers. Rather, that it will enable a balance between those factors, which are of interest to the processor, and the interests of fairness and equity (including commercial fairness) required by the growers.

This is achieved by the addition of factors in clause 5.(2)(b) of Part 2 of the Bill that are to be taken into account in arbitrations under the Bill, and by a specific list of matters that an arbitrator must take into account in an arbitration under Part 8 (clause 28.(3) of the Bill).

4.4 Assessment of Objectives

The Terms of Reference for this review also require the Review Panel to make an assessment of the issues that the objectives of the legislation seek to address and provide an assessment as to their importance to the community. This requires a cost benefit assessment of the objective of promoting equity between processors and tied growers by addressing the imbalance in bargaining power that exists in the South Australian chicken meat industry.

The Review Panel recognises that the decision to promote equity in the SA chicken meat industry is a policy decision of the South Australian Government instigated on the request of the growers. The fact that this decision has been broadly supported by both political parties (Liberal and Labor) is an indication that there is a perceived importance within the South Australian community in addressing the inequity in the South Australian chicken meat industry.

4.4.1 The Public Benefits

The Review Panel has identified a number of public benefits that derive from promoting equity between processors and tied growers by addressing the imbalance in bargaining power within the South Australian chicken meat industry.

The Review Panel notes that the Consultation Paper provides an assessment of the costs and benefits of providing growers with the option to negotiate collectively. As the provision of collective negotiation is a mechanism by which the imbalance in bargaining power is addressed, some of the benefits highlighted in that discussion are relevant to this assessment of the objectives of the Bill. Please refer to pages 20 to 22 of the Consultation Paper which identify:

- equity in the negotiation of exclusive growing agreements;
- enhanced grower investment; and
- promotion of industry harmony,

as public benefits to be derived from addressing the bargaining power imbalance in the chicken meat industry.

The following discussion expands, where necessary, on the public benefits already identified in the Consultation Paper.

Equity and efficient resource allocation

The Review Panel notes that pursuant to the Terms of Reference and the CPA both "equity" and "efficient resources allocation" are public benefit factors, which are to be considered in the conducting of a legislation review pursuant to clause 5 of the CPA.

It is the Panel's view that legislation that promotes equity between processors and tied growers by addressing the power imbalance within the chicken meat industry by way of providing for genuine negotiations will provide for more accurate pricing signals and thus decisions that reflect a more efficient allocation of resources.

Section 4.3 above argued that the current situation was sub-optimal. It referred to evidence of exercise of monopsony power that, over the long term, was likely to result in a lower level of chicken meat production in South Australia than would occur in a competitive market.

Despite, in some cases, the availability of collective negotiation under ACCC authorisation, it is clear from the grower submissions that growers perceive that they are presently not engaging in true negotiations with processors. Growers suggest that they are forced to accept contracts offered by processors. "Take-it-or-leave-it" contracts are inequitable, disproportionately protecting the interests of one party to the detriment of the other. They may also result in one party's capital investment being devalued, which may in turn lead to a long-term misallocation of resources within the community.

The scheme proposed in the Bill addresses the issue of "take-it-or-leave- it" negotiations by providing growers with access to collective negotiations and, more importantly, to the compulsory mediation and arbitration of disputes.

It has been suggested that addressing the power imbalance in the industry will result in outcomes that are "compromises", based on value judgements concerning equity, which are divorced from economic efficiency. This suggests that mediation/arbitration will inevitably

lead to 'palm tree justice' being dispensed, contrary to the interests of the processors. [11] As stated elsewhere in this Report, this argument fails to take into account the statutory guidance given to the arbitrator, and the incentives on both sides to reach a reasonable compromise, including their mutual dependency and the discipline of costs.

It is the Review Panels' understanding that effective negotiations result in beneficial outcomes for both parties based on their individual assessments of the proposed agreement. The negotiation process often involves elements of "compromise" from each party's ideal position or what they would propose as a "take-it-or-leave-it" contract. In terms of value judgements, the processors' view of what is "efficient" may not necessarily correlate with the growers' view.

The Review Panel notes that the proposed scheme does not deal with the actual negotiations between the parties. The Bill merely addresses the imbalance in bargaining power by providing growers with the choice to negotiate collectively and to seek the compulsory mediation and arbitration of disputes. Hence, the Bill does not prescribe outcomes.

The Bill merely provides growers with the tools to enter into genuine negotiations with processors, and therefore reach outcomes that are equitable to both parties and that encourage accurate pricing signals that would enable the parties to make decisions as to the appropriate allocation of resources, to the benefit of the community at large.

A South Australian Government Presence

The negotiation process under a deregulated market or under ACCC authorisation is perceived by growers to be completely processor-driven. Growers express feelings of isolation leading to a lack of confidence in their negotiations. Growers suggest that the involvement of the SA Government in the process would provide them with greater confidence in their negotiations with processors. There is also a perception that State government involvement will lead too more "civilised" relationships between growers and processors.

The Review Panel agrees that the mere involvement of the State Government, even to the minimal extent proposed in the Bill, may be of benefit in improving the confidence of the growers. Growers at the very least will have access to an impartial Registrar who will be available to outline their rights under the proposed scheme. The Registrar will have a good knowledge of the industry, and will be able to use his/her 'best offices' as a first step prior to mediation. [12]

Greater confidence on the part of growers should lead to improved negotiated outcomes, which are of benefit to the industry and the community as a whole.

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11 The term "Palm tree justice" is being used to describe the possible practice of arbitrators handing down decisions that focus disproportionately on the detriment of one party to a dispute (the poorer, less powerful party) without taking into consideration the merits of the matter, such as commerciality or the best interests of the industry.

12 It is anticipated that the Registrar will initially act informally to address any disputes, in other words, he will use his "best offices" as an independent observer to assist the parties to reach a resolution prior to the matter being formally referred to mediation or arbitration.

4.4.2 The Costs

Please refer to the discussion of cost relating to allowing for collective negations outlined on pages 22 to 24 of the Consultation Paper. The following issues raised in that discussion are relevant to this discussion of cost:

- the countervailing bargaining power of processors;
- the countervailing power of retailers and end consumers;
- the low value of growing fees as a component of the end-price paid by consumers; and
- the fact that the grower's involvement in the collective scheme is voluntary.

The following is an additional discussion of issues raised as part of the consultation process.

The Processors View

The processors' joint submission suggests that intervention by the South Australian Government in the States' chicken meat industry will result in increased costs. It is argued that such intervention will inevitably result in a judgement (by an arbitrator) based on equity where one party is favoured above another and that this will result in a distortion in the market (however, see the discussion on this issue elsewhere in this Report, including paragraphs 4.3.4 and 4.4.1).

Processors stress that even if, due to competition at the retail/wholesale level, they are unable to directly pass on any increases in growing fees to retailers and therefore consumers, that there will be "dead weight" losses in terms of reduced production.

Processors state that there is a potential cost to the community from a higher than necessary growing fee. They also state that this cost will be borne by owners of all the resources affected by lower production in South Australia. Processors have put forward a number of negative impacts that will arise due to this reduction in the level of production in South Australia. Please refer to Part 3 for a more detailed summary of the processors' submission.

Costs confined by competition at the retail and wholesale functional level

The chicken meat industry is highly vertically integrated and therefore any cost in terms of reduced production will also affect growers. Growers are part of the supply chain along with processors. If growers demand higher than sustainable growing fees, or conditions, then they will themselves suffer through a reduction in the demand in their growing services *i.e.* a reduction in the through-put of chickens. Submissions from growers indicate that they are aware of this relationship with processors.

The proposed scheme **does not regulate growing fees** or **the conditions of growing agreements**. Processors and growers negotiate growing agreements including growing fees. The level of productivity in the industry and the competitiveness of the supply chain relationship is a factor that should be considered as part of these negotiations. It is a critical part of the scheme proposed by the Bill that the Registrar has no right to intervene in negotiations and does not register any growing agreements. In fact, the Registrar is not required to know what is in the growing agreement and may never see a growing agreement.

Mediation and Arbitration

The only circumstance where fees, or for that matter any condition of the agreement, may be compulsorily set by a third party is if a dispute arises that leads to an arbitrated decision.

Processors suggest that they are destined to lose most disputes that go to arbitration. They consider that the arbitrator will dispense "palm tree justice" based purely on equity and not commercial reality. Further, that the number of these disputes will be such as to have an impact on the market.

This matter has been dealt with (on several occasions) elsewhere in the Report. The Review Panel notes that arbitrators are required under the Bill to take efficiency issues and commercial factors into consideration when reaching a decision. Failure to do so could give rise to an appeal by either party on a question of law. The Review Panel also finds it difficult to believe that an independent arbitrator would be so unprofessional so as to base his or her decisions purely on equity without considering the other factors relevant to a lawful decision, including the statutory factors that are required to be taken into account.

There is no evidence, and the Panel considers it contrary to rational economic analysis, that allowing for compulsory mediation and arbitration will automatically result in an increase in growing fees to an extent where it will effect the level of production, or increase prices paid by consumers, or act as a detriment to the SA economy as a whole.

In summary, the Panel considers that the mediation/arbitration provisions in the Bill will have a minimal, or no, effect on the price paid by consumers for chicken.

4.4.3 Conclusion

The Review Panel believes that the combination of South Australia's climate, the availability of high quality chicken-feed ingredients at competitive prices and a local market with a good appetite for chicken meat provide the basis for a competitive and prosperous chicken meat industry in the State. It considers that poor industry structure is a factor limiting growth and, while it concedes that the *Poultry Meat Industry Act* (pre-1996) may have had a role in that state of affairs, it also considers the present imbalance of bargaining power to be significant.

While preserving the right of processors to contract with the most efficient growers, the Bill should, as a source of increased confidence on the part of existing and potential new-entrant growers, provide a transition path to more sophisticated contractual arrangements in the industry ("strategic alliance" contracting). Since the transaction costs associated with the existing arrangements are substantial, their reduction is likely to contribute to the long-term viability of the industry. The potential public benefits arising from that eventuality include increased job opportunities in the industry and greater competitiveness in the retailing of chicken meat both locally and interstate. These benefits are expected to far outweigh the public cost of oversight and review of the proposed Act.

Recommendation 1:

Clause 5 correctly identifies the objectives of the Bill.

Further, taking into account that the addressing of the bargaining power imbalance should:

- aid in achieving an improvement in the long-term competitive position of the chicken meat industry; and
- that any short term adjustment costs are unlikely to be passed on to consumers;

the Review Panel is satisfied that the objectives of the Bill are of net public benefit.

Part 5. Analysis of Restrictions

5.1 Classifying Restrictions Upon Competition

Please refer to page 18 of the Consultation Paper, which provides:

- a discussion of the types of restrictions on competition; and
- an overview of the assessment of restrictions as either "trivial", "intermediate" or "serious".

5.2 Restrictions Contained in the Bill

The following restrictions upon competition in relevant markets have been identified in the Bill:

- legislative exemption from Part IV of the *Trade Practices Act, 1974*;
- mandatory mediation and arbitration;
- prohibition on exclusive or tied growing agreements unless the processor issues the prescribed notice to growers;
- restriction on the term of a growing contract to not exceed five years; and
- the imposition of a levy on industry participants.

Each of these restrictions is discussed below and, as required by the Terms of Reference for this review, the Review Panel has identified, where necessary, the public benefits and costs arising from each restriction and has considered alternative means to achieve the objectives of the Bill without restricting competition.

Please note that relevant information provided in the Consultation Paper has ***not*** been repeated in the following discussion.

5.3 Legislative Exemption from Part IV of the Trade Practices Act

Pages 19 to 28 of the Consultation Paper provide a discussion of the analysis of the legislative exemption from Part IV of the *Trade Practices Act* as required under the Terms of Reference of this Review.

5.3.1 Submissions

Grower submissions supported the conclusion reached by the Review Panel as presented in the Consultation Paper. Growers expressed the view that a State legislated exemption is the optimal method to achieve the objectives of the Bill, in that it provides certainty for growers and processors alike and will serve to stabilise the industry in South Australia.

Growers also suggested that a State legislative exemption was superior to ACCC authorisation. They pointed out that the ACCC authorisation is of limited duration, is difficult to obtain and renewal is not guaranteed. Further, that authorisation is seen by the ACCC as a transitional vehicle by which an industry is prepared for deregulation, which is

not (at least in the foreseeable future) suitable for the chicken meat industry. Further, the ACCC authorisation carries its own costs, with both the statutory fee and lawyers' fees being paid by the applicant.

Processor submissions did not challenge the overall benefits of collective negotiation within the South Australian chicken meat industry. However, the processors' joint submission suggested that ACCC authorisation had operated effectively for the last 5 years and questioned the need for State intervention.

5.3.2 Review Panels' Conclusion

The assessment of the decision of the South Australian Government to address the imbalance in bargaining power in the chicken meat industry is discussed in Part 4 of this Report.

The Review Panel notes that 60 grower submissions have not supported ACCC authorisation. Clearly, ACCC authorisation has not sufficiently addressed the imbalance in bargaining power in the industry.

The Review Panel also notes that the existence of the Bill does not preclude the operation of an ACCC authorisation.

As a matter of law both may operate at the same time. Under the proposed scheme growers are effectively granted the option to negotiate collectively with a processor pursuant to an ACCC authorisation. If a group of growers receive a notice and elect not to negotiate collectively under the State scheme, they are completely outside the operation of the State Act and are therefore free to negotiate collectively with their processor pursuant to an ACCC authorisation.

Recommendation 2:

State exemption from the operation of Part IV of the *Trade Practices Act* meets the net public benefit test. Further, ACCC authorisation is not a viable alternative as it does not achieve the objectives of the Bill. (Promotion of equity between processors and tied growers).

5.4 Compulsory Mediation and Arbitration

Under the Bill disputes may be referred to mediation and arbitration:

- during the collective negotiation of an Growing Agreement [clause 20];
- during the term of a collectively negotiated Growing Agreement [Part 7] - in relation to an alleged breach of an agreement, or dealings between the parties pursuant to the agreement - but not to amend an agreement outside agreed amendment processes; and,
- at the end of a collectively negotiated agreement - where a previously tied Grower has been excluded by receiving a notice to that effect [Part 8].

5.4.1 Classification of restriction

The dispute resolution provisions of the Bill are compulsory. On the request of a single party to a dispute, the matter may be referred by the Registrar to mediation and arbitration. Both parties will then be required to participate and will be bound by any arbitrated decision. The costs imposed by this process may represent an "**intermediate**" restriction. However, the Review Panel notes that, technically, the mediation and arbitration provisions of the Bill do not, of themselves, restrict competition.

5.4.2 Public Benefits

The following is a discussion of the public benefits of compulsory mediation and arbitration.

Supports the objectives of the Bill

Over the last 6 years the South Australian chicken meat industry has moved from a scheme of centralised price fixing and contract approval, to effective deregulation with some sectors of the industry operating under ACCC authorisations for collective negotiations.

It is clear from the submissions received from growers that simply relying on collective negotiations pursuant to ACCC authorisation has not sufficiently addressed the imbalance in bargaining power suffered by growers. Growers report that they are currently unable to engage in genuine negotiations with processors, feeling that they must accept contracts imposed upon them by processors. The conclusion from this evidence, is that ACCC authorisation has merely provided processors with the benefits of reduced transaction costs without providing a better bargaining position for growers.

The main practical distinction between ACCC authorisation and the scheme proposed under the Bill is that the Bill provides for compulsory mediation and arbitration.

Without clear recourse to mediation and arbitration:

- during the initial negotiation of growing agreements; and
- during the term of growing agreements;

growers, even as a collective group, will not be able to have genuine negotiations with processors and the objective of the Bill, the promotion of equity between processors and tied growers, cannot be achieved.

It is anticipated that the availability of compulsory mediation and arbitration will act as an incentive for processors to enter into genuine negotiations with growers, which in turn should lead to:

- better relationships between growers and processors in the chicken meat industry, leading eventually to "strategic alliance contracting";
- more accurate pricing signals being recognised in the processor / grower relationship; and,

- allowing industry rationalisation to occur at an appropriate pace - given the balance between equity and the efficiency and commerciality factors that the arbitrator must take into account;

thus meeting the stated objectives of the Bill as described at paragraph 4.1 of this Report.

Part 8 mediation and arbitration

The Bill provides for growers to request mediation and arbitration of a decision by processors not to offer previously tied growers a further contract. This Part was included in the Bill because, given the present state of relationships between processors and growers, it was recognised that grower representatives should be given some commercial protection. The Panel considered that this stance was justified when reports were received by PIRSA that grower representatives felt threatened.

This Part also recognises the substantial sunk investments growers make in the industry and the need to ensure that growers are not excluded for reasons unrelated to their efficiency or the commercial operations of the processor.

It should be kept in mind that the *Poultry Meat Industry Act, 1969*, restricted new entry into the market where sufficient growing services were already available. The *Poultry Meat Industry Act, 1969* protected growers' investments. The Bill does ***not*** stop new entry into the market and, pursuant to the criteria prescribed under clause 28.(3) of the Bill, it is expected that the least efficient growers and less sustainable farms will eventually exit the industry. (Please note that the criteria that must be considered by the arbitrator are discussed in detail below).

5.4.3 Costs

The following is a discussion of the costs of compulsory mediation and arbitration.

The cost to the parties

The parties to the dispute fund compulsory mediation and arbitration. These costs are difficult to assess as they will depend on the length and complexity of the dispute and the nature of any costs orders made by the arbitrator. However, these costs, while cheaper than litigation, will still act as a discipline to discourage unjustified disputes and will encourage a negotiated outcome.

Given that these costs are born by the parties and are ***specific to individual disputes***, the Review Panel is of the view that they represent marginal costs in terms of their impact on the chicken meat industry, and the South Australian community, as a whole.

The costs in terms of productivity

One of the benefits of deregulation is that it exposes industry participants to the operation of the market. This exposure provides incentives for productivity gains and innovation. Deregulation also provides a degree of flexibility to market participants allowing them to structure their business so as to be more competitive. These benefits have been discussed by the processors in their submissions and are summarised under Part 3 in this Report.

Processors submit that the potential cost of the compulsory mediation and arbitration provisions is that arbitrated decisions will result in outcomes that detract from the benefits of exposing the industry to the operation of the market. Specifically, it is argued that:

- the dispute resolution provisions of the Bill will operate to reduced incentives for parties to reach negotiated outcomes; and that,
- they will act as an impediment to structural change in the industry (in particular Part 8).

The Bill has taken this concern into account, and the Review Panel notes the following provisions of the Bill:

Clause 5.(2)(b) of the Bill declares that it is intention of the Act:

> "*that arbitration under Parts 5, 7 and 8 take into account the need to promote best practice standards and fair and equitable conditions in the chicken meat industry and the need for the industry to be dynamic and commercially viable.*"

and in relation to Part 8, clause 28.(3) provides that the arbitrator must take into account:

- To the processor's advantage:
  - the grower has been unreasonably excluded;
  - any change in the level of growing services that the processor requires;
  - the grower's level of efficiency as a grower;
  - the grower's level of compliance with the grower's obligations;
  - the grower's conduct in relation to the processor, including activities causing commercial detriment to the processor; and,
  - the interests of the chicken meat industry.
- To the grower's advantage:
  - the grower has been unreasonably excluded;
  - the need to redress the imbalance in negotiating power between processors and growers; and
  - the grower's conduct in relation to the processor, including the grower's activities as a grower negotiator or more generally as a grower representative.

Under the Bill, arbitrators must take these factors into account, or else they will risk appeal to the Supreme Court on a question of law. A dispute arising from a justifiable commercial decision by a processor is unlikely to result in a decision by the arbitrator in the grower's favour. The Registrar would make this clear to any grower when the grower seeks to have a dispute referred to mediation and/or arbitration.

Growers are still exposed to the commercial realities applying to the chicken meat industry. Their symbiotic/mutually dependent relationship with the processors will act to ensure that they will not be able to utilise the mediation or arbitration provisions to force processors to accept clearly uncommercial conditions in growing agreements or to impede structural change through the operation of Part 8.

Processors have submitted that Part 8 will result in "perpetual" or "continuous" contracts. The Panel considers that it is clear that the provision of compulsory mediation and arbitration under Part 8 **is not tantamount to creating perpetual grower contracts**. If a Processor does not offer a grower a contract because;

- they no longer need the same level of grower services (possibly because of loss of market share, or because of imports);
- the grower has been inefficient;
- the grower has not complied with its obligations; and/or,
- the grower has, though its conduct, caused commercial detriment to the processor;

then the grower will ***not*** be protected.

5.4.4 Review Panels' Conclusion

It is the conclusion of the review Panel that compulsory mediation and arbitration is necessary to promote equity between processors and tied growers, the stated objective the Bill. The Panel considers that there will not be any, or any significant, costs passed onto end-consumers or imposed upon the economy of the State as a whole, by allowing growers and processors to access compulsory arbitration. Further, given the present industrial culture in the chicken meat industry, compulsory arbitration is necessary to ensure that the parties engage in genuine negotiations.

The Panel considers that the benefits of compulsory mediation and arbitration -

> namely, that, in the context of the chicken meat industry, it provides a necessary discipline to support genuine negotiations, and that it should lead to:
>
> - better relationships between growers and processors in the chicken meat industry, leading eventually to "strategic alliance contracting";
> - more accurate pricing signals being recognised in the processor / grower relationship; and,
> - given the balance between equity and the efficiency and commerciality factors that the arbitrator must take into account, it should allow industry rationalisation to occur at an appropriate pace;

- outweigh the costs.

Recommendation 3:

Compulsory mediation and arbitration is necessary to foster genuine negotiations between growers and processors. Compulsory mediation and arbitration satisfies the net public benefit test.

5.5 Administrative costs of requiring Processors to Give Notice of an Intent to Exclusively Deal

The Bill requires that before a processor enters into negotiations with a grower for the purposes of an exclusive growing agreement, the processor must first send the grower a prescribed written notice. The notice provides the grower with the option to deal with the processor, either individually, or collectively as a member of the relevant PNG.

Please refer to pages 28 and 29 of the Consultation Paper, which provides an overview of the assessment of this restriction pursuant to the requirements of the Terms of Reference for this review.

5.5.1 Submissions

Growers supported the Review Panels' assessment of this restriction as "trivial".

Processors suggested an alternate approach, advocating that growers should vote as to whether they should join a PNG. PIRSA has received informal legal advice that the mechanics of such a scheme risk contravening the *Trade Practices Act*, particularly as it would involve a collective decision (a vote, presumably taken after some discussion) by growers to deal collectively. In order to ensure that an exemption under section 51 of the *Trade Practices Act* is effective, that is, that it has ***specifically identified*** the relevant growers who were reaching an arrangement or understanding that was likely to substantially lessen competition, the relevant growers would need to be identified at the time they voted.

Further, the requirement that the processor send out a notice to those growers with whom it wishes to deal is a better reflection of sound commercial practice - the processor first determines with which growers it wishes to deal, and then, those growers elect (making individual decisions) whether to deal individually with the processor, or to join that processors' PNG.

Finally, it is more pro-competitive that the growers make their election (whether to deal with the processor individually or collectively), not in a group-voting situation where they may be under some group pressure, but individually in response to the notice. This would enable those growers, to whom the processor had, at the time of the notice, provided some information as to the advantages of an individual contract, to more easily elect to enter into individual negotiations.

Given that the processor will already have a mailing list of its preferred growers, and that the form of the notice will be set out in regulations, there is negligible administrative cost incurred in such a mail out. Further, the process should only occur every 5 or so years, that is,

when existing contracts are reaching their expiry date, or to a small number of growers during the period of an agreement if a processor wishes to expand its portfolio of growers.

5.5.2 Review Panels' conclusion

The assessment made by the Review Panel in the Consultation Paper was accurate and the benefits of this restriction outweigh the costs.

Recommendation 4:

The requirement that processors give a notice of intent to deal exclusively with growers is a necessary mechanism in the scheme as a whole and imposes only a small administrative burden, and therefore satisfies the net public benefit test.

5.6 Restriction on the Term of the Contract

Please refer to page 31 of the Consultation Paper, which provides an overview of the assessment of this restriction pursuant to the requirements of the Terms of Reference for this review.

5.6.1 Submissions

Processors argued that restricting contracts to a period of 5 years would limit their ability to offer longer contracts to growers as an incentive for re-investment in their infrastructure. The Bill has been amended to allow contracts to be extended for up to an additional 5 years at the request of both parties. That is, the maximum contract period will be 5 years with the option of extensions for a further 5 years.

This will have the effect of enabling the negotiation of longer term contracts to support grower investment in new infrastructure, but will preclude processors from 'tying' growers for excessive periods so as to preclude new processors from entering the market.

5.6.2 Review Panels' Conclusion

The assessment made by the Review Panel in the Consultation Paper was accurate and the benefits of this restriction outweigh the costs.

Recommendation 6:

Limiting contracts to a period of 5 years, with the ability for an extension of up to an additional 5 years, satisfies the net public benefit test.

5.7 Imposition of a Fee on Industry Participants

Please refer to page 33 of the Consultation Paper, which provides an overview of the assessment of this restriction pursuant to the requirements of the Terms of Reference for this review.

5.7.1 Review Panels' Conclusion

The replacement of the CMIC with a Registrar has reduced the costs of the operation of the scheme (which would not, in any event, have been significant) and, accordingly, the resultant fee that industry participants will be required to pay.

Recommendation 7:

The industry fee, as a user pays mechanism to support a light-handed legislative scheme, satisfies the net public benefit test.

5.8 Amendments to the Bill

Replacement of the CMIC with a Registrar: As identified above in the discussion of the industry the CMIC has been replaced with a Registrar. Accordingly, processors will no longer be compelled to be involved in the CMIC, and their concerns regarding the release of confidential information, will no longer be an issue.

Deletion of the Code of Practice: The mandatory Code of Practice is no longer part of the scheme proposed in the Bill and accordingly this potential restriction on competition is no longer relevant.

Part 6. Administrative Burden

Pursuant to the Terms of Reference of the Review of the Bill, the Review Panel is required to consider whether any licensing, reporting, or other administrative procedures are unnecessary or impose an unwarranted burden on any person. The Review Panel has identified the following administrative procedures imposed on market participants by the Bill:

- processors are required to prepare a notice to all growers with whom they intend to deal exclusively;
- processors are also required to give a grower a written notice if the processor intends ***not*** to give that grower a subsequent contract;
- upon commencement of the Act, processors are required to inform the Registrar of each grower party to a growing agreement with the processor;
- processors are also required to inform the Registrar in writing, within 14 days, when:
  - a person becomes party to a growing agreement;
  - a grower indicates that they wish to be a member of processor's PNG;
  - the processor becomes aware of a change in the business name or business address of a grower;
  - a person ceases to be party to a growing agreement;
  - a grower withdraws from membership of a PNG and therefore ceases to negotiate collectively with the processor;
  - a processor becomes a party to a collectively negotiated tied growing agreement, the date of the commencement of the agreement and the date at which the agreement is to expire; and
  - a grower ceases to be bound by a collectively negotiated tied growing agreement.
- The activities of the Registrar, in maintaining the Register, overseeing collective negotiations and facilitating dispute resolution will impose an administrative burden on the South Australian Government. The South Australian Government will recoup these costs though the fee for service charged participants in the industry.
- The scheme may also impose some administrative costs to the South Australian Government in terms of education of both processors and growers as to the operation of the proposed scheme. For example, it is planned to issue an explanatory brochure to describe the operation of the scheme in simple terms.

All of these administrative procedures are the ***minimum*** that are required in order to establish a workable mechanism to give effect to the scheme proposed by the Bill, and to establish the "specificity" (identification of negotiating parties, etc) required for a section 51 *Trade Practices Act* exemption.

Industry participants may also be required to pay additional costs when seeking the mediation and arbitration of disputes. These costs are paid by the parties to a particular dispute and are therefore marginal and are not administrative costs that can be directly attributed to the operation of the Bill.

Part 7. Recommendations

1. Clause 5 correctly identifies the objectives of the Bill.

   Further, taking into account that the addressing of the bargaining power imbalance should:

   - aid in achieving an improvement in the long-term competitive position of the chicken meat industry; and
   - that any short term adjustment costs are unlikely to be passed on to consumers;

   the Review Panel is satisfied that the objectives of the Bill are of net public benefit.

2. State exemption from the operation of Part IV of the *Trade Practices Act* meets the net public benefit test. Further, ACCC authorisation is not a viable alternative as it does not achieve the objectives of the Bill. (Promotion of equity between processors and tied growers.)

3. Compulsory mediation and arbitration is necessary to foster genuine negotiations between growers and processors. Compulsory mediation and arbitration satisfies the net public benefit test.

4. The requirement that processors give a notice of intent to deal exclusively with growers is a necessary mechanism in the scheme as a whole and imposes only a small administrative burden, and therefore satisfies the net public benefit test.

5. Limiting contracts to a period of 5 years with the ability for an extension of up to an additional 5 years, satisfies the net public benefit test.

6. The industry fee, as a user pays mechanism to support a light-handed legislative scheme, satisfies the net public benefit test.

APPENDIX 1

TERMS OF REFERENCE

Preamble

The *Competition Principles Agreement* ("the Agreement"), ratified by the Council of Australian Governments in April 1995, requires participating governments to review and, where appropriate, reform legislation which restricts competition. Pursuant to clause 5(5) of the Agreement, new legislation must be accompanied by evidence that the legislation does not restrict competition unless:

- the public benefits of the restriction outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

The *Poultry Meat Industry Act 1969* is to be repealed and replaced with new legislation. The new legislation will regulate the South Australian chicken meat industry by allowing chicken meat growers to engage in collective negotiations with individual chicken meat industry processors, and will grant exemption from the *Trade Practices Act 1974* (C/wth) for that activity. The Bill to introduce the new legislation must be examined in accordance with the obligation contained in clause 5(5) of the Agreement.

Review Panel

The review of the Bill will be undertaken by a panel consisting of:

Mr Brian Bartsch
Manager Industry Development
Livestock Industries
Primary Industries and Resources SA

Mr Venton Cook
Principal Economics Consultant
Primary Industries and Resources SA [13]

Mr Bill Giles
Principal Industry Consultant Meat
Livestock Industries
Primary Industries and Resources SA

Mr Greg Cox
Managing Solicitor, Competition
Crown Solicitor's Office

[13] Mr Philip Taylor, Principal Strategy Consultant, Corporate Strategy and Policy, Primary Industries and Resources, SA, replaced Mr Venton Cook during the review period.

Mr Glenn Ronan
Principal Strategy Consultant
Corporate Strategy and Policy
Livestock Industries
Primary Industries and Resources SA

Objectives of the Review

When considering the appropriate form of regulation, the Review Panel will consider the following objectives:

1. New regulation should only be introduced if the benefits to the community as a whole outweigh the costs, and if the objectives of the regulation cannot be achieved more efficiently through other means, including non-legislative approaches.
2. Pursuant to clause 1.3 of the Agreement, in assessing the benefits of proposed regulation regard shall be had, where relevant, to:
   (a) effects on the environment and ecologically sustainable development;
   (b) social welfare and equity, including community service obligations;
   (c) occupational health and safety, industrial relations and access equity;
   (d) economic and regional development, including employment and investment growth;
   (e) consumer interests;
   (f) the competitiveness of Australian business, including small business; and
   (g) efficient allocation of resources.
3. Compliance costs and the paper work burden on small business should be reduced where feasible.

Issues to be Addressed

Issues to be addressed by the Review Panel include:

1. Clarify the objectives of the new legislation, identify the nature and magnitude of the social and economic issues that the new legislation seeks to address, and provide an assessment of the importance of these objectives to the community.
2. Identify the restrictions to competition contained in the new legislation:
   (a) describe the theoretical nature of each restriction (eg. barrier to entry, restriction on conduct etc);
   (b) identify the markets upon which each restriction impacts; and
   (c) provide an initial categorisation of each restriction (i.e. “trivial”, “intermediate” or “serious”).
3. Analyse and describe the likely effects of the restrictions on competition in the relevant markets, and on the economy generally:
   (a) what are the practical effects of each restriction on the market;
   (b) assign a weighting to the effect of each restriction in the market; and
   (c) assess the relative importance of each restriction in relevant markets, and in the economy as a whole.
4. Assess and balance the costs and benefits of the restriction.

5. Where the restriction is justifiable on the basis of public benefit, consider whether there are practical alternative means for achieving the objectives of the new legislation, including non-legislative approaches.

6. Consider whether any licensing, reporting, or other administrative procedures are unnecessary or impose an unwarranted burden on any person.

Consultation

The Review Panel will prepare a Consultation Paper, compile a list of stakeholders, and will provide a copy of the Consultation Paper to the stakeholders for comment. The Review Panel will also provide a copy of the Consultation Paper to those members of the public which respond to an advertisement in the "Advertiser" newspaper.

Report

The Review Panel will present to the Minister for Primary Industries and Resources, a report detailing:

(a) the Terms of Reference for the review;

(b) the stakeholders consulted during the review;

(c) the analysis of the new legislation in accordance with these Terms of Reference; and

(d) the recommendations of the Review Panel.

APPENDIX 2

SA CHICKEN MEAT GROWING INDUSTRY

Year	Grower fee/bird (cents) 2002 dollar value
1986	55.73022486
1987	54.02509176
1988	53.62426548
1989	51.39433816
1990	54.7420304
1991	57.64873212
1992	59.12570478
1993	60.31585492
1994	60.20011589
1995	58.15558315
1996	57.3611099
1997	60.16087104
1998	60.90214993
1999	59.13637336
2000	53.7909374
2001	52.89803328
2002	50.36