

Draft Report

Inquiry into the *Chicken Meat  
Industry Act 1977*

4 August 2010

Economic Regulation Authority



WESTERN AUSTRALIA

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## Executive Summary

In this draft report, the Authority presents its draft recommendations and findings for its inquiry into the *Chicken Meat Industry Act 1977* (“**Act**”). The Authority is conducting the inquiry at the request of the Treasurer of Western Australia in February 2010. The Act requires that its effectiveness be reviewed every five years.

The Authority has examined how the Act currently operates and the issues affecting the chicken meat industry in Western Australia and nationally. In assessing the Act, the Authority has had to consider if legislation of the industry in Western Australia is needed. If so, the question is whether the Act should be retained in its current form, or amended or replaced; or if there are alternative legislative mechanisms available to achieve the objectives of the Act.

The Act was enacted to “improve stability in the chicken meat industry”. In this industry, the production and processing of chicken meat is dominated by two large chicken meat processors, who control most stages of the production process, apart from the growing of chickens, which is contracted out to individual farms.

The Authority’s view is that there is an imbalance in negotiating power between growers and processors, and that some form of regulation is needed to improve the bargaining position of growers. The Act currently provides for an average price to growers to be determined on the basis of a notional model of an efficient chicken growing operation, and for mediation and arbitration through the Chicken Meat Industry Committee, on which growers and processors are equally represented.

After examining the way in which the Act works, the Authority’s draft finding is that it is possible that the benefits of the Act outweigh its costs. However, regulations under the Act which prescribe the way in which a growth in production should be shared between the existing growers in a group are likely to act as a barrier to entry and expansion, and the benefits of these restrictions are unlikely to outweigh the costs.

Questions remain as to whether the Act has been effective in sufficiently strengthening the bargaining position of growers, and encouraging productivity improvements in the chicken meat industry. The Authority will be further examining whether the Act, if retained, would need to be amended to address such issues.

In considering alternatives to the Act, the Authority observes that growers in other states have made use of provisions under the *Trade Practices Act 1974* (“**TPA**”) to improve their bargaining position in contract negotiations. The Australian Competition and Consumer Commission (“**ACCC**”) has authorised a number of groups of growers to bargain collectively in their contract negotiations with their processors (normally, collective bargaining is not permitted under the TPA).

The Authority considers that it is likely that growers in Western Australia would be given authorisation by the ACCC for collective bargaining. The Authority also notes that there is a high hurdle rate that must be met to justify industry-specific legislation, with the benefits to society clearly outweighing the costs of the legislation. However, it is likely that the costs of dispute resolution and arbitration would be higher under authorised collective bargaining than under the current legislation. The Authority will be examining this issue further in the light of submissions on this draft report.

The Authority wishes to thank those who provided submission in response to the Issues Paper. The Authority now welcomes further comments in response to its draft recommendations. Submissions are due by Friday 17 September 2010. Following receipt of these submissions, the Authority will prepare its final report to the Treasurer by 1 November 2010. The Government is then required to table the final report in Parliament within 28 days of its receipt.

## Summary of Draft Findings and Recommendations

- 1) The factors that shape the chicken meat industry in Western Australia are similar to those in other states.
  - The processing sector is dominated by a small number of large processors, who have integrated control over most stages of chicken meat production, apart from the growing of broiler chicks, which is contracted out to individual broiler growers.
  - In negotiating contracts, growers are in a weaker bargaining position than processors, due to the limited opportunity of growers to provide growing services to other processors, and the growers' significant investments in capital assets specific to chicken growing.
- 2) In the absence of regulation, it is likely that growers would be offered standard form contracts by processors and that growers would have little input into their contract terms and conditions. This could result in returns to growers that are below what they would be if there was a competitive market for growing services.
- 3) In principle, regulation could improve the bargaining position of growers in the negotiation and execution of their contracts with their processors. This would result in a transfer of welfare from processors to growers.
- 4) It is unclear how regulation could improve aggregate social welfare by increasing output by the growing sector, as output is determined by consumer demand. However, regulation could improve net social welfare by:
  - reducing the transaction costs and the costs of disputes and arbitration associated with grower contracts; and
  - helping to overcome any potential hold-up problems in investment by growers and encouraging an optimal level of investment.
- 5) It is possible that the benefits of the average price regime in the *Chicken Meat Industry Act 1977* may outweigh the costs.
  - The extent to which the average price regime may result in higher growing costs and therefore higher chicken meat prices to consumers than would be achieved under a competitive market for growing services is likely to be minimal, because:
    - the cost of production model used to set the average growing fee appears to be based on efficient production costs, and the model inputs can be scrutinised by both processors and growers;
    - the rate of return on capital used in the model appears low;
    - growers' fees can be further adjusted by processors to reflect growers' productivities and market factors, and average fees paid to growers are below the average price;
    - growers are free to enter into individual contracts with processors;

- countervailing power in the retail sector limits the extent to which any increases in growing fees can be passed on to consumers;
  - the growing fee is a small proportion of the costs of producing chicken meat;
  - the administration costs associated with the Act are minimal; and
  - any differences in productivity between the grower groups can be reflected in payments to growers through the incentive payment mechanisms in the contracts.
- Setting an average fee on the basis of the costs of an efficient notional production model:
    - allows growers to have greater input into the terms and conditions of their contracts and improves the balance of bargaining power between growers and processors;
    - appears to reduce the costs of arbitration, dispute resolution and other transactions involved in negotiating contracts; and
    - improves cost transparency in the industry, which can potentially enhance efficiency.
- 6) The Authority will be further examining any possible efficiency impacts from setting a notional price and the impacts of the legislation on productivity growth in the industry.
  - 7) The benefits of prescribed form agreements established under the *Chicken Meat Industry Act 1977* are likely to outweigh the costs, as they can help to ensure that minimum terms and conditions for growing contracts are met.
  - 8) The *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978* should be repealed, as the costs of these regulations are likely to outweigh the benefits.
    - These regulations restrict entry into the growing sector and the manner of expansion of existing growers. This can reduce competition in the growing sector and hinder the rate of innovation and efficiency improvement in the industry.
  - 9) There are protections available under the *Trade Practices Act 1974* to participants in the chicken meat industry in Western Australia. However, the costs of arbitration and dispute resolution under authorised collective bargaining are likely to be higher than under the current state legislation. The Authority will be further examining the extent of these costs in different jurisdictions.
  - 10) The effectiveness of the Act in achieving its objectives would also need to be considered to determine whether the Act should be amended (for example, to better encourage productivity growth, or to improve the balance of bargaining positions between growers and processors).



# 1 Introduction

The Treasurer of Western Australia gave written notice to the Authority, on 1 February 2010, to undertake an inquiry into the effectiveness of the *Chicken Meat Industry Act 1977* (“**Act**”).

Section 29(4) of the Act requires that the Minister cause the effectiveness of the Act to be reviewed five years after its enactment or continuation. The findings of the review are reported to the Minister, who shall not continue the Act unless he or she is satisfied that continuation is justified.

The Act was last continued on 31 December 2003, and is therefore due to be reviewed after 31 December 2008, with the review to be completed before the end of 2010.

The inquiry has been referred to the Authority under Section 38(1)(a) of the *Economic Regulation Authority Act 2003*, which provides for the Treasurer to refer to the Authority inquiries on matters related to industries that are not regulated.

## 1.1 Terms of Reference

The Terms of Reference for the inquiry are presented in **Appendix A**. The Terms of Reference require the Authority to consider and develop findings on:

- how the Act currently operates, including what actions are taken under the Act by chicken meat growers, chicken meat processors and the Chicken Meat Industry Committee;
- the current issues affecting the chicken meat industry in Western Australia, including issues relating to the major processors being based in the eastern states and competition from interstate chicken meat;
- whether there is a need for legislation to improve stability in this industry, which was the object of the Act when enacted, or any other reason, or if the Act should be repealed; and
- if there is a need for legislation, whether the Act in its current form is effective in meeting this need or should be amended or replaced.

The Authority must give consideration to, but will not be limited to:

- an examination of the chicken meat industry nationally;
- an examination of the relative negotiating power of chicken meat growers and chicken meat processors in relation to the terms of contract between them; and
- if any imbalance in negotiating power is found to exist, a consideration of whether any intervention is required or recommended to redress this imbalance.

In undertaking the inquiry, the Authority recognises section 26 of the *Economic Regulation Authority Act 2003*, which requires the Authority to have regard to:

- the need to promote regulatory outcomes that are in the public interest;
- the long-term interests of consumers in relation to the price, quality and reliability of goods and services provided in relevant markets;
- the need to encourage investment in relevant markets;

- the legitimate business interests of investors and service providers in relevant markets;
- the need to promote competitive and fair market conduct;
- the need to prevent abuse of monopoly or market power; and
- the need to promote transparent decision making processes that involve public consultation.

## 1.2 Background to the Inquiry

The *Chicken Meat Industry Act 1977* was enacted to “improve stability in the chicken meat industry”. In this industry, the production and processing of chicken meat is dominated by two large chicken meat processors, who contract out the growing of chickens to individual growers.

The Act replaced the repealed *Chicken Meat Industry Act 1975*, and continued the Chicken Meat Industry Committee (“**Committee**”), which was established under the 1975 Act. The Committee, which is appointed by the Minister, may, among other things, determine the standard price to be paid by processors to growers, prescribe the form of agreement between processors and growers, and resolve disputes.

Previous reviews of the Act, required under section 29(4) of the Act, have been completed internally by the Department of Agriculture (in 1996 and 2003). A continuation of the Act has effect for a period of seven years.

## 1.3 Review Process

The recommendations of this inquiry will be informed by the following public consultation process:

- The Authority published an issues paper on the inquiry on 26 February 2010 and invited submissions from stakeholder groups, industry, government and the general community on the matters in the Terms of Reference. The due date for submissions was 9 April 2010.
- Four submissions were received in response to the issues paper, from:
  - The Western Australian Broiler Growers Association (**WABGA**);
  - Bartter Enterprises (who were taken over by Baiada, but are continuing to trade under the Bartter label until the end of this financial year);
  - Inghams Enterprises; and
  - Department of Treasury and Finance.
- The submissions are published on the Authority’s website, [www.erawa.com.au](http://www.erawa.com.au).
- The Authority met with representatives of the WABGA, at their request, to discuss issues arising out of submissions. A similar invitation was extended to Bartter Enterprises and Inghams Enterprises but was not taken up.
- The Authority has consulted with its Consumer Consultative Committee (**ERACCC**), and will be consulting further with the ERACCC over the course of the inquiry.

- The final report for the inquiry is required to be delivered to the Treasurer by 1 November 2010. In accordance with the *Economic Regulation Authority Act 2003*, the Treasurer will then have 28 days to table the report in parliament.

In accordance with section 45 of the *Economic Regulation Authority Act 2003*, the Authority will act through the Chairman and members in conducting this inquiry.

## 1.4 How to Make a Submission

Submissions on any matter raised in this Issues Paper or in response to any matters in the Terms of Reference should be in both written and electronic form (where possible). Submissions should be marked to the attention of Dr Ursula Kretzer, Manager Projects, and addressed to:

Inquiry into the Chicken Meat Industry Act 1977  
Economic Regulation Authority  
PO Box 8469  
Perth Business Centre  
PERTH WA 6849

Email: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)  
Fax: (08) 9213 1999

Submissions must be received by **4:00 pm (WST) on Friday 17 September 2010**.

Submissions made to the Authority will be treated as in the public domain and placed on the Authority's website unless confidentiality is claimed. The submission or parts of the submission in relation to which confidentiality is claimed should be clearly marked. Any claim of confidentiality will be dealt with in the same way as is provided for in section 55 of the *Economic Regulation Authority Act 2003*.

The receipt and publication of a submission shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, where the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority in these circumstances.

Further information regarding this inquiry can be obtained from:

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## 2 Overview of the Chicken Meat Production Industry and Legislation

### 2.1 Introduction

The key focus in this inquiry is the negotiation of contracts between growers and processors, including whether there are issues that would warrant regulatory intervention, and if so, what approach should be used. In Western Australia, the *Chicken Meat Industry Act 1977* provides a framework for contractual negotiations, including the establishment of an average reference price to growers. In other states, there is no legislated reference price, and in some cases growers have received an authorisation from the Australian Competition and Consumer Commission (**ACCC**) to collectively bargain their contract terms.

This section provides an overview of the chicken meat production industry in Australia, the industry's structure and the background to the legislation in Western Australia. This is compared to current legislation of the chicken meat industries in other states.

### 2.2 The Chicken Meat Production Process

Chickens grown for meat production are known as “broiler chickens”.<sup>1</sup> Most stages in the production and processing of chicken meat are undertaken by chicken processing companies, apart from the contracting out of the growing of broiler chickens to individual broiler growers. The processing companies own and operate breeder farms, hatcheries and processing plants, and in some cases feed mills. The processors provide the feed and medicines required for the broiler chickens. The broiler growers own the sheds in which the chickens are raised and are responsible for growing the chickens.

The conventional process for producing chicken meat in Australia is as follows.

- The original genetic stock for Australian broiler chickens is imported from specialised breeding companies overseas, in the form of fertilised eggs, which are hatched under quarantine conditions to produce the great-grandparent stock for broiler chickens.
- The breeding stock is bred through several generations at specialised breeding farms, from the great-grandparent stock to the parents of the broiler chicks. (In Western Australia, there are no great-grandparent or grandparent breeding farms; fertilised eggs to form the parent birds are imported from the eastern states.) Fertilised eggs from the parent breeder farms are hatched in separate hatcheries, and day-old chicks are transferred directly to the broiler farm (or grower).
- Broiler chicks are grown in sheds that generally house up to 40,000 birds. A typical grower may have between three and eight sheds. The broiler chickens are grown under controlled temperature and feed conditions. Some are harvested at 30-35 days old and the remainder at 55-60 days old.

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<sup>1</sup> The Act defines a broiler chicken as “a chicken which is being or has been grown under intensive housing conditions specifically for consumption as meat after processing”. The chicken meat industry is a separate industry from the chicken egg industry, as the chickens grown for meat production are from a different genetic stock to those used for egg production. As a result of selective breeding, chickens used for meat production are fast growing, whereas chickens used for egg production are bred for egg quality rather than growth rate.

- The chickens are transferred live to a processing plant, where they are slaughtered and processed into chicken meat. The meat may be sold to retailers or fast food companies, or may be further processed into chicken meat products.

Some growers produce free range chickens or certified organic chickens, which have access to an outdoor forage area once they are 21 days old (10 days old for certified organic chickens). Around four per cent of chicken meat produced in Australia is free range, and around half of this is certified organic. Target stocking densities are lower than for conventional meat chickens.<sup>2</sup> Birds that have been treated with antibiotics cannot be sold as free range or certified organic. For certified organic chickens, feed must come from certified organic production and the use of genetically modified products in feed is not permitted.

## 2.3 Industry Structure

The chicken meat industry in Australia has grown from a production of around 3 million broiler chicks in 1950 to 475 million in 2008-09. Per capita consumption of poultry meat has also increased substantially over the past four decades, from an annual consumption of around 8 kg per person in 1969 to 38 kg in 2006.<sup>3</sup> Western Australian production of chicken meat is around nine per cent of the total national production (see Table 2.1).

**Table 2.1 Distribution of Chicken Meat Production by State (2007-08)**

	NSW	Vic	Qld	SA	WA	Tas	Total
Percentage of Total Slaughterings	34.3	27.9	18.3	9.1	9.0	1.4	441.6 million chickens
Percentage of Total Chicken Meat Produced	34.9	28.8	17.0	9.3	8.7	1.3	731,471 tonnes

Source: Australian Chicken Meat Federation Inc.

The structure of the chicken meat industry in Western Australia is similar to that in other states across Australia, with a small number of processors responsible for most stages of the production of chicken meat, apart from the contracting out of broiler growing to individual growers.

### 2.3.1 Processors

The processing of chicken meat in Australia is dominated by two major companies, Baiada Poultry Pty Ltd and Inghams Enterprises, who process around 80 per cent of the chicken meat produced in Australia. In February 2009, the ACCC allowed the acquisition by Baiada of Bartter, the third-largest of the national chicken meat processors, following an undertaking by Baiada to divest some of its assets to La Ionica Poultry in Victoria. The processors own most of the assets in the production process, including parent breeder farms, hatcheries, feed mills, processing plants, and some broiler farms. In Western Australia, Baiada and Inghams account for around 80 per cent of the broiler chickens processed (see Table 2.2).

<sup>2</sup> Maximum stocking densities are 28-40 kg/m<sup>2</sup> for conventional chicken meat, 16-32 kg/m<sup>2</sup> for free range chicken meat, and 25 kg/m<sup>2</sup> for certified organic. Source: Australian Chicken Meat Federation Inc.

<sup>3</sup> Victorian Department of Primary Industries website. Chicken accounts for 95 per cent of poultry meat sales.

**Table 2.2 Percentage of Broiler Chickens Processed in Western Australia by Processor**

Processor	Percentage of Broilers Processed in Western Australia (%)
Baiada	42
Inghams	38
Mt Barker Free Range Chicken	9
Finesse Poultry	8
Other	3
<b>TOTAL</b>	<b>100</b>

Source: Inghams Enterprises submission, p2

### Baiada Poultry

Baiada Poultry is the second largest producer of chicken meat in Australia, and the largest in Western Australia. Its products include the Steggles brand of chicken products, previously owned by Bartter. Baiada has a processing factory in Osborne Park, Perth, buys its feed from Wesfarmers, and owns two hatcheries and six parent breeder farms. As with Inghams, Baiada imports some fresh chicken meat into Western Australia.

In the eastern states, Baiada also owns and operates feed mills (one in NSW), processing factories (Queensland, Victoria and three in NSW), breeding farms, hatcheries and protein recovery facilities.

### Inghams

Inghams is the largest producer of chicken meat in Australia, and the second largest producer in Western Australia. Its processing factory is also in Osborne Park, and it produces its own feed at its feed mill in Wanneroo. Inghams owns a hatchery and nine parent breeder farms. Inghams also imports some fresh chicken meat into Western Australia from its processing plant in South Australia.

In the eastern states, Inghams owns another nine primary processing plants and nine further processing plants, breeder farms and ten feed mills.<sup>4</sup>

### Other Western Australian processors

Finesse Foods (Australia) Pty Ltd is located in Bunbury and was incorporated in 1988. It produces raw and deboned chicken and chicken products, including the Ferguson Valley Country Chickens range.

Mt Barker Chickens has a processing facility in Mt Barker. Its feed is produced by Milne Feeds, Welshpool.

There are a number of small processors, including Prestige Poultry, who buy chickens from the large processors for further processing.

<sup>4</sup> Source: Inghams website.



### 2.3.2 Growers

There are 42 growers in Western Australia, most of which (32) grow for either Inghams or Baiada. Inghams has 17 growers and 1 company farm located north of Perth. Baiada has 14 growers, located south of Perth. It is convenient for processors to have all the growers in their group located close together, to reduce time when making deliveries (of chickens, feed, medicines, etc) or picking up chickens. Growers also need to be located reasonably close to processing plants (ideally within one or two hours drive) as transporting live chickens over long distances increases the stress, injury rate and mortality rate of the birds.

Finesse Foods has five growers: two free-range growers (previously Inghams growers), and three other growers (previously Baiada growers).

Mount Barker Chickens has five growers, all in the Mount Barker region.

Chicken meat growers do not require licences, but are required to have their growing premises approved by the Chicken Meat Industry Committee under the *Chicken Meat Industry Act 1977* (see section 2.4 below). Expansions to capacity must also be compliant with the *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978*, which set out how processors should offer growers in their group the opportunity to meet an increase in output (see section 2.4.3 below). In addition, there is a range of legislation relating to the commercial production of chicken meat and eggs with which producers must comply (see **Appendix B**).

### 2.3.3 Retail Market

A further consideration is the retail market for chicken meat. Chicken meat may be sold fresh or further processed into frozen foods. The ACCC inquiry into grocery pricing in 2008 found that the two major supermarkets, Coles and Woolworths, account for around half the retail sales of fresh poultry (Woolworths around 30 per cent and Coles around 20 per cent), and independent retailers around 12 per cent.<sup>5</sup> In Western Australia, the independent retailers are the IGA stores, which are mostly supplied by a single national wholesaler, Metcash. Action, Dewsons and Supa Valu stores have recently joined the alliance with IGA.

Other retailers of fresh chicken meat include butchers (around 18 per cent of sales), fast food stores (around 12 per cent), restaurants, catering services, and institutions (e.g. hospitals, aged care homes).

The ACCC inquiry found that the major supermarkets, as the largest buyers, are able to exert some buyer power on processors.<sup>6</sup> The supermarkets typically source their supplies through an annual competitive tender process, and will switch between processors to secure the lowest price. Thus, there is potentially a high degree of competition between processors to secure supply contracts with the major buyers.

A further consideration is how sensitive the demand for chicken is to the retail price, and the price of other meats, such as pork, beef and lamb, that may be substitutes for chicken meat. Studies suggest that a one per cent increase in the price of chicken will result in a 0.3 per cent drop in the sales of chicken meat (as customers switch to other substitutes).<sup>7</sup>

<sup>5</sup> ACCC (2008), *Inquiry into the Competitiveness of Retail Prices for Standard Groceries: Final Report*, p54.

<sup>6</sup> *Op.cit.*, p244.

<sup>7</sup> Griffiths, G. *et.al* (2001), "Previous demand elasticity estimates for Australian meat products", *Economic Research Report No. 5*, NSW Agriculture.

However, demand for chicken appears to be less sensitive than other meats to changes in its own retail price and changes in the price of other meats.<sup>8</sup>

The submission by the WABGA includes a recent study for the federal Rural Industries Research and Development Corporation into consumers' chicken meat usage and attitudes, which confirms the popularity of chicken meat relative to other meats.<sup>9</sup> The study found that:

- chicken is the most frequently and heavily consumed main meal meat for households (with beef a close second);
- drivers for chicken consumption were that it was a habitual purchase, popular, children like it, convenient and value for money; and that
- consumers were not motivated by perceived health benefits of chicken (unlike beef, which was seen as a good source of iron, or fish, a source of Omega-3 oils) but neither were they motivated by health or animal welfare concerns.

### 2.3.4 Why has this Industry Structure Emerged?

The current structure of the chicken meat processing industry in Australia (i.e. a small number of large processors and large numbers of small contract growers) first emerged in the 1960s, and was based on a successful chicken meat company model that originated in the United States.<sup>10</sup> While processors do own some broiler farms, a consultant's report to the NSW Farmers Association in 2001 states that:

Processors prefer contract growing because it frees up working capital for marketing and business growth rather than locking funds into farm asset infrastructure....Growers contribute approximately 40 per cent of the capital investments in the industry through ownership of farms, shedding and other facilities used in the growing of chickens.<sup>11</sup>

Other stages of chicken meat production are less capital intensive, with processing plants representing around 30 per cent of the assets in the industry, and breeding farms, hatcheries, feed mills and transport and distribution making up the remaining 30 per cent.

In addition to processing plants, processors often have their own feed mills, hatcheries and breeding farms. One reason cited for the involvement of processors in most stages of chicken meat production is that it is important for processors to have control over the costs and timing of all operations in the supply chain.<sup>12</sup>

The structure of the industry in Western Australia reflects a common model internationally. Chicken meat industries in the other states of Australia, New Zealand, the United States and the United Kingdom are all based on an industry model involving a few large processors who have integrated most stages of production, but contract out the growing of chickens to small growing operations.

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<sup>8</sup> *Op.cit.* The survey of demand elasticity studies showed that a one per cent increase in the price of beef, pork and lamb results in drops in demand of 1.2 per cent, 1 per cent and 1.4 per cent respectively. However, there has been a downward trend in all own-price elasticities over the past two decades (i.e. consumer purchases of a particular meat have become less sensitive to price changes in that meat).

<sup>9</sup> WA Broiler Growers Association submission on issues paper, Attachment 3.

<sup>10</sup> Source: Australian Chicken Meat Federation Inc.

<sup>11</sup> The Allen Consulting Group, 2001, *A Structural Adjustment Package for the NSW Poultry Meat Growing Sector*, p2. The report notes a gross revenue to contract farms in NSW of \$124 million.

<sup>12</sup> ACCC (19 May 2004), *Determination: Application for Revocation of A90659 and its Substitution by A90888*, Inghams Enterprises Pty Ltd on its own behalf and on behalf of Tasmanian chicken growers, in relation to the collective negotiation of chicken growers' contracts in Tasmania, para.2.9.



One question is why processors – in Australia or in other jurisdictions – do not take over growing operations themselves, as they have done for other stages of production. This would eliminate the need to contract with growers, and could perhaps lead to fewer, larger company broiler farms. For existing farms, the answer is likely to be the legacy costs of past investments in land and capital by existing growers, which would be too costly for processors to buy out (in many instances, the land values for broiler farms would outweigh the commercial value of the broiler operation). The management experience and time commitment of owner-managers would also be difficult and costly to replace.

However, processors could move into broiler growing when industry growth occurs, by establishing new farms. A possible explanation as to why they do not is that it is not in their interests to do so: i.e. the owner-manager model is the least cost way of growing broiler chickens, and the returns to processors from growing chickens would be too low (and costs higher) if they were to do it themselves. In terms of the optimal size of broiler operations, there are advantages to having a larger number of smaller growing farms, rather than fewer large farms, as this can reduce biosecurity risks: this way, a disease outbreak can be contained to a single farm without major impact on a processor's total output.

While there are no legislative barriers to entry into the processing market, several factors can make it difficult for new, small processors to enter the market and compete with large processors, or for existing small processors to expand their operations.<sup>13</sup>

- There are likely to be considerable economies of scale associated with large processing plants and feed mills, which lowers the unit production costs, and favours large processors.
- Further, large buyers (supermarkets and fast food companies) prefer to deal with large processors, as they are likely to be better able than small processors to supply high volumes of chicken meat, produced to the buyers' quality and production specifications, at a lower price.

New processors that have entered the market in recent years have tended to specialise in niche markets, such as free range or organic chickens.

## 2.4 History of the *Chicken Meat Industry Act 1977*

In the 1960s, following the entry of large US fast food companies into Australia, the chicken meat industry in Australia grew rapidly from mainly backyard production for personal use, to an industry which mirrors the current industry structure, with large processing companies and contract growers. National production has grown from around 3 million broiler chickens in the 1950s to 475 million in 2008-09, and per capita annual consumption has increased from around 8 kg per person in 1969 to 38 kg in 2006.<sup>14</sup>

The rapid growth in the demand for chicken meat saw many new growers enter the market, at the same time as improvements in feed technology was raising production efficiency. This led to an overproduction of chicken meat, mainly in the eastern states, in the late 1960s.<sup>15</sup> Rising production costs, with the introduction of modern large-scale

<sup>13</sup> Previous restrictions in the *Chicken Meat Industry Act 1977*, providing for the Chicken Meat Industry Committee to provide advice to the Minister as to the need for the establishment of new processing plants, and for the Minister to approve or refuse applications for processing plants, were removed from the Act following the review of the Act in 1997.

<sup>14</sup> Victorian Department of Primary Industries website.

<sup>15</sup> Source: Second reading of the *Chicken Meat Industry Committee Bill*, Hansard, 6 May 1975, p2062.

heated sheds, and a reduction in the wholesale chicken price, increased uncertainty for growers regarding their future returns. Most state governments considered legislation as a means of stabilising their state's chicken meat industry.

In Western Australia, regulation in the chicken meat industry initially began with the formation of a Chicken Meat Advisory Committee through the *Chicken Meat Industry Committee Act 1975*, based on similar draft legislation in Victoria and South Australia. The Committee, consisting of grower and processor representatives and chaired by the then Director General of Agriculture, was tasked with agreeing upon a methodology to determine the average price to be paid by processors to growers. This was followed by 18 months of negotiation between growers and processors for an increase of 1.5 cents per bird. Although successful in their bid, this experience led Western Australian growers to approach the Government for assistance.<sup>16</sup>

The increasing integration of the chicken meat processors and the increasing dependence of growers on processors was recognised by Government at the time.<sup>17</sup> Legislation in the form of the 1975 Act was considered a way of placing:

...our industry in a safe place whereby growers can negotiate freely with the processors with what we might call an adjudicator – an independent officer from the Department of Agriculture – present as the seventh member of the committee.<sup>18</sup>

The bill for the *Chicken Meat Industry Committee Act 1975* was passed and the Committee established by the 1975 Act approved written contracts between growers and processors and provided a facility for arbitration. However unresolved disputes between the two parties continued to occur and as a consequence, stronger legislation in the form of the *Chicken Meat Industry Act 1977* was introduced.

### 2.4.1 Intent of the Legislation

The *Chicken Meat Industry Act 1977 (Act)* was enacted to:

...improve stability in the chicken meat industry, to repeal the *Chicken Meat Industry Committee Act 1975*, to provide for the continuation of the Chicken Meat Industry Committee, and for incidental and other purposes.<sup>19</sup>

The Department of Treasury and Finance submitted that:

When introduced in 1977 it was clear that the major objective of the legislation was the stabilisation of the chicken meat industry following a large increase in consumer demand. In particular, the Act was established to provide broiler chicken growers with countervailing measures to match the market power of chicken meat processors. (Department of Treasury and Finance submission, p2).

Growers have indicated to the Authority that one of the drivers for introducing the Act was that growers needed sufficient assurance of returns on their investments in order to obtain finance from banks. Another perceived problem at the time was that too many chicken growing sheds were being built, at the request of the processors, which was not financially viable for the chicken meat growers. The Act required that any new shedding be approved by the Chicken Meat Industry Committee.

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<sup>16</sup> Hansard (1975), Second reading of the *Chicken Meat Industry Committee Bill*, Extract from Tuesday 19 August 1975, p2067

<sup>17</sup> Ibid, p2242

<sup>18</sup> Ibid.

<sup>19</sup> *Chicken Meat Industry Act 1977*, p1.

Specifically the Act was introduced:

- to counteract an imbalance of bargaining power between processors and growers that resulted from the vertically integrated nature of the industry;
- to promote stability in the industry;
- to enable the Committee to determine the average price paid by processors to growers from which individual grower prices are negotiated;
- to improve chicken growing conditions in the industry with all growing premises requiring to be approved by the Committee; and
- to provide dispute resolution.

The chicken meat industry experienced relative stability for a while until the early 1980s, when:

...difficult market conditions and a surplus of growing area during 1980-82 caused relationships between growers and processors to deteriorate and culminated in termination notices being issued to a number of growers. (WA Broiler Growers submission, p6)

In 1982, the *Chicken Meat Industry Amendment Act* was passed. This changed the 1977 Act by:

- altering the structure of the Committee;
- providing for issues to be decided by a majority of votes;
- removing the provision for outside arbitration;
- limiting appeals against Committee decisions to the Supreme Court; and
- providing for the registration and approval of chicken growing facilities.

The adoption of these amendments brought the legislation into its current form.

The Act was reviewed in 1989 by the Department of Agriculture and extended unchanged to December 1996. A further review was conducted as part of the National Competition Policy legislation review in 2000, which allowed growers to opt out of the Act and also to appeal to the State Administrative Tribunal against any determinations made by the Chicken Meat Industry Committee. This and a subsequent review in 2003 are discussed in more detail below.

## 2.4.2 Functions of the Committee

The Committee, as defined by the Act, is appointed by the Minister and comprises an independent chairperson, two representatives each of chicken meat processors and chicken growers, and an additional two independent members. The Committee meets twice a year, and its functions are to:

- determine the standard price to be paid by processors to growers for broiler chickens;
- resolve disputes between processors and growers;

- set criteria to define an “efficient grower”, which is used as a condition for the entitlements of growers under the prescribed form of agreement between growers and processors;<sup>20</sup>
- approve facilities for the growing of broiler chickens, and maintain records of these facilities;
- report to the Minister on any matters relating to the chicken meat industry that it considers relevant; and
- make recommendations to the Minister on regulations relating to the Act.

### 2.4.3 Regulations Under the Act

The *Chicken Meat Industry Act Regulations* set out the prescribed form of agreement between processors and growers, as well as the methodology for determining the standard price to be paid by processors to growers.

Other regulations, the *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978*, set out rules and procedures for how any increase in output by a processor should be shared between growers contracted to the processor. The purpose of these provisions is to ensure that all growers in the pool have the same opportunity for expansion, and that grower farms in which processors have an interest are not favoured by the processor when an increase in output is required.<sup>21</sup> The regulations also include procedures for resolving disputes related to the participation of individual growers in output expansion.

Regulations may also be made under the Act, including regulations regarding environmental, health and animal welfare matters relating to the growing of chickens.<sup>22</sup>

### 2.4.4 Reviews of the Act

#### National Competition Policy Review (1997)

In 1997, the Act was reviewed for its compliance with the National Competition Policy (NCP).<sup>23</sup> This review recommended several reforms to the legislation, to:

- allow individual growers to opt out of collective bargaining if they wish to do so and enter into individual contracts with their processors;
- retain collective bargaining, but move away from bargaining at the industry level (between all processors and all growers) to bargaining at the company level (between each processor and its growers);
- provide for the Act to set regulations for mandatory codes of practice on health, environmental and animal welfare standards; and
- remove restrictions on entry into the processing sector.

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<sup>20</sup> In defining the criteria for efficient growers, the Committee is required to take into account factors such as the productivity of growers, the standard price paid to growers, and the market for chicken meat.

<sup>21</sup> The processor, when seeking to expand output, is required to maintain a constant ratio of shed area between private growers in the pool and growers in which the processor has an interest.

<sup>22</sup> *Chicken Meat Industry Act 1977*, sections 24(1) and 24(2).

<sup>23</sup> Department of Agriculture Western Australia (1997), *Report to the Competition Policy Unit on the Legislation Review of the Chicken Meat Industry Act 1979-92*.

As a result of the NCP review, the legislation was amended through the *Competition Policy (Amendment and Repeal) Act 2003* to implement the review recommendations.

### 2003 Review of the Act

The Act was last reviewed in 2003 by the Department of Agriculture.<sup>24</sup> This review of the Act coincided with the drafting of amendments to the Act that were recommended in the NCP legislation review. In the review of the Act, it was concluded that the NCP amendments would generally improve the regulation of the chicken meat industry, as it would implement competition reforms while keeping features of collective bargaining. A further conclusion in the review was that these amendments also addressed most of the concerns raised in the submissions made by stakeholders in response to the review.<sup>25</sup>

#### 2.4.5 Free Range Chickens

According to the Department of Agriculture, free range producers may not be subject to the Act with regard to prescribed agreements or the approval of growing facilities, as these particular parts of the Act are based on the definition of broiler chickens as those raised under intensive housing conditions.<sup>26</sup> This matter is unclear, as there is no definition in the Act of “intensive housing conditions”, and all commercial meat chickens, whether free range or shed reared, are kept in sheds for the first three weeks of their lives.

WABGA disputes the Department of Agriculture’s position that free-range chickens are not raised under “intensive housing conditions” and are therefore not subject to the Act. One of the submissions by a free range grower (a WABGA member) supports the WABGA position that free-range chickens are intensively housed, and therefore should fall under the Act.<sup>27</sup>

The WABGA submission also attaches the advice from the Crown Solicitor’s Office to the Department of Agriculture in 2003 that the housing conditions of free range chickens could be defined as “intensively housed”, and that the legislation was probably intended to cover all commercial chickens (as there were no free-range chickens at the time). However, the Crown Solicitor’s Office concludes that the legislation is unclear, and would need to be redrafted to remove the ambiguity.<sup>28</sup>

#### 2.4.6 How is the Act Currently Being Used?

The Chicken Meat Industry Committee meets at least twice a year, primarily to update the cost estimates in the cost of production model used to calculate the gazetted average price (currently set at 80.57 cents per bird).<sup>29</sup> The cost of production model is based on cost estimates of the inputs into an efficient notional broiler farm. The model is developed and updated in consultation with growers and processors, and is available to all industry parties. The gazetted price is then used as an input into the negotiation of contracts between growers and processors. Payments to growers in a pool (the set of growers producing a batch of chickens for a single processor) vary according to the productivity of

<sup>24</sup> Department of Agriculture Western Australia (December 2003), *Review of the Chicken Meat Industry Act 1977*.

<sup>25</sup> Department of Agriculture Western Australia (December 2003), *ibid*, p3.

<sup>26</sup> Department of Agriculture Western Australia (December 2003), *ibid*, p5.

<sup>27</sup> WA Broiler Growers Association, individual grower submissions, Attachment 1.

<sup>28</sup> WA Broiler Growers Association, individual grower submissions, Attachment 4.

<sup>29</sup> *Government Gazette*, 25 June 2010, p2887.

the growers, with efficient growers paid more than average and less efficient growers paid less than average.

Growers have the option of entering into individual contracts with their processors. However, most growers (83 per cent) are on prescribed form agreements under the Act (see Table 2.3). Only six growers are on individual contracts (one for Baiada and five for Mt Barker Chickens). The Inghams company farm does not have a contract as it is owned and operated by Inghams.

**Table 2.3 Number, Size and Affiliation of Main Chicken Growers in Western Australia**

Grower Affiliation	Number of Growers		Total Shed Area (m <sup>2</sup> )	
	Prescribed Agreements	Individual Contracts	Registered*	Not Registered
Inghams growers	17		182,770	
Baiada growers	13		131,694	
Finesse Foods	5		36,187	
Inghams company farms		1	18,190	
Baiada external grower		1		43,792
Mt Barker Chickens		5		n/a
<b>Total</b>	<b>35</b>	<b>7</b>	<b>368,841</b>	

Source: *Western Australian Broiler Growers Association (WABGA, January 2010), Cost of Production Model; and WABGA submission on Issues Paper, pp12-13.*

**Notes:**

\* Growers under prescribed agreements are required to have their growing facilities approved and registered by the Chicken Meat Industry Committee. The shed area for the Inghams company farm is registered as the original Act required that the ratio of the shed area between processor-owned farms and contract growers be maintained.

The Western Australian Broiler Growers Association, representing the (35) broiler growers who are on prescribed agreements under the Act, strongly supports the existing legislation, which it maintains has:

- encouraged the development of an efficient growing sector;
- allowed high standards for biosecurity and management practices to be maintained;
- ensured harmony in the industry and avoided the need for costly legal disputes;
- promoted transparency of cost information across the industry;
- ensured that growers are able to recover their costs of production and earn a reasonable return on their capital investments; and
- helped to provide contractual certainty for growers and assurance to finance lenders.

(See WABGA submission, p2-3 and individual growers' letters, Attachment 1.)

The WABGA submission and individual growers' letters showed particularly strong support for the arbitration and dispute resolution functions of the Act. The submission lists a range of disputes that have been dealt with by the Committee over the years. Individual growers submitted that disputes are often avoided due to the prospect of going before the Committee. The WABGA submission notes that the most recent review of the Act, by the



Department of Agriculture in 2003, recommended that the dispute resolution and arbitration provisions in the Act be retained.

The processing companies, on the other hand, do not support the Act, and argue that it should be repealed. Inghams Enterprises submits that the Western Australian legislation is:

...outdated, contrary to current practice, anticompetitive and restrictive to a point that precludes commercial outcomes. It is a legislative framework which has and will continue to make Western Australia less attractive for investment and the cost efficient production of poultry and poultry products. (Inghams Enterprises submission, p2)

Inghams is of the view that the Western Australian Legislation (the Act) as it now stands contributes little if anything to the attainment of the objective to which the Legislation was said to be directed.

It is cumbersome, inefficient and unnecessary in the business environment in which we operate and having regard to the national regulation that applies by the operation of the *Trade Practices Act*.

We would therefore encourage the Government to repeal the *Chicken Meat Industry Act 1977* in order for the Western Australian broiler industry to remain competitive and viable with other states. (Inghams Enterprises submission, p8)

Bartter Enterprises submit that:

Bartter Enterprises submission based on the intent of the *Chicken Meat Act Industry 1977* [...] is to repeal the Act in its current form on the basis the intent of the legislation is no longer applicable... (Bartter Enterprises submission, p1)

Bartter Enterprises submitted that one of the reasons for the introduction of the legislation was to protect existing growers at a time of declining production, and that this was no longer relevant, due to the current shortage of growing capacity.

Bartter Enterprises in recent years has been required to source additional grower capacity from new growers on top of existing farm shedding conversions/upgrades and natural expansion in order to meet local market demand resulting from continuing population growth thus ensuring market supply was achieved. This is contrary to one of the major points for establishment of the Chicken Meat Act of 1977 meaning where grower returns were being negatively affected by declined throughput. (Bartter Enterprises submission, p2)

Inghams Enterprises submitted that the fixing and gazetting of the growers' fee under the Act (s.16) is in breach of section 45 of the *Trade Practices Act 1974 (TPA)*, and therefore also of the *Competition Policy Reform (WA) Act 1996*. Inghams submitted that section 51 of the TPA allows for breaches of the TPA to be disregarded if specifically authorised by an Act of Parliament in a state; however, the *Chicken Meat Industry Act 1977* does not refer to the TPA, as required under s.51(1C)(a), so Inghams claims that this does not satisfy the requirement of s.51.

The understanding of the Authority is that the activities of the Chicken Meat Industry fall within the exclusions contained in the *Competition Policy Reform (Western Australia) Act 1996* (which applies the provisions of Part IV of the TPA as a law of Western Australia), because the Committee:

- is an emanation of the Crown in right of Western Australia, since its functions are of a regulatory nature, and the Committee is subject to Ministerial control and direction; and
- is not carrying on a business.

## 2.5 Other States

New South Wales, Victoria and Queensland also have acts related to their chicken meat industries, although industry participants have had little recourse to the various acts in recent years. Unlike the Western Australian Act, these acts do not provide for the determination of an average fee that is paid to growers. The South Australia legislation was repealed in 2009. The current status of the legislation in other states is summarised in Table 2.4 below.

Growers in several states have established collective bargaining arrangements, in which a local group of growers contracted to one processor negotiates the terms and conditions of their grower contracts on a collective basis. Such arrangements require authorisation by the ACCC. This process is discussed in section 2.5.1 below.

**Table 2.4 Summary of Current Chicken Meat Industry Legislation in Other States**

State and Legislation	Current Status
<b>New South Wales</b>	
<p><i>Poultry Meat Industry Act 1986</i></p> <ul style="list-style-type: none"> <li>• facilitates direct contract negotiations between growers;</li> <li>• authorises collective bargaining in contract negotiations; and</li> <li>• establishes a Poultry Meat Industry Advisory Group as a forum for growers and processors.</li> </ul> <p>Poultry Meat Industry Committee:</p> <ul style="list-style-type: none"> <li>• no centralised price setting function;</li> <li>• reduced in size from 15 to three; and</li> <li>• prepares a code of practice and agreement guidelines for negotiations between growers and processors.</li> </ul>	<p>Act still in force.</p> <p>Recently reviewed by Department of Primary Industries, with the recommendation that a further review of the poultry meat industry in NSW be carried out to determine the level of regulation required.</p>
<b>South Australia</b>	
<p><i>Chicken Meat Industry Act 2003</i></p>	<p>Act repealed 21 August 2009. ACCC have authorised collective bargaining and dispute resolution (Table 2.4).</p>
<b>Victoria</b>	
<p><i>Broiler Chicken Industry Act 1978</i></p> <ul style="list-style-type: none"> <li>• National Competition Policy Review in 1999 recommended that the Act be repealed.</li> </ul> <p>Committee:</p> <ul style="list-style-type: none"> <li>• no longer operating;</li> <li>• had responsibility for making recommendations about the terms of agreements, handling disputes and determining the standard price for chickens.</li> </ul>	<p>Act still in force.</p> <p>ACCC have authorised collective bargaining between the Victorian Farmers Federation and their processors (Table 2.4).</p>

*Continued...*



State and Legislation	Current Status
<b>Queensland</b>	
<p><i>Chicken Meat Industry Committee Act 1976</i></p> <ul style="list-style-type: none"> <li>to be reviewed in 2010</li> </ul> <p>Committee:</p> <ul style="list-style-type: none"> <li>still operating;</li> <li>may make recommendations about grower agreements;</li> <li>facilitates negotiations between growers and processors;</li> <li>refers disputes to mediation or arbitration; and</li> <li>is not permitted to set prices for chickens.</li> <li>An independent review of Queensland boards recommended that the Committee be abolished.</li> </ul>	<p>Act still in force and is currently being reviewed. Discussion paper expected to be published in August 2010.</p>
<b>Tasmania</b>	
No state level regulatory protection	<p>All growers contracted to one processor on mainland Australia.</p> <p>Growers authorised by ACCC to negotiate their agreements collectively. (Table 2.4)</p>

Sources:

*Inghams Enterprises submission on issues paper, p9*

*Minister for Primary Industries (2010), Statutory Review of the Poultry Meat Industry Act 1986, pp6 – 7*

*Western Australian Broiler Growers Association (2010), Submission on the Inquiry into the Chicken Meat Industry Act 1997, pp20 - 28*

## 2.5.1 ACCC Authorisation of Collective Bargaining

Normally, collective bargaining is not allowed under the *Trade Practices Act 1974*, as it can have detrimental impacts on competition, including inefficiency, higher prices and barriers to entry. However, the TPA provides for the ACCC to authorise certain anti-competitive conduct if it is in the public interest. Such an authorisation provides the parties engaging in the conduct immunity from legal action for a specified period of time.

In determining whether a collective bargaining arrangement is in the public interest, the ACCC applies a public benefit test and will only grant authorisation if it determines that there are public benefits which outweigh any potential detrimental impacts. The process of authorisation involves the parties concerned making an application to the ACCC, which then conducts a public consultation, considers submissions, issues a draft determination for further consultation, and issues a final determination. Over the past ten years, the ACCC has granted five authorisations allowing groups of chicken growers to collectively bargain in their negotiations with their processors (see Table 2.5).

In the Dawson Review of the TPA in 2003, submissions expressed dissatisfaction with the authorisation process, saying that it took too long and was too expensive. In response, the Dawson Review recommended establishing a notification process for collective bargaining, modelled on the process available for exclusive dealing.<sup>30</sup> The notification

<sup>30</sup> Section 93 of the Trade Practices Act provides for the notification of exclusive dealing which, if it were not for the notification, would be in breach of section 47 of the Act.

process involves parties lodging a notification of the conduct, which is given statutory protection once notified. In the case of collective bargaining in which competitors negotiate prices, the ACCC may withdraw protection if it determines that the benefit to the public that would result from the proposed arrangements does not outweigh the detriment to the public.<sup>31</sup>

The collective bargaining notification process was introduced in 2007. Since then, one notification of collective bargaining by a group of chicken growers (in South Australia) has been lodged and allowed to stand by the ACCC, and another is currently being considered (see Table 2.5).

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<sup>31</sup> This also applies for notifications that involve collective boycott, or exclusionary provisions defined under sections 45(2)(a)(i) or (b)(i) of the Act. The ACCC may also object to notifications not involving collective boycott, exclusionary provisions, or negotiation on price, but which could otherwise substantially lessen competition, if it determines that the conduct is likely to lessen competition, or is not likely to result in a public benefit that would outweigh the detriment.

**Table 2.5 ACCC Authorisations and Notifications of Collective Bargaining by Chicken Growers**

Applicants	Application Lodged	Final Decision	ACCC Determination
<b>Authorisations</b>			
Victorian Farmers Federation on behalf of Victorian chicken grower groups applied for an existing collective bargaining authorisation to be replaced by a similar one.	18 Feb 2010	21 Apr 2010	Authorisation granted for further 5 years
Baiada Poultry and four other processors applied for separate authorisations for collective bargaining by consenting growers in Victoria.	22 Dec 2003	2 Mar 2005	Authorisations granted with conditions
Inghams applied for an existing authorisation for collective bargaining by its contract growers in Tasmania to be replaced by a similar one.	5 Dec 2003	19 May 2004	Authorisation granted for a further 6 years
Inghams applied for an extension for an existing authorisation for collective bargaining by its growers in South Australia.	3 Apr 2002	22 Jan 2003	Authorisation granted for further 5 years
Inghams and seven other processors in NSW applied for the growers for each processor to be allowed to bargain collectively.	8 Sep 2001	8 Oct 2002	Authorisation denied
Inghams applied for authorisation for collective bargaining by its growers in Tasmania	28 May 1998	17 Mar 1999	Authorisation granted
<b>Notifications</b>			
Tasmanian Chicken Growers Association on behalf of six chicken meat grower members for collective negotiation with processor Inghams	22 Apr 2010	Currently under consideration	
South Australian Farmers Federation on behalf of 18 South Australian chicken growers for collective bargaining with processor Inghams	27 Feb 2009	26 Mar 2009	Notification allowed to stand for 3 years

Source: ACCC website

## 3 Is Regulation Necessary?

### 3.1 Introduction

In assessing whether regulation of the chicken meat industry in Western Australia is warranted, a key question is whether the absence of regulation would give rise to a market structure that is not in the best interests of society. Markets that work well are ones that encourage participation and competition by both buyers and sellers, so that high quality products or services are available to consumers at the lowest possible cost. Conversely, market failures can result in a misallocation of resources away from where they are most highly valued.

One cause of market failure is the abuse of market power, which may arise in markets where there are too few buyers or sellers.<sup>32</sup> Regulation may be required to prevent the abuse of market power, or to reduce market power by removing any barriers to entry or exit into the market.

However, there are risks with regulation, which can impose costs on society through unintended consequences. Governments are generally not best placed to second-guess markets, which is best left to the participants in an industry and consumers. Any regulatory intervention in markets therefore needs to be clearly justified in terms of overall benefits to society which outweigh the costs. Further, the transfer of welfare from one group in society to another group does not provide sufficient justification for regulation, if there is not an associated overall increase in welfare to society.

In the case of the chicken meat industry, a key market is the market for the provision of chicken growing services, in which the “seller” is the grower and the “buyer” of the service is the processor. Another market that is relevant is the market for processed chicken meat, as the degree of competition and countervailing power in the retail sector can mitigate the market power of industry participants. In this section, both of these markets are assessed to determine if there are factors which prevent the development of competition.

Another point is that it is natural for participants in a market to be motivated by self interest. Both growers and processors will seek to maximise the returns from their businesses, including capturing returns from each other. There is nothing wrong or immoral with this motive or behaviours associated with it: indeed, it is a fundamental condition of an efficient market. However, a problem arises when one side is not strong enough to resist such self-interested behaviour from the other side.

### 3.2 Background

As shown in section 2.3, the market structure for the growing of meat chickens in Western Australia, as in other states, is one that appears to have the following characteristics.

- There are a small number of dominant buyers of growing services (the large processors), and a large number of sellers (the contract growers).

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<sup>32</sup> Markets may also fail for other reasons, such as in the provision of public goods, such as defence or education; the presence of externalities (costs or benefits that are not factored in the price of a good or service); or asymmetry in the information available to market participants.

- The processors also maintain control of other upstream stages of the supply chain for chicken meat, such as the provision of breeding stock and feed.
- There are several factors that operate to make it difficult for processors to raise the prices they charge to chicken meat retailers.
  - There are a small number of large retailers (supermarkets and fast food companies) that would be in a position to exert some market power over the processors, who would not wish to lose a large buyer of their output.
  - At the same time, the retail market is highly competitive, with the retailers competing to provide chicken to consumers at the lowest possible price.

Given the structure of the industry, the question is whether the processors have market power relative to growers, and if so, whether this places growers at a disadvantage in contract negotiations. If growers cannot switch easily to another processor, or to an alternative output, their bargaining power relative to processors in negotiating contracts could be weakened, so that they may have less input into the terms and conditions of their contracts.

### 3.3 Submissions

Broiler growers represented by the WABGA submitted that growers are at a substantial disadvantage in contractual negotiations with processors.

First, growers submitted that they have limited options for shifting to different processors, due to the small number of processors.

In Western Australia the growers have limited options of changing processors in an effort to achieve a better deal with another processor due to the fact there is such a limited number of processors in this state.

Further, the growers submit that their capital investments are purpose built for the production of meat chickens and cannot be turned to alternative uses.

The contract broiler grower's farm facilities are designed for a very specific purpose which means that a grower has virtually no option to convert the farm to another industry. (WABGA submission, Attachment 1, submission by Lanaubra Farms)

Our sheds cannot be used for any other purpose (WABGA submission, Attachment 1, submission by W. McPhail and Sons)

The growers submit that in order to make capital investments, they require long-term contractual security and a reasonable rate of return, which they claim has been provided by the Act.

The regulations were seen as security for our family to invest \$5m into capital that has no short to medium term alternative use (poultry sheds). (WABGA submission, Attachment 1, submission by Terrigal Farm)

Lanaubra farms was able to finance and build the farm into a modern contract Broiler grower operation because the Western Australian Chicken Meat Industry Act gives the growers the ability to negotiate a fair contract and price for the entire industry. The banks require the security of a long term contract and fair price negotiations between the growers and the processors before they will provide the finance to build modern contract broiler operations. A long term contract backed by the Chicken Meat Industry Act allows a family company to borrow enough money to upgrade farm facilities to meet the minimum

standards that the processors...set. (WABGA submission, Attachment 1, submission by Lanaubra Farms)

The growers also submitted that there is often pressure from processors to reduce costs or to invest in further capital.

[Processors] can't cost recover from processing plants as workers are covered by labour laws, can't increase prices to their customers as Western Australia is unfortunate in that we have a duopoly with only the two major supermarkets and the easiest target therefore is the contract broiler grower... (WABGA submission, Attachment 1, submission by Raintree County)

If the processing company believes the growers shedding needs upgrading to a certain level or certain equipment needs to be installed, and if this is not done his agreement may be terminated. (WABGA submission, Attachment 1, submission by Nowergup Poultry)

[G]rowers have continually needed to go to the Chicken Meat Industry Act to get adjudication and resolution on increases in running costs and returns on investments and even then the growers have discounted the growing fee to help obtain an agreement with the processors. (WABGA submission, Attachment 1, submission by ER and JF Terace)

In addition, growers submitted that as individuals they do not have the financial resources to engage in legal disputes with processors over contract terms and conditions.

In all countries and states within Australia the major disputes are over price negotiation and contracts for growers. To resolve these disputes costs hundreds of thousands of dollars, with the costs in most cases being at the expense of the chicken farmer. (WABGA submission, Attachment 1, submission by B J & R Enterprises)

The processors, on the other hand, submitted that the protections to growers under the Act are not necessary, as individual contracts offered by the processors provide terms that are sufficient to encourage growers to expand or enter the market.

### **Inghams Enterprises**

Companies such as Inghams are developing uniform contracts that encourage best practice on our part and the part of our Growers wherever they are located in Australia.... The fact that Inghams has had persons recently entering the industry or wanting to expand production in such states as Queensland and South Australia, clearly demonstrates terms that are acceptable to both parties are being reached in the absence of Legislation such as the CMI Act. (Inghams Enterprises submission, p3 and p4)

### **Bartter Enterprises**

[G]rowers in other states and Western Australia have opted out of the Act and have private, long term (10-15 years), secure contracts in place clearly outline the roles and responsibilities of both parties, fee review mechanisms and agreed dispute resolution processes all which operate independent of the Act and Regulations. Bartter Enterprises currently has opted out contracts operating in Western Australia as well as the other states. Other chicken meat operations in Western Australia also have growers operating on opted out contracts including Mt Barker which all growers are on opt out contracts. The opt out growing contracts are designed and implemented to provide surety for both parties, growers and processors, and be mutually beneficial to enable sourcing of finance and industry re-investment achieved. (Bartter Enterprises submission, p1)

Bartter Enterprises submitted that there was effective competition in the processing sector in Western Australia and that regulation of the industry through the Act was not needed.

Bartter Enterprises supports the view that regulation of a market, such as through legislation, is not necessary and indeed can be counterproductive, in a market where full or effective competition exists. Full or effective competition it could now be argued is the case in Western Australia with 5 established processors operating including Ingham's, Bartter Enterprises (Baiada), Prestige Poultry, Mt Barker and Finesse. Mt Barker and Finesse in recent years have established their own chicken meat growing operations, established contract growing agreements, grown significantly in processing production numbers and given growers flexibility in growing arrangements... (Bartter Enterprises submission, p2)

Inghams Enterprises submitted that the relationship between processors and growers is one of mutual dependence.

Both the Processor and the Contract Grower have commercial pressures to conclude satisfactory negotiations and it is very much a question of mutual dependence. (Inghams Enterprises submission, p4)

It is interesting to note that the trend in growing contracts in recent years has been overwhelmingly in favour of [individual non-collective] contracts and away from the CMIC and the CMI Act, confirming recognition by both parties of a strong mutual dependence between Grower and Processor. (Inghams Enterprises submission, p2)

The processors dispute the claim that the balance of negotiating powers favours processors. Bartter Enterprises submitted that the growth of Mt Barker Chickens and Finesse Poultry in recent years has:

...created strong demand for shedding/growing capacity which in turn has led to a shortage of shedding/growing capacity. (Bartter Enterprises submission, p2)

Inghams Enterprises submitted that:

[i]t is clear that the dynamic of our industry is shifting, and has indeed in other states shifted faster than Western Australia, from small inefficient family owned farming operations to large sophisticated tunnel shedding operations which are well resourced and have ready access to quality legal and financial advisers. (Inghams Enterprises submission, p3)

## 3.4 Authority Assessment

As noted in the introduction, when considering the case for regulatory intervention, there is a need to establish that there is a clear welfare gain to society (i.e. the benefits of regulation outweigh the costs), and not simply a transfer of benefits from one group to another. The Authority has considered the assessment of the costs and benefits of intervention (in the form of allowing collective bargaining) carried out by the ACCC, as well as the particular factors in the Western Australian chicken meat industry that might provide grounds for regulation.

### 3.4.1 ACCC Assessment of the Costs and Benefits of Collective Bargaining

In its various decisions on collective bargaining authorisations and notifications for chicken growers (see Table 2.5), the ACCC has in each case carried out a public benefit test comparing the benefits of collective bargaining arrangements with the detriments which could arise out of such arrangements. These assessments are based on an analysis of the relevant markets (for chicken growing services and for processed chicken meat) and whether there are market failures that can be alleviated by allowing collective bargaining.



Costs and benefits are assessed against the “counterfactual” – how the market would react if collective bargaining arrangements were not in place. In each case, the ACCC has assumed that if there was no collective bargaining, the imbalance in bargaining powers between processors and growers would result in processors offering standard form contracts to growers (i.e. a standardised form of contract offered by a processor to all its growers), with little input from growers into the terms and conditions of those contracts.

In all but one case, the ACCC has allowed groups of chicken growers to enter into collective bargaining arrangements with their processors, for the following reasons.

- Processing is dominated by a small number of large companies, who directly control the growers’ operations through the provision of chicks, feed, medicines and growing specifications.
- Growers are limited in the extent to which they can provide growing services to other processors, due to the small number of processors, and the need for growers for one processor to be located close to each other and to processing facilities.
- Growers face significant switching costs as they have made significant investments in assets that are highly specific to chicken growing, so are limited in their ability to provide services other than to their processor.
- Growers have limited resources and expertise in contract negotiations compared to large processing companies.
- Collective bargaining can help to improve the balance of power by allowing growers to have greater input into their contract terms and conditions.
- Collective bargaining can reduce transaction costs by allowing common contractual problems to be addressed in a more streamlined manner and lessening the need for dispute resolution.
- Any detriments that may arise from collective bargaining by growers would be limited, as:
  - the level of negotiation that could be expected to occur in the absence of collective bargaining (in which case growers would be most likely to be subject to standard form contracts with little input from growers) is low;
  - participation in collective bargaining is voluntary (individual growers can opt out);
  - collective bargaining arrangements are limited to growers providing services to the same processor, and there is no common representation across groups;
  - collective boycotts are not allowed; and
  - the balance of bargaining power would not be altered to such an extent that collective bargaining would allow growers to place pressure on processors to increase growing fees.

The ACCC also recognised the market power of the large processor companies in its determination on Baiada’s takeover of Bartter (then the third-largest of the national meat processors).<sup>33</sup> The ACCC initially opposed the takeover on the grounds that it would substantially lessen competition in the markets for the supply of wholesale chicken.

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<sup>33</sup> ACCC (27 February 2009), *Public Competition Assessment: Baiada Poultry Pty Ltd – Proposed Acquisition of Bartter Enterprises Pty Ltd*.



However, the ACCC later allowed the takeover, by requiring an undertaking by Baiada to divest some of its assets to another Victorian processor, La Ionica Poultry.

### 3.4.2 *Relevant Factors in the Western Australian Chicken Meat Industry*

The Authority considers that factors in the Western Australian chicken meat industry give rise to a market structure similar to those seen in other states.

The two major processing companies, Inghams Enterprises and Baiada, dominate the processing sector in Western Australia, with over 80 per cent of growers contracted to one of these companies. There are barriers to entry into the processing sector which make it difficult for new processors to enter into the market, or smaller processors to expand operations, including:

- the high cost and economies of scale of large processing plants;
- the efficiencies gained by large processors by controlling different stages of production; and
- the preference for large retailers to sign supply contracts with large processors.

While some new processors have entered the market (such as Mt Barker Chickens), these have tended to be in niche markets, such as free range chickens, so it is likely that the dominance of the conventional broiler market by the two major companies could be expected to continue.

As in the other states, growers tend to be small, family-run operations. The location of growers near other growers who supply the same processor, and reasonably close to processing plants, is largely due to the improved logistics and reduced transport costs to processors, who deliver feed, chicks and medicines to grower farms, as well as collect chickens for processing. The need for growers to be grouped relatively close together, as well as the small number of processors in Western Australia, makes it difficult for growers to switch their services to another processor. Further, the capital intensity and high degree of asset specificity in broiler growing operations makes it difficult for growers to switch to another output.

The Authority notes that the example of Finesse Foods shows that it is possible for growers to switch to another processor (two growers for Finesse were once Inghams growers and three are ex-Baiada growers), and for growers to be located at some distance from each other and the processing plant (the processing plant for Finesse Foods is in Bunbury while the growers are near Perth). However, the Authority understands that the situation for Finesse Foods is unusual, and arises largely due to the processor having difficulty establishing growers in the Bunbury region, due to the planning requirements for broiler farms. The Authority therefore considers that existing growers will continue to be limited in their opportunities for switching to other processors.

A further question is whether processors, where they have market power over growers, are likely to exert that power. Given that processors have limited scope to raise wholesale prices to retailers, they would have an incentive to seek reductions in growing costs to increase their own profit margins. Processors may also have an incentive to seek excess capacity in the growing sector, which would give them some protection against the risk of failing to meet supply contracts with retailers. That is, having spare capacity in the growing sector would give processors more flexibility to meet short-term increases in demand. The ability of processors to import chicken meat from their operations in the eastern states gives the processors further bargaining power over the growers.

### 3.4.3 Monopsony Markets (*Few Buyers, Many Sellers*)

There is limited empirical data on the Australian chicken meat industry. For example, the Australian Bureau of Statistics does not publish chicken meat production figures for Western Australia, to protect commercial confidentiality in the processing sector. However, some understanding of how the chicken meat industry in Western Australia works can be gained by drawing on economic models of similar industry structures. These models will not be exact replicas of the Western Australian chicken meat industry, but can provide some insight into the key forces at play.

Given the small number of processors, and the difficulty that growers face in switching away from their own processor, the market structure for chicken meat growing services in Western Australia could be described as regional monopsonies – that is, regional markets in which a large number of sellers (i.e. broiler growers) sell their services to a single buyer (i.e. the processing company to which the growers belong).

Monopsony markets tend to produce prices (or wages) that are lower than in markets where there is competition between buyers, and where sellers are able to move freely between buyers. This is because in a competitive market the buyers would need to compete for sellers, by offering higher prices (wages) to attract new sellers and retain their existing sellers. Monopsony markets also result in an aggregate production (employment) that is lower than in competitive markets.<sup>34</sup>

Regulation of monopsony markets (if competition cannot be introduced) may involve raising the minimum price (wage) to the higher level which would occur under competitive conditions.

- This has the effect of redistributing wealth from the buyer to the seller (since the buyer pays the seller higher wages).
- However, overall social welfare is also increased, as output and employment is increased. The benefit to sellers from raising the minimum wage is greater than the net loss to the buyer (from paying the higher wages), because the buyer also gains from increasing output.<sup>35</sup>

Applying these concepts to the chicken meat industry is complicated by the presence of large retailers with countervailing market power, who set the level of demand for chicken meat.

- Raising the wage level of growers (in this case, the growing fee) most likely results in a transfer of wealth from processors to growers.
- However, chicken meat retailers limit the extent to which output can be increased in the broiler sector: the level of demand for chicken meat is set by consumers. Therefore, regulation of the growing fee may have little impact on output from the growing sector.

The Authority therefore considers that the net welfare gains arising from the regulation of growers' fees are uncertain, although higher growing fees would result in a transfer of welfare from processors to growers.

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<sup>34</sup> The monopsony outcome is directly analogous to the outcome for a monopoly (a market with one seller and many buyers). Monopolists have an incentive to restrict output and increase price; monopsonist employers have an incentive to restrict employment and decrease wages.

<sup>35</sup> In economic terms, there is a net loss in aggregate social welfare, known as a deadweight loss, which arises from the restriction of output and employment under monopsony, relative to a competitive market.

### 3.4.4 The Hold-up Problem

There is some economics literature that examines broiler markets where growers are highly dependent on their processor and growers' assets have low salvage value outside the contractual relationship.<sup>36</sup> Research suggests that in these situations:

- growers will be reluctant to make substantial new investments, because this will give processors increased bargaining power and could lead to a reduction in profits for growers; and
- processors may request upgrades and technological improvements as a condition of contract renewal, leading to a high degree of physical asset specificity for the growers, which may be used by the processor to induce higher effort from the grower without the need for higher compensation.

For example, it would be in the processors' interest to encourage growers to invest in excess capacity (more than is needed to meet the demand by retailers), and then to reduce the stocking density in order to get growers to accept a lower fee.<sup>37</sup> An analogy is airlines or convention centres, where the owner is willing to accept a lower price for spare seats, in order to maximise throughput. Growers, however, recognise the additional risks to their returns which could result from over-investment in growing space, and may therefore be reluctant to invest.

The above situation is an example of the "hold-up problem", which is where two parties would be better off working together cooperatively, but do not do so, because one party fears that by entering into the contract they will increase the bargaining power of the other party and potentially reduce their own profits. Hold-up can result in investment levels which are below the socially optimal level.

However, if growers can be induced to over-invest in growing capacity, this is also a cost to society, as more money is being spent than is necessary to meet the required level of demand (set by retailers).

Growers in Western Australia claim that processors do use their bargaining power in contract negotiations to get growers to convert to tunnel sheds, while growers are reluctant to make significant investments without contractual assurance of sufficient returns.

All of the Baiada farms [who switched to Finesse Foods] were under duress from the processor [Baiada] who indicated that their contracts would not be renewed unless they converted to tunnel. (WABGA submission, p12)

A major expansion of the farm occurred in 2004 which involved replacement and extension of existing sheds and converting them all to tunnel ventilation. This was done at the request and pressure from the processor because the performance from naturally ventilated shedding was deemed by them to be not as good as tunnel ventilation shedding,

<sup>36</sup> For example, Vukina, T. and Leegomonchai, P. (August 2006), "Oligopsony power, asset specificity and hold-up: evidence from the broiler industry", *American Journal of Agricultural Economics*, 88(3):589-605. The article is based on a study of the American broiler industry, which has a similar structure to the Australian broiler industries, with small numbers of large processing companies and many small contract growers. The article found evidence to support the hypotheses that (1) the smaller the number of processors in an area (i.e. the less competition in the processing sector) the greater the tendency for growers to under-invest in housing facilities; and (2) in cases where there was a single processor, an increase in growers' asset specificity resulted in a decrease in grower compensation rates.

<sup>37</sup> The Authority, however, does not have direct evidence of this behaviour by processors in Western Australia, apart from anecdotal evidence from growers that stocking rates are often below the maximum shed capacity. This issue will be further examined before the final report.

hence anyone who hadn't converted by July 2010 wouldn't have their chicken growing contracts renewed.

Unfortunately if growers can't expand or convert to tunnel ventilation and contracts aren't renewed there is little use for existing poultry sheds and equipment, unlike other rural industries where land can be used for growing different crops or animals as circumstances change. (WABGA submission, Attachment 1, submission by ER and JF Terace)

In order for us to continue to invest in our operation we require the ability to borrow additional funds. In order to secure funding we require a continuation of our contracts to ensure that financial institutions have the confidence to continue to support the industry with available funds. (WABGA submission, Attachment 1, submission by Redmond Pty Ltd)

The growers also provided evidence that stocking density can be an issue, with the number of birds per square metre at times below the maximum density of the tunnel sheds. Growers have an incentive to achieve the maximum throughput for which the sheds were designed.

[T]here is no incentive for processors to resolve disputes especially related to the fee increases, density reduction or pool payment systems where processors can regain part of the growing fee. (WABGA submission, Attachment 1, submission by ER and JF Terace)

The site is 4.2 hectares or 10 acres with 5 convection sheds registered to house 120,000 broiler chickens, at present due to [processor] edicts we are only placing 106,000 chickens, 11.6% below registered and budgeted figures. (WABGA submission, Attachment 1, submission by Colleen Broad)

The Authority considers that there is evidence that the relationship between growers and processors gives rise to a hold-up problem, in which growers are reluctant to invest in new capital or technology because the increased bargaining power of processors could reduce the growers' future returns. The example of demands by processors for growers to convert from conventional barns to tunnel sheds, particularly at the time of contract renewal, and the reluctance of growers to do so unless provided with assurance of a return on their investment (which involves maintaining high stocking densities and batch rates), is widely cited in the submissions by the Western Australian broiler growers. On the other hand, some growers have found that their throughputs, and therefore their returns, are lower than they expected at the time they made their investments.

One way to achieve an optimal level of investment would be for the two parties to merge (i.e. vertical integration). However, as noted in section 2.3.4, vertical integration between chicken growers and processors is likely to be too costly for processors, due to the large amount of sunk costs by growers in the land and capital associated with growing operations, and because the contract arrangement appears to be the lowest cost method of growing chickens.

The hold-up problem is not exclusive to Western Australia, and is found in broiler industries in the eastern states, as well as deregulated broiler industries in the UK and the US. The universal persistence of the contract broiler model – even though processors could benefit by vertically integrating broiler growing – provides further evidence that contract growing, despite the hold-up problems, is still the least-cost model for broiler growing.

On the basis of the submissions by growers, it is unclear if the hold-up problem has been adequately resolved by the existing legislation.

### 3.4.5 Limits to Processor Bargaining Power

The Authority notes that some factors may limit the bargaining power of the processors, who have an obligation to meet their supply contracts with buyers. The loss of production from a grower (due to a failure to reach a contractual agreement) may be difficult to replace at short notice by establishing new growers, or through expansion by other growers, due to the need for additional capital investment, or the need to meet health, planning and environmental guidelines and other regulatory requirements. Further, it may not always be possible to increase the volume of imported chicken to meet supply shortfalls.

Thus, to some extent there is a mutual dependence between growers and processors, and it is therefore in the interests of processors to have a stable and sustainable growing sector that ensures reliability of supply. Processors who would like to expand production by their growers would need to offer contract terms and conditions that give the growers (and their financiers) sufficient confidence to invest in new capital.

### 3.4.6 Summary

On balance, the Authority considers that, in the light of the recent decisions by the ACCC, and the similarity between the market structure in Western Australia and those in the various cases considered by the ACCC, there is an imbalance in negotiating power between chicken meat growers and processors. In the absence of mechanisms to address this imbalance, the most likely outcome for growers would be a standard form contract from the processors in which the growers would have little influence over the contract terms and conditions.

Providing for growers to have greater input into their contracts could result in returns to growers that are higher and more in line with returns in a competitive market (e.g. where there are many processors and growers could move freely between processors). This would equate to a transfer of welfare from processors to growers, although the impacts on net social welfare are unclear, as output from the growing sector is determined by the retail market.

Thus, if there are any social welfare gains from regulation of the chicken meat industry, these are likely to be in the nature of savings in the transaction costs or dispute costs in contract negotiations, or improved investment decisions, such as the resolution of any hold-up problems.

However, the *Chicken Meat Industry Act 1977* has not stopped processors from implementing tunnel sheds through a number of growers, which may have weakened the growers' bargaining position.

## Draft Findings and Recommendations

- 1) The factors that shape the chicken meat industry in Western Australia are similar to those in other states.
  - The processing sector is dominated by a small number of large processors, who have integrated control over most stages of chicken meat production, apart from the growing of broiler chicks, which is contracted out to individual broiler growers.
  - In negotiating contracts, growers are in a weaker bargaining position than processors, due to the limited opportunity of growers to provide growing services to other processors, and the growers' significant investments in capital assets specific to chicken growing.
- 2) In the absence of regulation, it is likely that growers would be offered standard form contracts by processors and that growers would have little input into their contract terms and conditions. This could result in returns to growers that are below what they would be if there was a competitive market for growing services.
- 3) In principle, regulation could improve the bargaining position of growers in the negotiation and execution of their contracts with their processors. This would result in a transfer of welfare from processors to growers.
- 4) It is unclear how regulation could improve aggregate social welfare by increasing output by the growing sector, as output is determined by consumer demand. However, regulation could improve net social welfare by:
  - reducing the transaction costs and the costs of disputes and arbitration associated with grower contracts; and
  - helping to overcome any potential hold-up problems in investment by growers and encouraging an optimal level of investment.



## 4 Assessment of the *Chicken Meat Industry Act 1977*

### 4.1 Background

This section presents the Authority's assessment of the *Chicken Meat Industry Act 1977*. The assessment is against the background set out in the preceding sections, which set out the history of the development of the legislation and the current structure of the industry.

In assessing the legislation, the Authority has had regard to the Western Australian Government's guidelines for legislative review.<sup>38</sup> The guidelines set out a process for a public interest assessment of legislation, which involves clarifying the objectives of the legislation (see section 2.4.1), identifying the nature of any restrictions on competition, assessing the effects of the restrictions, assessing the balance of costs and benefits of the restrictions, and considering any alternative means of achieving the same results.

There are three main restrictions to competition under the Act.

#### 1) *Average Price Regime*

- The Act allows for the Committee to determine the average price to be paid by processors to growers (s.15(a), s.16). The Act also allows for regulations to be made to prescribe how the average price should be determined (s.24(2)(b)). The methodology for determining the average price is set out in the second schedule of the *Chicken Meat Industry Act Regulations*.

#### 2) *Prescribed Form of Agreements*

- The Act allows for regulations to be made on the form of prescribed agreement between growers and processors (s.24(2)(a) and s.24(3)).
- The Committee may also lay down the criteria for determining whether a grower is "efficient" for the purposes of determining growers' entitlements under the prescribed form of agreement (s.15(1)(c)). These criteria may include the productivity of growers, the average price, and the market for chicken meat (s.15(2)).

#### 3) *Barriers to Entry into the Growing Sector*

- The *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978* give incumbent growers the first right of refusal in any expansion sought by their processor. The expansion offered to growers must maintain the ratio of shed areas between broiler farms that are owned by the processor (such as the Inghams company farm) and farms not owned by the processor. The processor may enter into agreements with new growers only if the existing growers are unable to meet the increased production sought by the processor.

<sup>38</sup> Government of Western Australia (November 2001), *Public Interest Guidelines for Legislation Review*, Competition Policy Unit, Department of Treasury and Finance.

- The Act also prohibits the growing of broiler chickens unless they are grown on premises approved by the Committee (s.19A). The Act provides for the regulations to be made to prescribe the requirements with which growing premises must comply (s.19(5a)), which could include factors other than the suitability of the growing facilities.

The first two restrictions (the average price regime and the prescribed form of agreements) act together to fix the average fee to growers, and are therefore in the nature of a control on price. The implementation of these restrictions is supported by the ability of the Committee to determine disputes arising out of prescribed form agreements (s.15(b) and s.18).

The third restriction is in the nature of a restriction on the entry or exit into the market for the provision of growing services.

Earlier forms of the Act had restrictions that imposed barriers to entry into the processing sector, by requiring that the Committee provide advice to the Minister on the need for new processing plants to be established. However, these restrictions have been removed from the Act.

The broiler growing industry in Western Australia is of considerable size and significance. Western Australian growers produce around 50 million chickens per year and supply almost all of the chicken consumed by Western Australian consumers. Growers on prescribed form agreements currently produce around 38 million chickens per year, so that the total payments to these growers are between \$23 million and \$26 million a year. Restrictions to the industry can be considered to be major restrictions, which warrant a detailed analysis and public benefit test.

The following sections examine the costs and benefits of each restriction in turn.

## 4.2 Restriction 1: Average Price Regime

### 4.2.1 Background

#### *Setting the Average Price*

The gazetted average price (currently 80.57 cents per bird) is used as a reference price by growers and processors in the negotiation of individual contracts.<sup>39</sup>

The average price is determined using a model of production costs for a notional broiler farm, which is currently assumed to be a tunnel farm with a shed area of 11,000 m<sup>2</sup>, and a stocking density of 21.5 birds per square metre.<sup>40</sup> Production costs are calculated on the basis of the estimated efficient costs of such a farm (land, site works, plant, equipment and operating requirements). Total production costs comprise a return on capital, depreciation, operating costs and a working capital charge.

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<sup>39</sup> The average price regime is referred to in various places in the Act as the “standard price”. However, the term “average price” is more accurate, as the method for determining the price provides for different prices to be paid to growers depending on their productivity. Further, the price is gazetted as “the average price that is to be paid by processors to growers for broiler chickens”, in cents per bird.

<sup>40</sup> This stocking density is higher than that of a standard farm, to ensure that the average price sets an efficient benchmark. The mortality rate is assumed at 5.05 per cent, with a throughput of 5.75 batches of birds per year.



## Payments to Growers

The growers in the pool are paid the average price, adjusted by a productivity factor. The productivity of a grower is measured by the average live weight of the grower's birds at the time of culling, adjusted for factors outside the control of the grower – the age of the birds at the time of culling (which is determined by the processor), and the feed conversion ratio (the mass of food consumed divided by the mass of meat produced, which is determined genetically and/or by the type of feed mix used).<sup>41</sup> More efficient growers (with birds that are heavier than the pool average, taking into account their age and feed conversion ratio) will be paid more than less efficient growers (with birds that weigh less than the average pool weight, taking into account their age and feed conversion ratio).

Payments to growers within a pool may be further adjusted (or “compressed”) to ensure that the difference between the lowest paid grower and the highest paid grower is no more than a specified amount (e.g. no more than 15 per cent of the average price.)

Most contracts also contain provisions for dealing with inefficient growers, with inefficiency defined on the basis of the performance of the growers relative to others in the pool. For example:

- a contract may define a grower as inefficient if their productivity is below 97% of the average productivity of the growers in the pool. Growers that are determined to be inefficient more than three times in a row may have their growing fees and stocking density reduced, and may be excluded from the pool if they are inefficient more than five batches in a row; or
- growers may have their fees reduced (or increased) if their productivity is below (or above) the productivity of a benchmark grower (e.g. the fourth most productive grower in a pool); and
- contracts may also contain other conditions for termination of growers' contracts (for example, if losses of chickens due to heat exceed one per cent of a batch).

The performance payment systems are not symmetrical: total rewards to efficient growers in a pool (those who perform better than the pool average) are less than the total penalties to inefficient growers (who perform worse than the average). For example, the position of a performance benchmark may be set at 30 per cent of the total number of growers (i.e. out of 20 growers, this position would be the sixth most efficient grower). Also, growers who perform better than the benchmark may be paid (for example) 0.2 cents per bird more than the average growing fee, while growers who perform below the benchmark may be paid 0.4 cents per bird less than the average growing fee.

Contracts may also contain clauses limiting growing fees due to “market forces”. These are not explicitly defined, but provide the processor with some flexibility to respond to short-term supply and demand conditions in the chicken meat market. This may impact on the number of broiler chickens delivered to a farm in a batch, and therefore on the stocking density for that batch, or the amount of down time between batches.<sup>42</sup>

<sup>41</sup> Broiler chickens typically have feed conversion ratios less than 1.9 (i.e. less than 1.9 kg of feed is required to produce 1 kg of chicken meat).

<sup>42</sup> The Act provides for the Committee to take into account the market for chicken meat in the criteria that it may lay down for determining an efficient grower. These criteria are not set out in the legislation or regulations, but are defined in the contracts between growers and processor. However, the Act provides scope for any disputes arising from these matters to be determined by the Committee.

## 4.2.2 Submissions

Bartter Enterprises submitted that the average fee mechanism in the Western Australian legislation is not necessary, and is anti-competitive.

A notable difference exists to the Western Australia Chicken Meat Act when compared to other state Acts in they do not provide determination of an average fee that is paid to growers. In Western Australia it appears this fee setting mechanism via the CMIC is the primary reason behind the Act being continued from a grower's perspective. Bartter Enterprises believes the fee setting mechanism is not necessary...as growers in other states and Western Australia have opted out of the Act and have private, long term (10-15 years), secure contracts in place clearly outline the roles and responsibilities of both parties, fee review mechanisms and agreed dispute resolution processes all which operate independent of the Act and Regulations. (Bartter Enterprises submission, p1)

Anti competitive growing fee determination mechanisms have been in part a contributing factor to why one of Western Australia's larger processors has cut back local chicken meat processing production numbers, increased imports sourced from the eastern states and abstained from participating in the CMIC meetings and fee review process. (Bartter Enterprises submission, p2)

Inghams Enterprises submitted that the restrictions of the Act had caused them to cut back on their processing operations in Western Australia over recent years (see Table 4.1 below). Inghams submitted that:

This decrease in processing numbers is not a result of decreasing sales but rather a result of the Company's move to invest and expand its operations in other states (Queensland, South Australia and Victoria) at the expense of Western Australia. The anticompetitive and restrictive Legislation within Western Australia is one of the factors contributing to the decision not to invest further in Western Australia. (Inghams Enterprises submission, p3)

**Table 4.1 Size of Inghams Enterprises Operations in Western Australia**

Indicator	2007	2010	Reduction (per cent)
Number of growers	20	16	20
Total growing space (m <sup>2</sup> )	220,034	191,932	12.8
Number of broilers processed ('000s)	21,172	17,277 (planned)	18.4

Source: Inghams Enterprises submission, p3.

The WABGA has commented to the Authority on the claims by Inghams regarding the reduction to the size of Inghams' operations. WABGA maintain that the reduction was due to the loss of three Inghams growers to Finesse Food, following requests by Inghams that the growers convert their standard sheds to tunnel sheds.

The WABGA submitted that the fee setting mechanism has encouraged cost efficiency in the Western Australian grower industry. This is because the average fee is calculated using a cost of production model based on a notional farm which is an efficient broiler operation (with modern technology, a relatively large size, and least costs of inputs). One processor (Inghams) also owns a farm, and so would be familiar with the costs of production and whether further efficiencies could be achieved. Attachment F to the WABGA submission presents the cost of production model from the most recent full review of the model in July 2008.

Further, the WABGA submits that the actual payments that growers receive are consistently lower than the gazetted average price (see Figure 4.1). The growers submit that this is due to the further adjustment of the gazetted fee to take into account the growers' productivity relative to other growers in their group, and other factors such as market forces.

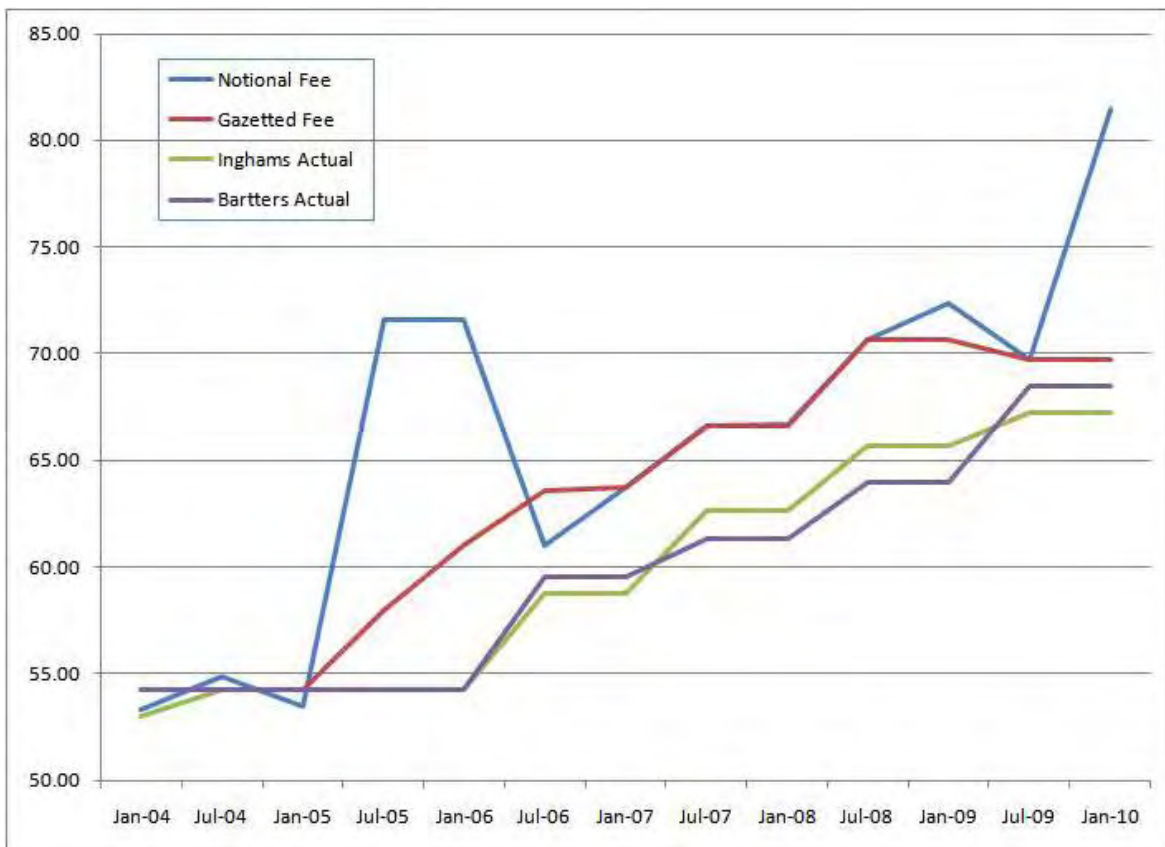
The Growing Fee is determined by the [Committee] by determining a gazetted fee based upon a submission by the growers deemed as a 'notional fee', derived from a 'Notional Model' in accordance with the Act and Regulations. This in turn is then modified, based on the level of productivity of the grower's particular processor...and market forces that prevail, specifically loss of market share within WA or to an interstate processor. (WABGA submission, pages 9 and 19)

The WABGA also submits that the pool incentive mechanisms further reduce payments to growers, as the aggregate penalties to inefficient growers (those whose productivity is below the benchmark productivity) exceed the aggregate reward payments to efficient growers (those who perform better than the benchmark).

[G]rowers above a certain benchmark are rewarded by a certain margin and those below the benchmark system are penalised three times the magnitude of the same margin, effectively allowing the processor to participate in the distribution of the agreed pool price.

Hypothetically, if 1,000,000 birds are marketed at the agreed price of 70 cents per bird, bearing in mind that the agreed fee has already been adjusted downwards from the Notional Fee to a Gazetted Fee and then to the Agreed Fee,...the Processor manages to only pay \$620,000 instead of the \$700,000 or an average of just 62 cents per bird. (WABGA submission, p19)

**Figure 4.1 Actual Fees Paid to Growers, Notional Fees from the Cost of Production Model, and Gazetted Fees (Cents per Bird)**



Source: WABGA submission, p9.

### 4.2.3 Authority Assessment

In this section, the various costs and benefits of setting an average price are assessed.

#### *Costs/Disadvantages*

The Authority has considered a range of possible costs associated with the setting of an average price:

- 1) the potential for the average price to raise growing fees, and therefore to increase the price of chicken meat;
- 2) higher administration costs; and
- 3) reduced incentives for efficiency, if productivity differs between groups of growers.

#### **1) Potential for higher chicken meat prices**

The Act provides a mechanism for growers to collectively bargain on the basis of the growing fee. This can potentially produce a growing fee that is above what would be achieved in a competitive growers' market.

A one cent increase in the growing fee to growers on prescribed form contracts, if passed on to consumers, would amount to a total of around \$380,000 per year.

#### *Efficiency of grower fees*

The Authority has examined the cost of production model used to calculate the gazetted fee to determine whether the model provides a reasonable estimate of the efficient costs for an efficient broiler growing operation. Attachment F to the WABGA submission, presents the July 2008 version of the cost of production model.

The Authority has analysed the model and its inputs for a series of years from 1993 to the current year. The notional farm used in the model appears, generally, to define the inputs that would be required for an efficient broiler operation that meets the regulatory requirements for the industry. The Authority will be examining in more detail some of the cost estimates in the model.

- The model assumes labour costs for a full-time farm hand of \$90,526 in July 2010, which seems high relative to the current Western Australian average annual earnings of \$57,000.
- The model includes a \$200,000 allowance for a worker's cottage.

However, the Authority notes that:

- Processors and growers have equal opportunity to scrutinize and query the model and its cost estimates, both in the review of the model every three years and in the bi-annual cost updates. One processor also has a farm, so is familiar with production costs.
- The methods of estimating the costs of most of the model inputs seem appropriate for determining the efficient cost of those inputs.
- The rate of return on capital used in the model appears to be low relative to other industries. The rate of return is based on a risk free rate equal to a five year average of the 10-year Commonwealth bond rate (discounted for inflation based

on the five year average of the Perth CPI), plus an industry risk allowance of 1.5 per cent.

- The 1.5 per cent risk premium has been unchanged since 1993. According to growers, the rate has been kept low in order to keep the growing fee low, to appease the processors.
- The rate of return is likely to be much lower than the processors would be seeking if they were to take over the growing operations. By comparison, the risk premium for a regulated gas pipeline business – considered as a low risk business compared to the economy-wide average level of risk – is currently around 4.5 per cent.<sup>43</sup>
- The gazetted growing fee determined by the cost of production model appears to be higher than the average fee received by growers (see Figure 4.1).

Further, the pool payment systems set out in the contracts to growers appear to further encourage efficiency in grower performance, by rewarding growers that are relatively efficient and penalising those that are inefficient. Such incentive mechanisms are a common feature of grower contracts in Australia, and also in other countries. However, the asymmetry in the incentive mechanism, with aggregate rewards to growers less than aggregate penalties, is unusual, and will further reduce the fees paid to growers. This is different to the U.S. broiler industry, for example, where incentive mechanisms are typically symmetrical.<sup>44</sup>

In summary, the Authority does not consider the cost of production model is likely to have resulted in prices that are too high relative to the efficient costs of production.

### *Changes in Productivity*

The Authority also examined the changes in the productivity of the Western Australian broiler industry, using the data in the cost of production models. Productivity growth in an industry is generally due to improvements in technology or processes. In broiler production, productivity growth can be measured, for example, by decreases in bird mortality, increased bird numbers and increased bird weight. These improvements could be the result of improvements in housing facilities, feed quality, medicines, genetic stock, or management practices.

Productivity in agricultural industries in Australia has generally improved over the past ten years. The Australian Bureau of Agricultural and Resource Economics (**ABARE**) regularly examines productivity growth in a range of agricultural sectors. ABARE has found that productivity growth in agriculture has averaged 2.8 per cent per year over the past two decades, compared with a market average productivity growth of 1.4 per cent per year.<sup>45</sup>

<sup>43</sup> The Economic Regulation Authority regulates natural monopoly industries such as gas, electricity, rail and water networks. In a recent determination on the access arrangement for the gas transmission company, Goldfields Gas Pipeline, the Authority allowed a nominal pre-tax weighted average cost of capital of 10.48 per cent, relative to a risk-free rate based 10-year Commonwealth government bonds of 5.79 per cent. The difference between these figures gives a risk premium for the business of around 4.7 per cent. The equity beta for the business (the variability of its returns relative to the variability of returns of the market as a whole) is between 0.8 and 1.0, which means it has a risk that is lower than or equal to the risk for the market as a whole (a company with average risk would have an equity beta of 1.0, while a company with higher than average risk would have an equity beta above 1.0).

<sup>44</sup> Vukina, T. *et al* (2006), *op.cit.* refer to these mechanisms as “tournaments” and note that these “work such that one half of the participants receives the bonus and the other half receives the penalty. Aggregate bonus and aggregate penalty cancel each other out precisely” (p596, footnote 12).

<sup>45</sup> Nossal, K. and Gooday, P. (November 2009), “Raising productivity growth in Australian agriculture”, *ABARE Issues Insights*, 09.7. ABARE estimates the Total Factor Productivity for agricultural sectors, which

The Authority has not yet fully examined productivity trends in the data provided in the cost of production models. This will be examined in the final report. The large step-change in the production process of the introduction of tunnel sheds will be a difficulty in this analysis, as most productivity measures are most accurate for small changes in inputs and outputs.

It should be noted, however, that partial productivity measures, such as birds per square metre, may not fully reflect underlying total factor productivity. For example, there is no clear evidence at this stage that the move towards tunnel sheds has resulted in marked improvements in productivity. The July 2002 model, based on conventional sheds, was compared with the July 2008 model, based on tunnel sheds. The comparison showed that tunnel sheds have led to a 24 per cent increase in output, from 97 marketable birds per square metre per year in the conventional farm, to 120 marketable birds per square metre per year using tunnel sheds. However, to achieve this increase in output, capital costs have increased by 29 per cent, in constant dollar terms (dollars of July 2008). Thus, it is unclear whether productivity has improved or not.

Data from the WABGA suggests there is little difference between conventional sheds and tunnel sheds in terms of mortality rates or batch rates, but that the maximum stocking density for tunnel sheds is higher than that of conventional sheds (see Table 4.2). However, this suggests that unless sheds are operating at full capacity, there may be little difference in productivity between the two technologies. This would appear to support anecdotal evidence from growers, who claim that tunnel sheds are expensive to build and operate, but do not greatly improve the number or size of chickens produced, compared with conventional sheds.

In order to enhance productivity, it would be important that the notional model is based on an efficient type of operation, taking into account inputs and outputs. Capital inputs, actual typical stocking rates, and productivity for different types of growing systems should be carefully assessed to determine the most efficient model on which to base the notional model.

**Table 4.2 Average Productivity for Conventional Sheds and Tunnel Sheds in Western Australia and Nationally (June 2010)**

	Conventional Sheds		Tunnel Sheds	
	WA Average	National Average	WA Average	National Average
Batch rate (per year)	5.66	5.37	5.66	5.57
Birds per square metre	16.05	17.40	20.15	19.57
Mortality (%)	4.75	4.85	4.75	5.60
Growing fee	67.13	67.23	69.43	67.42

Source: WA Broiler Growers Association

The Authority will be further examining productivity changes in the broiler industry in Western Australia before the final report.

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is a measure of the efficiency with which the inputs of a production model are combined to produce an output.



*Limits to potential for price increases*

The ACCC has noted several factors which can limit the potential for collective bargaining arrangements to increase prices to consumers.

- If collective bargaining arrangements are non-compulsory, growers can choose to opt out of the arrangements (e.g. growers that are more efficient).
- If there is countervailing power in the retail market, processors are less able to raise their margins through higher wholesale prices than by lowering fees to growers.
- The chicken growing fee is a small proportion of the retail price.
- If there is an over-supply of chicken meat in the market, the bargaining power to growers is reduced, and there is less scope for an increase in the growing fee.

The Authority considers that some of these limitations to the potential for increases to the growing fee, and therefore to chicken meat prices, are also likely to apply in Western Australia.

- Since the amendments to the Act following the National Competition Policy review in 1997, prescribed form agreements are not compulsory, and growers in Western Australia have the ability to enter into individual contracts with their processor. As indicated in Table 2.3, six growers in Western Australia are on individual contracts.
- As discussed in section 2.3.3, there is a countervailing pressure on retail chicken meat prices due to a competitive retail sector, with large retailers who are able to exert some market power on processors.
- The growing fee is small in relation to the retail price for chicken. The growing fee of 80.57 cents per bird is around 10 per cent of the retail price of whole chickens in the supermarkets. WABGA submitted that the growing fee represents 10.7 per cent of the average cost of production of processed chicken meat (WABGA submission, p9).

**2) Higher administration costs**

The administration costs associated with the Act include the costs of Committee meetings (around twice a year) and the determination of the average price through the cost of production model.

- Administration costs of the Committee are minimal (less than \$1,500 per year) and are borne by the growers and processors, who fund the operations of the Committee. Data collection and updating of the cost of production model is carried out by the WABGA free of charge.
- The current Chairman and Secretary of the Committee are employees of the Western Australian Department of Agriculture and Food, so their costs are paid by the Department (around \$6,100 per year).

The total administration costs of the Act are therefore small (around \$7,500 per year). The component of administration costs that could potentially be passed on to chicken meat consumers (\$1,500) is minimal, and would have negligible impact on consumer prices even if costs were fully passed through.



### 3) Industry level fee not appropriate if productivity differs between grower groups

If there is a difference in productivity between the two main grower groups, an industry-wide average fee may not be appropriate. For example, productivity may differ between groups due to the quality of inputs by processors, such as feed, chicks, medicines, etc. In this case, an industry-wide average fee would disadvantage growers in the less efficient group, whose costs are higher than the efficient group. A “one size fits all” approach to collective bargaining can be anti-competitive, in that it reduces the competition that could occur between grower groups. It can also discourage entry by new processors that do not have the economies of scale of the larger processors.

The 1997 review of the Act considered whether the industry level fee was appropriate and concluded that at the time there was little difference in productivity between the two groups of growers, with a maximum difference of 1 to 1.5 cents per bird. However, it was noted that the industry-wide average price could potentially impact on any third processor. The review therefore concluded that company level bargaining should be considered if the productivity of the two groups were to diverge significantly, or if there was the scope for a third processor to enter the market.

The ACCC considers that the anti-competitive impacts of collective bargaining are lessened if the coverage and composition of bargaining groups are restricted to small groups of growers working for a single processor and if there is no common representation across groups.<sup>46</sup> The ACCC has authorised collective bargaining arrangements for limited bargaining groups, and where there is no common negotiation across groups, as it considers that this allows contracts to better reflect the specific supply and demand conditions of each processor’s business and encourages competition between grower groups.

The Authority has examined the productivity and costs of the growers in each group. The difference between the groups in terms of the cost of production (in July 2010) is around 0.6 cents per bird. Productivity, as measured by the number of birds marketed per annum per model farm, differs by less than 2.5 per cent between the two groups. Thus, there appears to be little difference currently between the groups in terms of productivity or costs.

The Authority also notes that the cost of production model used to determine the average price is based on a notional model of a broiler operation. This means that, if the cost parameters are set appropriately, the average price would reflect the efficient cost of production, rather than a simple average cost of production across the industry. In addition, processors make further adjustments to the price paid to growers, to reflect the productivity of growers in their group, additional costs (e.g. growers with tunnel sheds may be paid more) and market conditions. This approach should provide sufficient flexibility to allow for fees to reflect cost and productivity differences between growers.

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<sup>46</sup> For example, ACCC (26 March 2009), *Decision in Respect of a Collective Bargaining Negotiation Lodged by the South Australian Farmers Federation on Behalf of Eighteen South Australian Chicken Growers*; and ACCC (21 April 2010), *Determination: Application for Revocation and Substitution of Authorisation A40093 Lodged by the Victorian Farmers Federation on Behalf of its Member Chicken Meat Grower Groups in Respect of Collective Bargaining by Chicken Meat Grower Groups with the Nominated Processors in Victoria*.

## *Benefits/Advantages*

The Authority has next considered a range of possible benefits associated with the restriction imposed by the setting of an average price:

- 1) an improvement in the balance of power between growers and processors;
- 2) lower costs of dispute resolution and arbitration;
- 3) lower transaction costs of negotiating contracts; and
- 4) improved cost transparency across the industry.

### **1) Improved balance of power between negotiating parties**

The effect of the legislation is to enable collective bargaining by growers on the terms and conditions of their contracts and the growing fee. Collective bargaining can be used to redress an imbalance in negotiating power between two parties. The ACCC notes that, if buyers or sellers are constrained in the extent to which they can provide input into the terms and conditions of their contracts, the most efficient outcome for those contracts may not be achieved. The ACCC has therefore authorised collective bargaining by grower groups, based on the view that this would strengthen the bargaining power of growers and increase prices to growers to a level which would sustain efficient production in the long run.

The Authority is of the view that the setting of the average fee on the basis of the cost of production model is a strong tool for improving the negotiating power of the growers. However, the composition of the Committee limits the extent to which growers can exercise their power and results in a balanced position rather than favouring one party in particular.

### **2) Dispute resolution and arbitration**

The Committee can determine disputes arising out of prescribed form agreements and disputes in relation to the regulations on participation in growth expansion. Parties may apply to the State Administrative Tribunal to appeal against decisions by the Committee.

Inghams Enterprises and Baiada processors submitted that individual contracts contained sufficient arbitration and dispute resolution provisions.

The growers, on the other hand, are strongly supportive of the dispute resolution and arbitration provisions in the Act, which they claim have resulted in more industrial harmony, fewer disputes and lower legal costs when compared with other states that did not have similar legislation.

[T]his current legislation resulted in a dramatic decrease in disputes between processors and growers and improved industry stability. (WABGA submission, p6)

In all countries and states within Australia the major disputes are over price negotiation and contracts for growers. To resolve these disputes costs hundreds of thousands of dollars, with the costs in most cases being at the expense of the chicken farmer. The Act in WA has always acted as a back stop thus expensive court cases have not been necessary. (WABGA submission, Attachment 1, individual growers submissions, BJ & R Enterprises).

Over the years there has been a need for a dispute resolution facility which is offered by the act and regulations, especially related to the growing fees, performance and efficiency criteria as the growers have continually needed to go to the Chicken Meat Industry Act to get adjudication and resolution on increases in running costs and returns on investments and even then the growers have discounted the growing fee to help obtain an agreement with the processors. (ER and JF Terrace)

WABGA disputed the statement in the issues paper that there had been no formal appeals to the Committee in recent years. WABGA has provided the Authority with examples of disputes that have been dealt with by the Committee, including:

- a contractual dispute in 2001 relating to the sale of a broiler farm;
- a dispute between growers and processors in 2006 regarding the estimation of land values and the use of current cost accounting in the cost of production model;
- a contractual dispute in 2007 relating to the purchase of a broiler farm; and
- a dispute between Baiada growers and their processor in 2009 regarding the growing fee to the Baiada growers.

The most recent review of the Act, by the Department of Agriculture in 2003, reiterated the recommendations of the NCP review that the arbitration provisions in the Act be retained “as it is an efficient way to resolve disputes between growers and processors and makes it very difficult for aggrieved parties to challenge the arbitrator’s decision”.<sup>47</sup>

The Authority accepts that the dispute resolution and arbitration provisions in the Act are strong, as the “fall-back” position is the gazetted fee determined by the cost of production. This provides a deterrent effect on all parties against entering into disputes involving excessive demands that diverge too far from the model.

It is difficult to determine the level of disputes that would arise in the absence of the legislation. The Authority agrees with the ACCC assessment that the most likely outcome for growers, if there were no regulation of the industry, would be that they would be offered a standard form contract in which they would have little influence over the contract terms and conditions. Disputes would need to be resolved through dispute mechanisms specified in the contracts, or through the courts. Small growers may not have the same financial resources as processors to engage in costly legal disputes.

### **3) Lower transaction costs**

Collective bargaining, such as that provided by the Act, can lower the transaction costs associated with contract negotiations. Costs which would otherwise be incurred by each grower in individual negotiations with their processors are instead incurred once by the collective. The reduction in transaction costs associated with collective bargaining arrangements is one of the benefits cited by the ACCC in its decisions to authorise such arrangements for other grower groups.<sup>48</sup>

It is difficult to quantify the savings in transaction costs associated with collective bargaining. The benefits of lower transaction costs would accrue mainly to growers, but also to processors. However, competition in the retail sector and market power by large retailers could result in some of these savings being passed through to consumers.

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<sup>47</sup> Department of Agriculture (December 2003), *Review of the Chicken Meat Industry Act 1977*, p5.

<sup>48</sup> For example, ACCC (21 April 2010) determination on collective bargaining by chicken meat growers in Victoria.

#### 4) Improved cost transparency

The cost of production model used to calculate the average fee to growers is highly transparent, as the model and its inputs are available to all growers and processors, who are able to provide their own input. The model is reviewed by the Committee every three years and updated twice a year. Since the Committee comprises equal numbers of representatives of processors and growers, as well as two independent members and an independent Chairman, the process for the review and updating of the model is consistent with the development of an unbiased model.

The growers submit that:

The act gives the opportunity for the industry to provide the best quality at the most cost effective price. All costs that are arrived at by the growers in WA are transparent to the whole community and are based on constant minimum returns. The processors and retailers costs do not provide this same transparency. (WABGA submission, Attachment 1, submission by Raintree County)

The Act and the arbitration on growing fees through the CMIC gives growers an opportunity to demonstrate how cost pressures, both local and global, are affecting the profitability of the industry and allow a structured avenue for a fair and reasonable growing fee to be achieved. Specific examples of additional costs recently incurred by Redmond Pty Ltd are:

- significant increases in electricity tariffs;
- the construction of a commercial property entrance at total cost to Redmond Pty Ltd as a condition of expansion; and
- installation of specific heating equipment as requested by Bartter Enterprises.

(WABGA submission, Attachment 1, submission by Redmond Pty Ltd).

The Authority accepts that cost transparency can strengthen the bargaining position of growers, by providing information on the costs of production and the appropriate rates of return. It can also encourage efficiency across the industry, if the model is based on efficient production costs, as growers are then able to compare their own costs with efficient costs. Cost transparency can also limit the scope for claims by either party that diverge significantly from the agreed cost of production model.

## Summary: Assessment of Costs and Benefits of the Average Price Regime

### Draft Findings and Recommendations

- 5) It is possible that the benefits of the average price regime in the *Chicken Meat Industry Act 1977* may outweigh the costs.
  - The extent to which the average price regime may result in higher growing costs and therefore higher chicken meat prices to consumers than would be achieved under a competitive market for growing services is likely to be minimal, because:
    - the cost of production model used to set the average growing fee appears to be based on efficient production costs, and the model inputs can be scrutinised by both processors and growers;
    - the rate of return on capital used in the model appears low;
    - growers' fees can be further adjusted by processors to reflect growers' productivities and market factors, and average fees paid to growers are below the average price;
    - growers are free to enter into individual contracts with processors;
    - countervailing power in the retail sector limits the extent to which any increases in growing fees can be passed on to consumers;
    - the growing fee is a small proportion of the costs of producing chicken meat;
    - the administration costs associated with the Act are minimal; and
    - any differences in productivity between the grower groups can be reflected in payments to growers through the incentive payment mechanisms in the contracts.
  - Setting an average fee on the basis of the costs of an efficient notional production model:
    - allows growers to have greater input into the terms and conditions of their contracts and improves the balance of bargaining power between growers and processors;
    - appears to reduce the costs of arbitration, dispute resolution and other transactions involved in negotiating contracts; and
    - improves cost transparency in the industry, which can potentially enhance efficiency.
- 6) The Authority will be further examining any possible efficiency impacts from setting a notional price and the impacts of the legislation on productivity growth in the industry.

## 4.3 Restriction 2: Prescribed Agreement Between Processors and Growers

### 4.3.1 Background

The *Chicken Meat Industry Act Regulations*, provided for under section 24 of the Act, set out the prescribed broiler growing agreement. This agreement specifies the minimum terms and conditions for growers and processors, including:

- processors' obligations, regarding the supply of chickens, supply of feed and medication, broiler flock supervision, transport and loading of chickens, processes for sharing output expansion and contraction among growers, notice to be given to growers for supply and collection of chicks, and procedures in the event of the failure of the processor to supply feed, chicks or medicine, etc;
- growers obligations, regarding identification of the farm and sheds, building and equipment, provision of water and labour, insurance, keeping of records, use of feed and medications, notification of disease, allowing of access to property, preparation of sheds, management of chicks, providing assistance at pickup, exclusion of other poultry; and
- procedures for:
  - the weighing of chickens;
  - the calculation of the growing fee;
  - exclusion from the pool, and payments to growers excluded from the pool;
  - early termination of a batch;
  - liability for insurable losses;
  - independence of growers from processors;
  - insolvency;
  - termination of agreements;
  - goods unused on termination of agreement;
  - transfer of business by processors;
  - transfer of growing agreements; and
  - arbitration.

Prescribed form agreements are not compulsory: growers are free to enter into individual contracts with their processors. However, processors are not free to enter into individual contracts if the growers in their group wish to have prescribed form agreements.

It is not the role of the Committee to examine contracts and determine whether or not they are, or are to the effect of, a prescribed form of agreement. Rather, if the intention of a processor and grower is to enter into a contract that is to the effect of a prescribed form of agreement, this is sufficient to establish the applicability of the Act to that contract. (See WABGA submission, Attachment 2.)



### 4.3.2 Authority Assessment

In this section, the costs or disadvantages of the prescribed form agreements are assessed first, followed by the benefits.

#### *Costs/Disadvantages*

The disadvantage of prescribing the form of agreement between growers and processors is that it prevents other forms of contracts from emerging, which could have advantages over the prescribed form contracts. Prescribed form contracts can potentially stifle innovation and efficiency improvements.

The Authority notes that there is some scope for variation in prescribed form agreements. The Authority has compared the contracts offered to growers of both groups and notes that there is considerable variation between the groups in the terms and conditions of the contracts, and between individual growers, in how their payments reflect performance.

#### *Benefits/Advantages*

The benefits of prescribed form agreements are that, in an environment where there is the potential for processors to exert bargaining power over growers to the detriment of growers, prescribed form contracts can ensure that minimum terms and conditions to growers are maintained. This provides a basis for dispute resolution (by the Committee) and could potentially reduce the costs of disputes and arbitration.

Any growers that are disadvantaged by the prescribed form agreement (for example, growers that are much more efficient than others in their group) can opt to enter into an individual contract.

It is likely that in a de-regulated broiler industry, some form of regulatory intervention would be needed to ensure that growers' contractual rights are protected. In the United States, where growers negotiate individual contracts with their processors, the US Department of Agriculture sets rules and regulations regarding the minimum provisions in grower contracts. For example, in November 2009, the USDA published a final rule on poultry contracts initiation, performance and termination.<sup>49</sup> This rule requires that poultry dealers provide copies of contracts to growers in a timely manner, and include information in the contract about any performance improvement plans and provisions for termination of the contract. The rule also allows growers to discuss the terms of their contracts with designated individuals, including other growers in their group (which was often prohibited by confidentiality clauses in contracts). The reasons for the implementation of this rule are identical to the reasons used by the ACCC for collective bargaining authorisations (i.e. protecting growers from processors' misuse of their greater bargaining power in the negotiation and execution of contracts).

#### *Summary: Costs and Benefits of Prescribed Form Agreements*

The prescribed form agreements appear to operate in a similar way to the average price setting mechanism, in that they provide a statutory basis for minimum terms and conditions in growing agreements, which can be referred to in dispute resolution by the Committee.

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<sup>49</sup> US Department of Agriculture Grain Inspection, Packers and Stockyard Administration (December 2009), "Final Rule: Poultry Contracts – Initiation, Performance and Termination", *Federal Register*, Vol.74, No.231, pp.63271-7



The Authority notes that there is sufficient scope to allow for variation in contracts between growers and grower groups to reflect individual circumstances. Further, growers can opt out of prescribed form contracts and enter into individual contracts with their processors.

The Authority therefore considers that it is likely that the costs of the restriction imposed by the prescribed form agreement would be outweighed by the benefits.

### Draft Findings and Recommendations

- 7) The benefits of prescribed form agreements established under the *Chicken Meat Industry Act 1977* are likely to outweigh the costs, as they can help to ensure that minimum terms and conditions for growing contracts are met.

## 4.4 Restriction 3: Barriers to Entry into the Growing Sector

### 4.4.1 Background

One barrier to entry into the growing sector is the “participation in growth expansion” regulations, which require that existing growers must be given first opportunity to supply an increase in output sought by their processor. Further, any capacity increase that is offered must not favour processor-owned farms over those independent of the processor. The processor may seek additional supply from growers outside the group only in the event that the capacity increase cannot be met by growers in the group.

Another potential barrier to entry for new growers, or expansion of existing growers, is the requirement for new growing premises to be approved by the Committee (section 19A of the Act), which may take into account factors other than the suitability of the facilities for growing chickens. Since growers are represented on the Committee, this provision essentially allows existing growers to have an input into whether or not new growers should be allowed into the industry, or the extent to which existing growers are able to expand their operations.

Both of these provisions have the potential to limit the entry of new growers, or to prescribe how existing farms expand, and thereby could hamper competition in the growing sector over the long term.

### 4.4.2 Submissions

One of the processors submitted that it had had difficulties in sourcing additional capacity from its existing growers.

Bartter Enterprises in recent years has been required to source additional grower capacity from new growers on top of existing farm shedding conversions/upgrades and natural expansion in order to meet local market demand resulting from continuing population growth thus ensuring market supply was achieved. (Bartter Enterprises submission, p2)

The growers indicated that there is a need to control shed expansion, in order to maintain high batch rates to existing growers.

The W.A Chicken Meat Industry Act 1977 over the years has given growers in WA some stability and say in the industry. There is a model farm to base a growing fee, a means to control shed expansion and maintain a high batch rate needed without which it would be far too risky for us to borrow the large amounts of capital required to expand or enter the industry.

### **4.4.3 Authority Assessment**

#### *Costs/Disadvantages*

##### **1) Reduced innovation and dynamic efficiency**

Competition between growers can encourage innovation, technological development and efficiency improvements (lower costs). Reducing barriers to entry also encourages dynamic efficiency, in which an industry evolves over time, with the entry and exit of participants, to become more efficient.

By favouring the growth of existing farms, the regulations make it more difficult for new growers to enter the market with new facilities. This reduces competition in the growing sector, with the risk that innovation is slower than it would be in a competitive environment. Restrictions to entry into the growing sector could also hinder dynamic efficiency over the long term.

The regulations on growth expansion also place controls over the way in which existing farms may expand, by seeking to ensure that capacity growth is shared across the growers in a group. This could prevent more efficient and innovative farms expanding at a faster rate than other farms in the group, and could also hinder the exit of the least efficient farms.

With regard to the approval of growing premises by the Committee, discussions with growers indicate that the main purpose of these provisions is to provide a basis for arbitration of disputes between growers and processors relating to the specifications required by processors for new growing premises to be built by growers. In this regard, the provisions for the approval of growing premises may be similar to the prescribed agreement, in that it provides a safeguard to growers against unreasonable demands from processors regarding the standards of new growing facilities.

##### **2) Higher grower fees**

Restricting the development of more competition between growers, by restricting entry into the growing sector, can also result in grower fees that are above the efficient (competitive) level, as the effect of competition is to drive down costs across an industry to the efficient costs.

The Authority considers that over the longer term the regulations could result in higher grower fees than if there were unrestricted entry and exit into the growing sector, as the regulations on growth expansion could potentially hamper innovation that could be introduced into the sector by new entrants.

## Benefits/Advantages

### 1) Better economies of scale

The 1997 NCP assessment of the Act concluded that one benefit of controlling expansion by growers was that it had enabled better economies of scale to develop in the industry, by encouraging existing farms to get larger. The average broiler farm size has increased from a shed area of less than 4,000 m<sup>2</sup> in 1992 to around 10,500 m<sup>2</sup> in 2010.<sup>50</sup> The growers have submitted that one of the benefits of the legislation is that it has resulted in the average farm size in Western Australia being twice the size of that in other states:

Western Australia continues to set the trend in the Model Farm size, which is approximately double the National average. (WABGA submission, p2)

It is difficult to assess the extent of scale economies in the growing sector. Growing fees in Western Australia are similar to growing fees in other states, and growers in Western Australia claim that costs of production are higher than in other states, due to additional regulatory requirements in Western Australia, such as concrete floors in all sheds to prevent contamination of groundwater. Anecdotal evidence from growers suggests that there are economies of scale up to a certain size of farm (around 15,000 m<sup>2</sup>), but beyond this point there is a need for additional management and labour resources, which causes a jump in unit production costs. However, more information is needed on the costs of production to establish the extent to which unit production costs are reduced as farm size increases. The Authority will be further examining this issue before the final report.

The existence of substantial economies of scale would benefit consumers by allowing for lower grower fees, which if passed through to consumers would lower retail prices of chicken meat. However, these benefits would need to offset the benefits which could be gained by encouraging competition in the growing sector (including improved innovation and efficiency).

### 2) Counterbalance to incentive of processors to seek excess capacity in growing sector

The 1997 NCP review of the Act suggested that processors may prefer to encourage entry by many smaller growers in order to improve the processors' bargaining power.

The Authority recognises that an excess of capacity in the growing sector, in terms of the available shed area and the number of growers, would work to the advantage of processors, who would then be in a stronger bargaining position in contract negotiations. Existing growers, on the other hand, have an incentive to maintain high throughput through their sheds, as any reduction in their stocking rates or batch rates will lower the rate of return on their investments.

However, there are factors that naturally prevent an excess of capacity from developing in the industry. Spare capacity across the industry lowers the returns to growers, reducing the incentive for existing growers to expand or for new growers to enter into the market.

The Authority understands that the factors which initially led to the introduction of the regulations on growth expansion (an excess of capacity in the growing sector) no longer prevail. The processors submitted that there is currently a shortage of growers in the market. The Authority notes that this may be because growing fees are not high enough to attract new growers or encourage existing growers to expand. Further, there are other

<sup>50</sup> WABGA submission, Figure 7 on p15.

regulations with which growers must comply (for example, animal welfare, health and safety, land planning, environmental, water licensing), in addition to the regulations under the Act, which can make it difficult for processors to procure additional growing capacity.

Overall, the Authority's view is that the regulations on participation in growth expansion are not necessary to prevent an excess of spare growing capacity. If the Act is to be retained, the Authority will examine how expansion might occur in the absence of regulations.

### *Summary: Assessment of Costs and Benefits of Barriers to Entry into the Growing Sector*

The Authority considers that the costs associated with the regulations on growth expansion, in terms of the restrictions they impose on entry into the growing sector and expansion by existing growers, are likely to outweigh the benefits.

The factors that gave rise to the legislative constraints on entry (an excess of growing capacity in the sector) no longer prevail. In the absence of these constraints, the factors that would discourage the development of excess capacity are lower returns to growers and the relatively low cost of making use of available spare capacity.

The Authority therefore considers that these regulations should be repealed. The Authority will further consider how expansions would occur in the absence of regulations.

However, the approval by the Committee of chicken growing premises provides a mechanism for independent dispute resolution regarding the specifications placed by processors on new growing facilities and the benefits of this restriction could outweigh the costs.

## **Draft Findings and Recommendations**

- 8) The *Chicken Meat Industry Act (Participation in Growth Expansion) Regulations 1978* should be repealed, as the costs of these regulations are likely to outweigh the benefits.
  - These regulations restrict entry into the growing sector and the manner of expansion of existing growers. This can reduce competition in the growing sector and hinder the rate of innovation and efficiency improvement in the industry.

## 5 Alternative Approaches

In reviewing the *Chicken Meat Industry Act 1977*, the Authority is mindful that strong justification is needed for state-based legislation if there are alternative universal mechanisms available that would achieve the same aims. As submitted by Inghams Enterprises:

Legislation such as the CMI Act is a privilege that is not afforded to many other economic groups in similar situations within the Australian economy. There should be particularly strong and substantive reasoning to justify such use of Government power. (Inghams Enterprises submission, p4)

Regulation should be avoided where it is not necessary, and if necessary, implemented in a way so as to avoid unintended adverse consequences. The justification for state-based legislation needs to meet two hurdles:

- Is regulation necessary?
- If so, is there an alternative approach that could achieve the objectives of the legislation at lower cost?

### *ACCC Authorisation of Collective Bargaining*

In the absence of regulation, each grower would need to negotiate their own contract with their processor. However, given the structure of the broiler industry in Western Australia and the experience to date in the eastern states, the Authority considers that it is highly likely that notification, or a request for authorisation, of collective bargaining by Western Australian broiler growers to the ACCC would be successful. As outlined in section 3.4, the Authority considers that the factors considered by the ACCC in its various determinations as justifications for collective bargaining are equally applicable to the Western Australian broiler industry, i.e:

- the processing sector is dominated by two large processing companies who supply around 80 per cent of the retail market for chicken meat;
- growers are in a weaker bargaining position than processors, as they have limited opportunity to provide their services to other processors, have capital-intensive investments that are highly specific to chicken growing, and are solely reliant on their processors for their income; and
- processors have direct control over growers' operations, through the provision of chicks, feed and other inputs and specification of growing conditions.

The ACCC's authorisations are based on the view that collective bargaining can help to strengthen the negotiating power of growers and allow them to have greater input into their terms and conditions, allowing growers to better identify and achieve efficiencies in their businesses by addressing common contractual concerns and resulting in lower transaction and dispute costs compared with individual negotiations.

The Western Australian legislation, therefore, is best evaluated on the assumption that the alternative arrangement would be one in which collective bargaining by growers is authorised by the ACCC. It is also likely that, if collective bargaining is authorised, Baiada growers would have a separate arrangement to those of Inghams growers, as the ACCC has in previous decisions provided authorisation on the basis that bargaining groups are limited to the growers for one processor and that there is no common representation across bargaining groups.

## Industry Views

The processors are highly supportive of deregulation, but also of the ACCC authorisation process. In several cases, the processors themselves have made the application to the ACCC for collective bargaining on behalf of their growers.<sup>51</sup>

However, the growers oppose deregulation, citing evidence from other states that deregulation would lead to a large number of legal disputes between growers and processors. The WABGA submission lists a number of recent and ongoing disputes between growers and their processors in NSW over delayed increases in grower payments and failure to negotiate new contracts (WABGA submission, p20). The length and cost of some disputes may dissuade some growers who have few financial resources and legal expertise from pursuing their claims against processors through the courts. In April 2010, a Federal Court decision on a case between Yarrabee Chicken Company and Steggles Ltd (now Baiada), relating to a contract dating back to 2004, ruled against the processor on 18 out of 20 counts of breach of contract.

Further, the position of the Western Australian growers is that ACCC authorisations do little to strengthen the bargaining position of growers. This is because collective bargaining does not provide for mediation or arbitration, or compel processors to negotiate, particularly on the growing fee.

Since 2005, the five [Victorian Farmers Federation] branches have with varying success managed to negotiate collective contracts for their members although in most cases this has taken years to conclude and has involved, at times, bitter and expensive legal action. Although authorisation enables growers to collectively bargain it does not compel processors to enter into negotiations, which at times leads to a Mexican stand-off. As a result, negotiation costs have risen exponentially, as both parties seek legal advice to develop and administer contracts. (WABGA submission, p21, comments by Mike Shaw, Victorian Farmers Federation)

According to the WABGA, the strength of the Western Australian legislation is that it is underpinned by an average fee model and a prescribed form agreement that can be used to ensure that growers' efficient costs of production are covered and minimum contract terms and conditions are met. The support to growers is counterbalanced by the equal representation of growers and processors on the Committee, the joint development of the model by industry participants, and the provision for incentive payment systems in grower contracts to encourage efficiency. In a deregulated industry, breaches of contract by the processor, such as underpayment by the processor, would need to be pursued through the legal system. In Western Australia, disputes of this nature are often avoided, as the negotiating parties recognise that any ruling by the Committee is likely to be consistent with the cost of production model.

## Experience of Authorisation in Other Jurisdictions

The recent review of the NSW *Poultry Meat Industry Act 1986* summarises the experience of transition from a regulated growing fee to individual agreements. Until 2006, the NSW Poultry Industry Committee set the price to be paid to growers per bird. In 2009, many

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<sup>51</sup> For example, Bartter Enterprises, La Ionica, Hazeldene, Baiada and Inghams lodged applications for authorisation of collective bargaining by Victorian chicken growers (authorisation given March 2005); Inghams Enterprises has applied for authorisation on behalf of its growers in Tasmania (authorisations given in 2003 and 1999).



growers' five year contracts were due to expire and had to be renegotiated. The review noted that:<sup>52</sup>

Contract renewal negotiations are usually a challenging time, with price (or "grow fees") the main point of contention....Despite a difficult period, most chicken growers have now signed new agreements. However, one group of growers has lodged a dispute with the Poultry Meat Industry Committee. Two other groups of growers have commenced court proceedings. These 36 growers [out of a total of 285 poultry farms in NSW] have not yet signed new agreements.

The Authority notes that the move away from regulation in other states is relatively recent, and that the legal precedents set by cases such as the Yarrabee Chicken Company case will dissuade processors from employing such practices elsewhere. Other evidence, such as the submission by the Victorian Farmers Federation in its application in early 2010 for re-authorisation of collective bargaining by some of its growers, suggests that collective bargaining has been helpful to growers:<sup>53</sup>

In relation to [the previous authorisation], an increase in grower input into contracts and retention of industry experience were suggested as potential public benefits of authorisation. Both have proved to be the experience following authorisation. The prescribed contract terms of the regulated era allowed no variation but in the negotiations which have followed authorisation there have been grower instigated innovations put forward, particularly in relation to a fee adjustment mechanism and productivity adjustments, which have resolved difficulties...It is submitted that the outcomes under [the previous authorisation] have been positive...

In light of these comments, the Authority notes that it is difficult to assess the extent of legal disputes which would arise in a deregulated chicken meat industry. However, it is highly likely that the resolution of disputes through the courts or through commercial arbitration would involve higher costs to both parties, mainly in the form of legal fees, than dispute resolution under the current legislation.

## Conclusion

The *Chicken Meat Industry Act 1977* contains some restrictions on competition in the form of barriers to entry into the growing sector, through the regulations in growth expansion, and the requirement under the Act for the Chicken Meat Industry Committee to approve new growing premises. The Authority considers that the costs of these restrictions, resulting from the restriction of competition in the growing sector, are likely to outweigh the benefits, and that these restrictions should be removed. No other jurisdictions have similar provisions for controlling entry into the growing sector.

Other restrictions on competition under the Act are the setting of the average price, through the cost of production model, and the prescribed form of agreement. The Authority's assessment of these restrictions concluded it was possible that the benefits of these restrictions may exceed the costs. Relative to an industry where growers are offered individual standard form contracts by processors, the legislation appears to have provided growers with a stronger bargaining position and greater input into their growing contracts.

<sup>52</sup> State of NSW through Industry and Investment NSW (May 2010), *Statutory Review of the Poultry Meat Industry Act 1986*, p6.

<sup>53</sup> Victorian Farmers Federation, 18 February 2010, Application for Revocation of a Non-Merger Authorisation and Substitution for a New Authorisation, p18. However, another grower submitted to the ACCC that he would prefer the Victorian Broiler Industry Negotiating Committee to be re-established. Failing this, he supported the application for authorisation.



However, regulation cannot be justified solely on the basis that it results in a transfer of welfare between buyers and sellers: an increase in welfare to society as a whole must be demonstrated. As output from the broiler industry is determined at the consumer level, the Authority is of the view that regulation will have little effect in raising welfare through increased output (see section 3.4.3 for discussion). Rather, any welfare gains are more likely to be associated with savings in the transaction costs of contract negotiations and lower costs of disputes and arbitration. It is also possible that regulation could help to improve investment decisions, including the hold-up problem that presents a barrier to investment in the industry.

There is a further issue that the Western Australian legislation does not appear to have been fully effective in ensuring efficient returns to broiler growers in this state. As discussed in section 4.2.2, the average fees to growers are consistently lower than the average fee, which is based on a cost of production model that assumes a low rate of return, relative to other industries. Thus, it appears that the Western Australian system provides sufficient flexibility in contract arrangements to allow processors to improve their returns relative to the notional model.

The next consideration is whether other mechanisms are available to achieve (or perhaps better achieve) the aims of the state legislation. The retention of specific purpose state legislation should be assessed against the comparative benefits available in broader economically-based legislation (such as the TPA). The Authority considers that it is likely, given the conditions in the Western Australian chicken meat industry, that an application by growers to the ACCC for authorisation or notification of collective bargaining arrangements would be successful.

Questions remain as to the extent to which collective bargaining benefits growers. The general support of processors for authorisation of collective bargaining may be an indication that processors stand to lose little under collective bargaining arrangements, if these result in some savings in transaction costs, but have little impact on growing fees.

However, there is some evidence from ACCC determinations that authorisation of collective bargaining has provided grower groups in other states with better bargaining power and greater input into their contracts relative to a totally free market. Legal protections are available for breaches of contract by either party, as they are in any industry involving contracts. Legal precedents should over time shape the terms and conditions in grower contracts so that they mutually benefit growers and processors. Growing fees in Western Australia still appear to be consistently below the gazetted average price, so it is possible that the growers could achieve higher growing fees under a regime in which the claims of negotiating parties were tested in court.

However, a consequence of relying on the legal system to resolve disputes is that there will be higher costs for negotiating parties. There is also a risk that parties that are better resourced, financially and in terms of negotiating expertise, will be favoured under such a system. The experience in other states to date suggests that the number of legal disputes between growers and processors is still higher than in Western Australia, even in jurisdictions where collective bargaining arrangements are in place. Also, the costs of disputes dealt with by the Chicken Meat Industry Committee are minimal compared to cases taken to court.

The Authority therefore considers that, while there are protections already available to industry participants under the *Trade Practices Act 1974*, these mechanisms are likely to involve higher dispute resolution and arbitration costs than under the current state legislation. The Authority will be seeking further information on the extent of legal costs under collective bargaining arrangements before its final report.

Another option is to retain the state legislation, in which case the effectiveness of the Act in achieving its objectives would need to be considered. A relevant factor is the impact the Act has had on productivity growth in the chicken meat industry. The Authority will also be examining the extent to which the Act has improved the balance of bargaining positions between growers and processors. Amendments could involve strengthening the legislation to improve the position of growers, while retaining the benefits of low dispute resolution costs.

### Draft Findings and Recommendations

- 9) There are protections available under the *Trade Practices Act 1974* to participants in the chicken meat industry in Western Australia. However, the costs of arbitration and dispute resolution under authorised collective bargaining are likely to be higher than under the current state legislation. The Authority will be further examining the extent of these costs in different jurisdictions.
- 10) The effectiveness of the Act in achieving its objectives would also need to be considered to determine whether the Act should be amended (for example, to better encourage productivity growth, or to improve the balance of bargaining positions between growers and processors).

# APPENDICES

## Appendix A. Terms of Reference

### INQUIRY INTO THE CHICKEN MEAT INDUSTRY ACT 1977

#### TERMS OF REFERENCE

I, TROY BUSWELL, Treasurer, pursuant to Section 38(1)(a) of the *Economic Regulation Authority Act 2003* request that the Economic Regulation Authority (the Authority) undertake an inquiry into the effectiveness of the *Chicken Meat Industry Act 1977* for the purpose of fulfilling the requirements of section 29(4) of that Act.

The *Chicken Meat Industry Act 1977* provides for the termination of the Act unless the Minister publishes a notice continuing it for 7 years from the date it would otherwise have expired.

Before the Minister publishes such a notice section 29(4) of the Act requires that he or she cause an investigation and review to be conducted and a report to be prepared. The Act is not to be further continued unless the Minister is satisfied, after considering the report, that the continuation is justified in the circumstances. The investigation and review is to be carried out when 5 of the 7 years of continued operation have elapsed.

The Act has been continued pursuant to these provisions since 1989 and most recently for a period of 7 years succeeding 31 December 2003, that is, until 31 December 2010.

Consequently the Act became due for its next investigation and review after 31 December 2008 and the review must be completed before the end of 2010.

In conducting the inquiry, the Authority is expected to consider and develop findings on:

- How the Act currently operates, including what actions are taken under the Act by chicken meat growers, chicken meat processors and the Chicken Meat Industry Committee;
- The current issues affecting the chicken meat industry in Western Australia, including issues relating to the major processors being based in the eastern states and competition from interstate chicken meat;
- Whether there is a need for legislation to improve stability in this industry, which was the object of the Act when enacted, or any other reason, or if the Act should be repealed;
- If there is a need for legislation, whether the Act in its current form is effective in meeting this need or should be amended or replaced.

The Authority must give consideration to, but will not be limited to:

- An examination of the chicken meat industry nationally;
- An examination of the relative negotiating power of chicken meat growers and chicken meat processors in relation to the terms of contract between them;
- If any imbalance in negotiating power is found to exist, a consideration of whether any intervention is required or recommended to redress this imbalance.

The Authority will release an issues paper as soon as possible after receiving the reference. The paper is to facilitate public consultation on the basis of invitations for

written submissions from industry, government and all other stakeholder groups, including the general community.

A report providing a draft analysis is to be available for further public consultation on the basis of invitations for written submissions.

The Authority will complete a final report for the purpose of section 29(4) of the Act no later than nine months after receiving the Terms of Reference.

**TROY BUSWELL MLA  
TREASURER, MINISTER FOR COMMERCE;  
SCIENCE AND INNOVATION; HOUSING AND**

## Appendix B. Legislation Relevant to Chicken Meat Production in Western Australia

Issue	Statute	Regulatory Agency
Animal welfare (including space requirements for chickens)	<i>Code of Practice for Poultry in Western Australia 2003</i> – under the <i>Animal Welfare Act 2002</i>	Department of Local Government and Regional Development
Transporting poultry (load size and containment)	<i>Road Traffic Act 1974</i>	Western Australian Police Service
	<i>Code of Practice for the Transportation of Poultry in Western Australia 2003</i>	Department of Local Government and Regional Development
Agricultural and veterinary chemicals	<i>Agricultural and Veterinary Chemicals Act 1994</i>	Australian Government Department of Agriculture, Fisheries and Forestry
Use, storage, handling and disposal of pesticides	<i>Health (Pesticides) Regulations 1956</i>	Department of Health
Storage of fuels, solvents, explosive and dangerous goods	<i>Dangerous Goods Safety Act 2004</i>	Department of Consumer Employment and Protection
Farm model and activities	<i>Chicken Meat Industry Act 1977</i>	Chicken Meat Industry Committee
Environment	<i>Environmental Code of Practice for Poultry Farms in Western Australia, May 2004</i>	Department of Environment and Conservation
	<i>Environmental Management and Cleaner Production Directory for Small and Medium Businesses: A Guide to Pollution Prevention.</i>	Department of Environment and Conservation
	<i>Environment Protection and Biodiversity Conservation Act 1999</i>	Department of Environment, Water, Heritage and the Arts
Odour emissions	<i>Odour Methodology Guideline 2002</i>	Department of Environment and Conservation
Noise emissions	<i>Environmental Protection (Noise) Regulations 1997</i>	Department of Environment and Conservation
NPI substance emissions; i.e. ammonia	<i>Environmental Protection (NEPMNPI) Regulations 1998</i>	Department of Environment and Conservation
Licence to take surface water and groundwater	<i>Rights in Water and Irrigation Act 1914</i>	Department of Water
Development in public drinking water source areas	<i>Metropolitan Water Supply, Sewerage and Drainage Act 1909</i> ; or <i>Country Water Supply Act 1947</i>	Department of Environment and Conservation, and Department of Water

(table continued...)

Issue	Statute	Regulatory Agency
Approval for developments that may affect the Swan-Canning estuary	<i>Swan River Trust Act 1988</i>	Swan River Trust
Impact on the values and ecology of land or natural waters	<i>Environmental Protection Act 1986</i>	Department of Environment and Conservation
Registration of offensive trades; handling of poultry manure	<i>Health Act 1911 (as amended)</i>	Department of Health
Sale, supply and use of poultry manure	<i>Health (Poultry Manure) Regulations 2001</i>	Department of Health
Safety in the workplace - Worksafe	<i>Occupational Safety and Health Act 1984</i>	Department of Consumer Employment and Protection
Food standards	<i>Australia New Zealand Food Standards Code</i>	Food Standards Australia and New Zealand
Weights and measurement	<i>Trade Measurement Act 2006</i>	Department of Consumer and Employment Protection
Food hygiene and safety	<i>Health (Meat Hygiene) Regulations 2001</i>	Department of Health
	<i>Health (Food Hygiene) Regulations 1993</i>	Department of Health
	<i>Health (ANZ Food Standards Code Adoption) Regulations 2001</i>	Department of Health
Subdivision of land	<i>Town Planning and Development Act 1928</i>	WA Planning Commission; Department of Planning
Land zoning and development approval	<i>Town Planning and Development Act 1928</i>	Local shires or councils
Land use planning	<i>Statement of Planning Policy No.4.3: Poultry Farms Policy, June 2004</i>	WA Planning Commission

Source: WA Department of Agriculture and Food website



## Appendix C. Glossary

ACCC	Australian Competition and Consumer Commission
Act	<i>Chicken Meat Industry Act 1977</i>
Authority	Economic Regulation Authority
CMIA	<i>Chicken Meat Industry Act 1977</i>
Committee	Chicken Meat Industry Committee
ERACCC	Economic Regulation Authority Consumer Consultative Committee
NCP	National Competition Policy
TPA	<i>Trade Practices Act 1974</i>
USDA	United States Department of Agriculture
WABGA	Western Australian Broiler Growers Association