

Final Report

Inquiry into the *Chicken Meat Industry
Act 1977*

1 November 2010

Economic Regulation Authority



WESTERN AUSTRALIA

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Economic Regulation Authority
Perth, Western Australia
Phone: (08) 9213 1900

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Contents

List of Tables	iv
List of Figures	iv
Executive Summary	v
Summary of Findings and Recommendations	vii
1 Introduction	1
1.1 Terms of Reference	1
1.2 Background to the Inquiry	2
1.3 Review Process	2
2 Overview of the Chicken Meat Production Industry and Legislation	4
2.1 Introduction	4
2.2 The Chicken Meat Production Process	4
2.3 Industry Structure	5
2.3.1 Processors	5
2.3.2 Growers	6
2.3.3 Production	7
2.3.4 Retail Market	9
2.3.5 Why has this Industry Structure Emerged?	10
2.4 History of the <i>Chicken Meat Industry Act 1977</i>	11
2.4.1 Intent of the Legislation	12
2.4.2 Functions of the Committee	13
2.4.3 Regulations Under the Act	13
2.4.4 Reviews of the Act	14
2.4.5 Free Range Chickens	14
2.5 How is the Act Currently Being Used?	15
2.5.1 Setting the Gazetted Average Price	16
2.5.2 Fee Negotiations	16
2.5.3 Adjustments for Productivity	17
2.5.4 Prescribed Form Agreements	18
2.6 Overview of Industry Participants' Views on the Act	19
2.6.1 Growers	19
2.6.2 Processors	19
2.7 Other States	21
2.7.1 ACCC Authorisation of Collective Bargaining	23
3 Industry Structure without the Act	25
3.1 Background	25
3.2 Industry Structure without Collective Bargaining by Growers	26
3.2.1 Industry Views	27
3.2.2 Authority Assessment	30
3.3 Market Structure with Authorised Collective Bargaining	33
3.3.1 ACCC Assessment of the Costs and Benefits of Collective Bargaining	33

3.3.2	Impact of Collective Bargaining	35
3.4	Investment Hold-up	36
3.5	Experience in Other States	37
3.5.1	Queensland	38
3.5.2	South Australia	38
3.5.3	New South Wales	39
3.5.4	Victoria	40
4	Impact of the Act	42
4.1	Restrictions Under the Act	42
4.2	Effect of the Act on Market Structure	43
4.3	Independence of the Committee	44
4.3.1	Industry Views	44
4.3.2	Authority Assessment	45
4.4	Efficiency of the Notional Model	46
4.4.1	Industry Views	46
4.4.2	Authority Assessment	51
4.5	Barriers to Entry and Exit in the Growing Sector	57
4.5.1	Industry Views	57
4.5.2	Authority Assessment	58
4.6	Impact of the Act on Growth in Investment and Output	60
4.6.1	Industry Views	60
4.6.2	Authority Assessment	61
4.7	Growth in Productivity	63
4.8	Impact on Imports	64
4.8.1	Industry Views	64
4.8.2	Authority Assessment	65
4.9	Impacts on Retail Chicken Meat Prices	67
4.10	Prescribed Form of Agreement Between Processors and Growers	69
4.11	Administration Costs	71
4.11.1	Industry Views	72
4.11.2	Authority Assessment	72
4.12	Dispute Resolution and Arbitration Costs	73
4.12.1	Industry Views	73
4.12.2	Authority Assessment	76
4.13	Transaction Costs	77
5	Options for Reform	79
5.1	Option 1: Reform the Act and Committee	79
5.1.1	Different Gazetted Fee for Different Groups	80
5.1.2	Price Flexibility	80
5.2	Option 2: Repeal the Act.	80
5.3	Summary of Costs and Benefits of the <i>Chicken Meat Industry Act 1977</i>	81
5.4	Implementation Issues	82

APPENDICES	83
Appendix A. Terms of Reference	84
Appendix B. Legislation Relevant to Chicken Meat Production in Western Australia	86
Appendix C. Glossary	88

List of Tables

Table 2.1	Percentage of Broiler Chickens Processed in Western Australia by Processor	5
Table 2.2	Distribution of Chicken Meat Production by State (2007-08)	7
Table 2.3	State Shares of National Chicken Meat Production	9
Table 2.4	Number, Size and Affiliation of Main Chicken Growers in Western Australia	15
Table 2.5	Summary of Current Chicken Meat Industry Legislation in Other States	22
Table 2.6	ACCC Authorisations and Notifications of Collective Bargaining by Chicken Growers	24
Table 4.1	Average Growing Fees for Conventional Sheds and Tunnel Sheds in Western Australia and Nationally (June 2010)	48
Table 4.2	Comparison of Inghams Enterprises Grower Fees and Earnings	49
Table 4.3	Size of Inghams Enterprises Operations in Western Australia	49
Table 4.4	Average Productivity for Conventional Sheds and Tunnel Sheds in Western Australia and Nationally (June 2010)	64

List of Figures

Figure 2.1	Number of Growers in Western Australia and Average Shed Area Per Farm (Excluding Mt Barker Chickens)	8
Figure 2.2	Total Shed Area in Western Australia (Excluding Mt Barker Chickens)	8
Figure 4.1	Actual Fees Paid to Growers, Notional Fees from the Cost of Production Model and Gazetted Fees (Cents per Bird)	47
Figure 4.2	Average Weekly Full-Time Adult Earnings for Australia and Western Australia	66
Figure 4.3	Growth in Real Retail Prices (Dollars of 2008) Since 1986 for Beef, Lamb, Pork and Chicken Meat	68

Executive Summary

In this final report, the Authority presents its final recommendations and findings for its inquiry into the *Chicken Meat Industry Act 1977 (Act)*. The Authority conducted 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 there is a need for legislation for the industry in Western Australia. 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 Authority has been conscious that there must be a strong case to justify industry-specific legislation, with the benefits to society clearly outweighing the costs of the legislation.

The Act was introduced to “improve stability in the chicken meat industry” at a time when there had been rapid expansion in the chicken meat growing sector. 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 (growers). The Authority acknowledges that there are factors that create an imbalance in negotiating power in favour of the processors, including the limited opportunity for growers to switch to another processor, or to convert their significant capital investments to an alternative use. However, processors are also to some degree dependent on their growers to maintain reliable supplies of chicken meat.

The current legislation establishes a forum intended to facilitate collective negotiation and provide a means for mediation/negotiation and intends to improve the balance of bargaining power between growers and processors. The Act provides for the gazettal of an average price to growers, determined on the basis of a notional model of an efficient chicken growing operation, and mediation and arbitration through the Chicken Meat Industry Committee. The Committee constitutes two grower representatives, two processor representatives, two independents and an independent Chairman.

The Authority’s review of the chicken meat industry in Western Australia has shown that there are serious problems with the sector under the existing legislation.

- There has been little expansion in total growing shed area or total production over the past decade, while consumption in Western Australia has continued to steadily grow. In recent years the gap between production and demand has been met by interstate imports (currently, around 14 per cent of Western Australian chicken meat is imported). By comparison, there has been a significant expansion in the growing sectors and chicken meat production in other States, particularly South Australia and Queensland.
- There has been a breakdown in the relationships between growers and processors under the Act. Processors do not accept the validity of the notional model and claim that the Committee is biased in favour of the growers. They have abstained from participation in the determination of the gazetted fee.

The Authority also notes that production in Western Australia has been impacted over the past decade by: rising costs in Western Australia; increased efficiencies in growing and processing in South Australia; and transport efficiencies.

There are some strong reasons for the small number of processors in the sector, arising from the significant economies of scale in chicken meat processing, and economies from vertical integration of different stages of the supply chain. These factors can make it difficult for new processors to enter the market. In the absence of the Act, the market structure can be defined as a monopsony (few processors and many growers). This type of market will produce less chicken, at higher prices, than a competitive market with many processors and growers who are able to switch freely between processors.

The Authority accepts that collective bargaining can improve the position for growers, as it allows them greater input into the terms and conditions of their contracts. It can also potentially reduce the transaction costs associated with contract negotiations, and the costs of dispute resolution. In other States, some groups of growers gain authorisation from the Australian Competition and Consumers Commission (**ACCC**) to be allowed to collectively bargain with their processor. The Authority considers that it is likely that growers in Western Australia would be given authorisation by the ACCC for collective bargaining if they were to seek it.

In the draft report, the Authority considered that the costs of dispute resolution and arbitration were likely to be higher under authorised collective bargaining than under the current legislation. To examine this matter further the Authority has reviewed the experience of other States.

- Growers in other States either negotiate individually with the processors, or collectively under ACCC authorisations or notifications.
- No other State has legislation to determine a growing fee. Industry committees, where they exist, do not deal with matters relating to the growing fee.
- According to industry participants, negotiations between growers and processors are often difficult, although most growers have signed contracts. While there are a small number of long and costly legal disputes, the Authority has found that relatively few cases have been brought to formal dispute resolution or arbitration, given the number of growers.

Overall, the Authority considers that the price-setting functions of the Act, while favourable to growers, are detrimental to the industry as a whole. Change, either in the form of a restructuring of the Committee and the basis on which the gazetted fee is calculated, or by repealing the Act, is required.

In particular, the Authority considers that the current operations of the Act may act as a deterrent for future significant processing investment decisions, although it is one of many factors in such decisions.

The Authority also considered the administrative costs associated with the average price regime. While these are currently low, the administrative framework would need to be substantially modified if it is to be made to work effectively. This would include removing any perception of bias from the Committee, through the appointment of an independent professional arbitrator instead of the independent members, and the review and maintenance of the notional model by an independent consultant. These changes would significantly increase administration costs, and erase any advantages of the current approach over an alternative, such as authorised collective bargaining.

The Authority also examined whether there would be net benefits to regulating the minimum terms and conditions which should be provided for in growing agreements. The Authority considers it is likely that there are sufficient protections available to growers under normal commercial law in Australia to make such regulation obsolete.

The Authority notes that the current legislation is unlikely to improve the outcome for society from this market, with the main effect of the Act being to transfer income from processors to growers. Additionally, the Authority considers that the Act probably has a negative impact on efficiency over time (i.e. dynamic efficiency). The Authority notes that the Act makes differential pricing for new capacity, which would improve efficiency and potentially allow the industry to grow, less likely.

The recommendation of the Authority is therefore that the *Chicken Meat Industry Act 1977* be repealed.

The Authority wishes to thank all those who provided submissions and information to the inquiry. The Authority would also like to acknowledge Emeritus Professor Cliff Walsh from the University of Adelaide for his analysis, advice and peer review of earlier drafts.

Summary of Findings and Recommendations

Market Structure in the Absence of Collective Bargaining

- 1) Western Australia's market for broiler growing services is dominated by two buyers (processors) and growers have limited opportunity to switch between processors or convert their broiler growing infrastructure assets for alternative uses. This can be described as a market with monopsony buyers.
 - The market structure is driven mainly by economic factors that make it cheaper for chicken meat to be processed by a few large companies rather than by many processors.
- 2) Monopsony markets lead to production that is lower than the economically efficient level, and also lead to processors capturing as monopsony profits part of what, in a competitive market, would be returns to growers.
- 3) Price differentiation (the payment of each grower individually on the basis of their willingness to supply) can lead to an increase in output relative to a market where all growers are paid the same fee. However, it is unclear whether processors would be able to implement such a system.

Market Structure with Authorised Collective Bargaining

- 4) The ACCC has assessed the balance of power between processors and growers in other States and has in most cases authorised collective bargaining arrangements by growers, but not collective boycott rights.
- 5) If there were no *Chicken Meat Industry Act 1977*, Western Australian broiler growers would most likely receive ACCC authorisation for collective bargaining should they seek it.
- 6) Authorisation for growers to collectively bargain would provide growers with some degree of countervailing power in negotiations with processors, but not to the extent of creating a bilateral monopoly situation. The market would remain essentially monopsonistic.

Experience in Other States

- 7) Review of the experience in other States, where grower fees are not regulated, indicates that some of these regions (especially South Australia and Queensland) have shown considerable growth in their chicken meat growing sectors and that the incidence of formal disputes between growers and processors is low, given the large number of growers.

Independence of the Committee

- 8) There is disagreement between processors and growers regarding the validity of the mechanism for determining the average grower fee under the Act. This has led to a breakdown in the functioning of the Chicken Meat Industry Committee, with the processors no longer participating in the gazetted fee determination process.
- 9) If the Committee is to continue in a price-setting role, to remove any perception of bias it is important that any independent representatives on the Committee are appointed by an independent process, for example, a single independent professional arbitrator appointed by the Treasurer.

Efficiency of the Notional Model

- 10) The current system of average price setting is likely to substantially improve the growers' bargaining position relative to a market with authorised collective bargaining by growers, making the situation more like a bilateral monopoly.
 - The long-term efficiency impact of a bilateral monopoly over a monopsony market is unclear, with the main impact being a transfer of income from processors to growers.
- 11) The notional model aims to determine the costs of a notional efficient broiler operation. It is important that, if the price setting function of the Act is to continue, the model fee represents the fee that growers would be competing against in a market without the Act (the efficient new entrant).
- 12) If the growers are successful in negotiating a price close to their preferred bargaining position, then the impact on production (relative to a market with authorised collective bargaining) is unclear.
 - However, the Authority considers that the incentives under the Act to improve dynamic efficiency (i.e. to improve the productivity of the industry over time) are less than would be the case without the Act.
- 13) If the Act is to continue then the model should be reviewed and updated by an independent party (e.g. a consultant) appointed by the independent arbitrator to reflect the cost of an efficient new entrant.
- 14) The consultant should carefully examine useful asset lives in the model to ensure that growers are not compensated for the same asset more than once.
- 15) The Act requires clarification to reflect the actual relationship between the notional model fee, the gazetted fee and the average negotiated fee.
- 16) Current cost accounting could be used to value the efficient new entrant in a deregulated market, so can be used to value the notional efficient new entrant. However, the inputs to this calculation should not include an average of all existing growers.
- 17) The cost of this review and update of the model should be borne equally by the growers and processors.

Regulations on Participation in Growth Expansion

18) 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.

Growth in Investment and Output

19) The Authority considers that the Act is likely to deter future processing investment in Western Australia, although it is only one of a range of factors that will influence investment decisions.

Impact of the Act on Imports

20) The Act is likely to have favoured imports over expanding local production, compared to what would be the case under authorised collective bargaining, by facilitating grower fees above the minimum efficient cost. However, higher costs in Western Australia, driven by the mining industry, are also likely to have played a role in reducing the relative competitiveness of chicken meat production in this State.

Impact on Retail Chicken Meat Prices

21) Any price efficiencies resulting from reforming the *Chicken Meat Industry Act 1977* are likely to be passed through to consumers in the form of lower prices.

Prescribed Form Agreements

22) Prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements as there are sufficient protections available under Australian contract law.

Administration Costs

23) Administration costs under the current regime are low, but would increase significantly if the fee model were to be independently administered and reviewed.

- These higher administration costs are likely to be similar to those under authorised collective bargaining arrangements.

24) Administration costs under individual bargaining would be higher than under collective bargaining, due to the duplication of administrative tasks.

Dispute Resolution and Arbitration Costs

25) The dispute resolution and arbitration mechanisms under the current legislation are low cost, but are not operating effectively. Appointment of an independent arbitrator to resolve disputes would be highly desirable, even though it would increase costs.

26) Dispute resolution under authorised collective bargaining arrangements or individual contracts requires independent, best practice dispute resolution processes in order to avoid substantial legal costs to industry participants.

Transaction Costs

27) It is likely that collective bargaining, under ACCC authorisation or through a legislative mechanism that includes an independent pricing model, would result in similar savings in transaction costs relative to individual agreements.

Differences in Productivity between Grower Groups

28) If an average price regime were to be retained, the model should allow for the determination of different average fees for each grower group to reflect the specific demand and supply conditions within each group.

Costs and Benefits of the Act Compared to Alternative Approaches

29) The benefits of the *Chicken Meat Industry Act 1977* are unlikely to outweigh its costs.

30) There are likely to be alternatives available for strengthening the bargaining power of growers, such as authorised collective bargaining, that would not have the costs associated with the Act.

31) The *Chicken Meat Industry Act 1977* should be repealed.

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 was 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 required 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 was required to give consideration to, but was not 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 has recognised 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 have been 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);
 - Inghams Enterprises; and
 - The Department of Treasury and Finance.
- The submissions are published on the Authority’s website, www.erawa.com.au.
- The Authority published a draft report on 4 August 2010. Submissions on the draft report closed on 17 September 2010. One submission (Bartter Enterprises) was granted a two-week extension. Four submissions were received on the draft report, which are published on the Authority’s website:
 - WABGA;

- Inghams Enterprises;
- Bartter Enterprises; and
- The Department of Treasury and Finance.
- The Authority's Secretariat has met with representatives of the WABGA, Bartter Enterprises and Inghams Enterprises during the course of the inquiry to obtain evidence and to clarify the views of the parties.
- The Authority's Secretariat has also met with the independent members and Secretariat of the Chicken Meat Industry Committee.
- The Authority has consulted with its Consumer Consultative Committee (**ERACCC**).
- The final report for the inquiry was delivered to the Treasurer on 1 November 2010. In accordance with the *Economic Regulation Authority Act 2003*, the Treasurer then has 28 days to table the final report in Parliament.

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

The Authority wishes to thank all those who provided submissions and information to the inquiry. The Authority would also like to acknowledge Emeritus Professor Cliff Walsh from the University of Adelaide for his analysis, advice and peer review of earlier drafts.

2 Overview of the Chicken Meat Production Industry and Legislation

2.1 Introduction

The key focus in this inquiry has been 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”.¹ 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; all parent stock is imported from the eastern States as day-old chicks.) Fertilised eggs from the parent farms are hatched in separate hatcheries, and day-old broiler chicks are transferred directly to the broiler farm (or grower).
- Broiler chicks are grown in sheds that generally house up to 40,000 birds. “Tunnel” sheds are fully enclosed and are ventilated by fans which blow air through the sheds, while conventional sheds are naturally ventilated. A typical grower may have between three and eight sheds. The broiler chickens are grown

¹ 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.

under controlled temperature and feed conditions. Some are harvested at 30-35 days old and the remainder at 55-60 days old.

- 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 for free range chickens are lower than for conventional meat chickens.² 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 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. This suggests that this industry structure is independent of the Act.

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 (as Bartter Enterprises) and Inghams account for around 80 per cent of the broiler chickens processed (see Table 2.1).

Table 2.1 Percentage of Broiler Chickens Processed in Western Australia by Processor

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

Source: Inghams Enterprises submission on issues paper, p2

² Maximum stocking densities are 28-40 kg/m² for conventional chicken meat, 16-32 kg/m² for free range chicken meat, and 25 kg/m² for certified organic. Source: Australian Chicken Meat Federation Inc.

Baiada Poultry

Baiada Poultry is the second largest producer of chicken meat in Australia and the largest in Western Australia (as Bartter Enterprises). Its products include the Steggles brand of chicken products, previously owned by Bartter. Bartter 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, Bartter 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.³

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 Wesfeeds in Welshpool.⁴

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

2.3.2 Growers

There are 42 growers in Western Australia, most of which (32) grow for either Inghams or Bartter. Inghams has 17 growers and 1 company farm located north of Perth. Bartter 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 Bartter growers).

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

³ Source: Inghams website.

⁴ At the time of the draft report, Mt Barker Chicken's feed was produced by Milne Feeds in Welshpool.

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 Production

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 2006.⁵ Western Australian production of chicken meat in 2007-08 was around nine per cent of the total national production (see Table 2.1).

Table 2.2 Distribution of Chicken Meat Production by State (2007-08)

	NSW	Vic	Qld	SA	WA	Tas	Total
Percentage of Total Slaughtering	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.

Figure 2.1 and Figure 2.2 below show that over the past ten years there has been a decrease in the number of growers in Western Australia (excluding the five growers for Mt Barker Chickens, who are not covered by the Act), with the average shed area per farm increasing from around 6,000 m² in 1993 to around 11,000 m² in 2010. However, there has been no increase in the total shed area over the past ten years by Inghams and Bartrter growers. In fact, total shed area for growers covered by the Act has declined since 2002, with only once recent expansion due to a large grower on an individual contract for the Bartrter group.⁶

⁵ Victorian Department of Primary Industries website. Chicken accounts for 95 per cent of poultry meat sales.

⁶ The ProTen Ltd farm in Serpentine commenced production in 2008-09. It has 16 sheds (43,520 m²) and a production capacity of around 940,000 birds per year. Source: www.proten.com.au, Shareholder Newsletter 30/04/09.

Figure 2.1 Number of Growers in Western Australia and Average Shed Area Per Farm (Excluding Mt Barker Chickens)

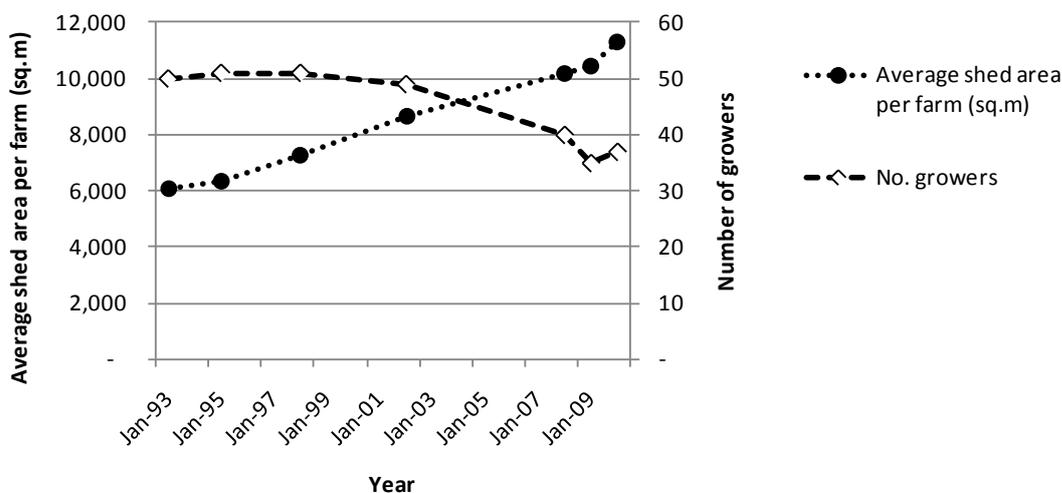
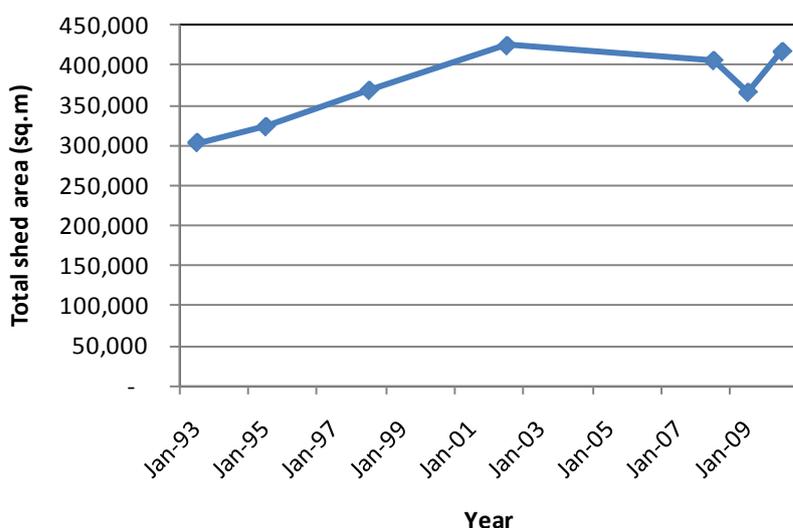


Figure 2.2 Total Shed Area in Western Australia (Excluding Mt Barker Chickens)



Comparison with production in other States is difficult, as there are no publicly available data on chicken meat production for Western Australia and South Australia since 1997.⁷ However, publicly available information from the submission by Bartter Enterprises indicates that Western Australia’s share of national production has declined from around 10 per cent (between 1987-97) to around 8 per cent (between 2005-10). By comparison, Queensland’s share increased by 2.6 percentage points between the same periods, Victoria by 3.1 percentage points, and South Australia by 1.9 percentage points (see Table 2.3 below).

⁷ The Australian Bureau of Statistics does not publish data that would reveal information about individual companies. Due to the small number of chicken meat processors in South Australia and Western Australia, publication of total production figures would reveal production figures for individual processors.

Table 2.3 State Shares of National Chicken Meat Production

State	Average Share of Total National Chicken Meat Production (Per Cent) ^(a)	
	1987-1997	2005-2010
Western Australia ^(b)	10.0	8.1
South Australia ^(c)	8.6	10.5
Victoria	25.6	28.7
New South Wales	41.1	34.5
Queensland	15.7	28.7

Notes and sources:

- (a) All data from Australian Bureau of Statistics, Series 72150.0, Table 18, unless otherwise indicated. Tasmanian production is negligible and is not included in the ABS total production figures.
- (b) See Bartter Enterprises submission on draft report, p16.
- (c) South Australian share calculated from ABS total production data and Bartter Enterprises estimate of Western Australian shares.

2.3.4 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.⁸ 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.⁹ 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).¹⁰ 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.¹¹

⁸ ACCC (2008), *Inquiry into the Competitiveness of Retail Prices for Standard Groceries: Final Report*, p54.

⁹ *Op.cit.*, p244.

¹⁰ Griffiths, G. *et.al* (2001), "Previous demand elasticity estimates for Australian meat products", *Economic Research Report No. 5*, NSW Agriculture.

¹¹ *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.

2.3.5 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 chicken meat company model that originated in the United States.¹² 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.¹³

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.¹⁴

The apparent reason that processors have little involvement in broiler growing is that the returns to processors from broiler growing would be lower than the returns for other stages of the supply chain, such as processing and further processing. Growers have substantial investments in land and capital that would make it costly for processors to buy out existing farms, and the management experience and time commitment of owner-managers would be difficult and costly to replace.

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 relatively small growing operations.

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.¹⁵

- 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.

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).

¹² Source: Australian Chicken Meat Federation Inc.

¹³ The Allen Consulting Group (2001), *A Structural Adjustment Package for the NSW Poultry Meat Growing Sector*, p2. The report noted a gross revenue to contract farms in NSW of \$124 million.

¹⁴ 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.

¹⁵ 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.

- Further, large buyers (supermarkets and fast food companies) are likely to prefer to deal with large processors, who, due to their size and control over different stages of the supply chain, 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.

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 were raising production efficiency. This led to an overproduction of chicken meat, mainly in the eastern States, in the late 1960s.¹⁶ Rising production costs, with the introduction of modern large-scale 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 industries.

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.¹⁷

The increasing integration of the chicken meat processors and the increasing dependence of growers on processors was recognised by Government at the time.¹⁸ Legislation in the form of the 1975 Act was considered as 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.¹⁹

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.

¹⁶ Source: Second reading of the *Chicken Meat Industry Committee Bill*, Hansard, 6 May 1975, p2062.

¹⁷ Hansard (1975), Second reading of the *Chicken Meat Industry Committee Bill*, Extract from Tuesday 19 August 1975, p2067.

¹⁸ Ibid, p2242.

¹⁹ Ibid.

2.4.1 Intent of the Legislation

The *Chicken Meat Industry Act 1977* 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.²⁰

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 on issues paper, 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.

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;
- promote stability in the industry;
- enable the Committee to determine the average price paid by processors to growers from which individual grower prices are negotiated;
- improve chicken growing conditions in the industry with all growing premises requiring to be approved by the Committee; and
- 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 on issues paper, 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.

²⁰ *Chicken Meat Industry Act 1977*, p1.

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, the results of 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.

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 on issues paper, p2)

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;²¹
- 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, including 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

²¹ 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.

the processor when an increase in output is required.²² 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.²³

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).²⁴ 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.

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.²⁵ 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.²⁶

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.²⁷ This matter is unclear as there is no

²² 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.

²³ *Chicken Meat Industry Act 1977*, sections 24(1) and 24(2).

²⁴ Department of Agriculture Western Australia (1997), *Report to the Competition Policy Unit on the Legislation Review of the Chicken Meat Industry Act 1979-92*.

²⁵ Department of Agriculture Western Australia (December 2003), *Review of the Chicken Meat Industry Act 1977*.

²⁶ Department of Agriculture Western Australia (December 2003), *ibid*, p3.

²⁷ Department of Agriculture Western Australia (December 2003), *ibid*, p5.

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.²⁸

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.²⁹

Table 2.4 Number, Size and Affiliation of Main Chicken Growers in Western Australia

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

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.

2.5 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).³⁰ 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 average price (or fee) is then used as an input into the negotiation of contracts between growers and processors. Payments to individual growers in a pool

²⁸ WA Broiler Growers Association submission on issues paper, individual grower submissions, Attachment 1.

²⁹ WA Broiler Growers Association submission on issues paper, individual grower submissions, Attachment 4.

³⁰ *Government Gazette*, 25 June 2010, p2887.

(the set of growers producing a batch of chickens for a single processor) vary according to the productivity of 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 2.4).³¹ Only six growers are on individual contracts (one for Bartter and five for Mt Barker Chickens). The Inghams company farm does not have a contract as it is owned and operated by Inghams.

2.5.1 *Setting the Gazetted Average Price*

The gazetted average price is determined using a model of production costs for a notional efficient broiler farm, which is currently assumed to be a tunnel shed farm with a shed area of 11,000 m² and a stocking density of 21.5 birds per square metre.³² Production costs are calculated on the basis of the estimated costs of such a farm (land, site works, plant, equipment and operating requirements), based on quotations from suppliers and a survey of growers.³³ Total production costs comprise a return on capital, depreciation, operating costs and a working capital charge.

The inputs into the cost of production model are updated twice a year and the model is reviewed every three years. Attachment F to the WABGA submission on the issues paper presents the July 2008 cost of production model from the most recent full review of the model (published on the Authority's website).

2.5.2 *Fee Negotiations*

The gazetted average price is used as a reference price by growers and processors in the negotiation of individual contracts to agree a negotiated average price (or fee) to be paid to the group of growers in a pool (i.e. a group of growers for the same processor growing a batch of chickens within a particular time period).³⁴ The Act allows for other factors to be taken into account in these negotiations, including that of "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 (mainly the price of imported chicken meat).

³¹ Inghams Enterprises commented that its growers "have not had a signed agreement in place since the previous growing agreement expired in 2004. As it currently stands, all Inghams growers are on a batch to batch agreement" (Inghams Enterprises submission to the draft report, p11). The batch to batch agreements are based on the lapsed agreement, which was a prescribed form agreement. Inghams growers have not signed new agreements proposed by the processor as these would require them to opt out of the Act (clause 22.8 of the proposed contract require that "the parties agree that they will not refer a Dispute to any committee or other body established under the [Chicken Meat Industry] legislation" (see Inghams Enterprises submission on the draft report, p10).

³² 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.

³³ The 2008 review of the farm model noted that there was a 90 per cent participation rate in the growers' survey.

³⁴ 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.

Over recent years, the negotiated average fee has always been less than the gazetted fee, currently sitting at 71 cents per bird for Inghams growers and 75 cents per bird for Bartter growers (Inghams submission on draft report, p8).

2.5.3 Adjustments for Productivity

The individual growers in the pool are paid the negotiated average price, further 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 harvesting, adjusted for factors such as the age of the birds at the time of harvesting (which is determined by the processor) and the feed conversion ratio (the mass of food consumed divided by the mass of meat produced).³⁵ Feed conversion ratios are dependent on multiple factors, including genetics, feed quality, temperature, health of the chickens and management; some of these will be in the control of the processors, and others in the control of growers. 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 individual 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 two times in a row may have their growing fees and stocking density reduced;
- 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);
- growers may have their contracts terminated if they are inefficient more than five batches in a row;
- 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).³⁶ 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 negotiated average growing fee, while growers who perform below the benchmark may be paid 0.4 cents per bird less than the negotiated average growing fee.

³⁵ 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).

³⁶ This is a current source of dispute by some growers.

The returns to growers may also be impacted by changes in 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.³⁷

In practical terms, the negotiation of the average fee, the adjustments for productivity, and changes to stocking density or batch rates, result in the average actual fees paid to growers being lower than the gazetted average fee.

2.5.4 Prescribed Form Agreements

The *Chicken Meat Industry Act Regulations*, provided for under section 24 of the Act, set out the prescribed form 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 on issues paper, Attachment 2.)

³⁷ 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.

2.6 Overview of Industry Participants' Views on the Act

In summary, most growers in Western Australia are highly supportive of the Act, while the processors are highly opposed to it.

2.6.1 Growers

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 on the issues paper, p2-3 and individual growers' letters, Attachment 1.)

For example, one grower submitted that the Act and the operations of the Chicken Meat Industry Committee provided for an "amicable decision-making process between the Growers' Association and the processor", provided growers with the confidence to invest, and provided a low-cost arbitration mechanism.

The process allows for growers to review their capital and operating costs and present these to the [Committee] for negotiation with the processor, which still has the mechanism to allow the processor to incorporate cost factors...On each review there has been a negotiated discount benefit to the processor.

The system allows for the confidence of growers to "continue" to invest in the industry for a safe product from "breeder farm to plate".

There have been a number of times that the [Committee] has been engaged to arbitrate between growers and processor. Without this arbitration mechanism there are a large number of growers who could not afford legal representation and would be exposed to grow under conditions that would not support the investment made for a long term return.

(WABGA submission on issues paper, Attachment 1, submission from Terrigal Farm)

2.6.2 Processors

The view of the processors, on the other hand, is that the notional model is not independent and results in an inflated growing fee, higher than growing fees in other States, with the result that the competitiveness of the industry in Western Australia relative to other States is harmed.

The processing companies 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 on issues paper, p8)

Barter 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. Barter 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 [that] clearly outline the roles and responsibilities of both parties, fee review mechanisms and agreed dispute resolution processes all [of] which operate independent of the Act and Regulations. (Barter Enterprises submission on issues paper, p1)

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.

The processors 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 on issues paper, p3 and p4)

Bartter Enterprises

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 [where] 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 to be mutually beneficial to enable sourcing of finance and industry re-investment achieved. (Bartter Enterprises submission on issues paper, p1)

The processors are highly supportive of repealing the Act, but also support the ACCC authorisation process (this process is discussed in section 2.7.1 below). In several cases, the processors themselves have made the application to the ACCC for collective bargaining on behalf of their growers.³⁸

2.7 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 2.5 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 2.7.1 below.

³⁸ 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).

Table 2.5 Summary of Current Chicken Meat Industry Legislation in Other States

State and Legislation	Current Status
New South Wales	
<p><i>Poultry Meat Industry Act 1986</i></p> <ul style="list-style-type: none"> • facilitates direct contract negotiations between growers; • authorises collective bargaining in contract negotiations; and • establishes a Poultry Meat Industry Advisory Group as a forum for growers and processors. <p>Poultry Meat Industry Committee:</p> <ul style="list-style-type: none"> • no centralised price setting function; • reduced in size from 15 to three; and • prepares a code of practice and agreement guidelines for negotiations between growers and processors. 	<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>
South Australia	
<p><i>Chicken Meat Industry Act 2003</i></p>	<p>Act repealed 21 August 2009. ACCC have authorised collective bargaining and dispute resolution (Table 2.6).</p>
Victoria	
<p><i>Broiler Chicken Industry Act 1978</i></p> <ul style="list-style-type: none"> • National Competition Policy Review in 1999 recommended that the Act be repealed. <p>Victorian Broiler Industry Negotiating Committee:</p> <ul style="list-style-type: none"> • no longer operating; • had responsibility for making recommendations about the terms of agreements, handling disputes and determining the standard price for chickens. 	<p>Act still in force.</p> <p>ACCC have authorised collective bargaining between the Victorian Farmers Federation and their processors (Table 2.6).</p>
Queensland	
<p><i>Chicken Meat Industry Committee Act 1976</i></p> <ul style="list-style-type: none"> • to be reviewed in 2010 <p>Committee:</p> <ul style="list-style-type: none"> • still operating; • may make recommendations about grower agreements; • facilitates negotiations between growers and processors; • refers disputes to mediation or arbitration; and • is not permitted to set prices for chickens. <p>An independent review of Queensland boards recommended that the Committee be abolished. The State Government has accepted this recommendation.</p>	<p>Act still in force and is currently being reviewed.</p> <p>A discussion paper published in September 2010 outlines a number of options, including transferring the functions of the Committee to an industry-based body.</p>

Continued...

State and Legislation	Current Status
Tasmania	
No State level regulatory protection	All growers contracted to one processor (Inghams). Growers authorised by ACCC to negotiate their agreements collectively (Table 2.6)

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 issues paper*, pp20 – 28

2.7.1 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 2.6).

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.³⁹ In response, the Dawson Review recommended establishing a notification process for collective bargaining modelled on the process available for exclusive dealing.⁴⁰ The notification 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.⁴¹

The collective bargaining notification process was introduced in 2007. Since then, two notifications of collective bargaining groups of chicken growers have been allowed to stand, one in South Australia and one in Tasmania (see Table 2.6).

³⁹ Commonwealth of Australia (January 2003), *Review of the Competition Provisions of the Trade Practices Act*.

⁴⁰ Section 93 of the *Trade Practices Act 1974* provides for the notification of exclusive dealing which, if it were not for the notification, would be in breach of section 47 of the TPA.

⁴¹ 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 2.6 ACCC Authorisations and Notifications of Collective Bargaining by Chicken Growers

Applicants	Application Lodged	Final Decision	ACCC Determination
Authorisations			
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
Notifications			
Tasmanian Chicken Growers Association notified on behalf of six chicken meat grower members for collective negotiation with processor Inghams	22 Apr 2010	6 May 2010	Notification allowed to stand
South Australian Farmers Federation notified 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 Industry Structure without the Act

3.1 Background

The *Chicken Meat Industry Act 1977* operates as a form of collective bargaining by growers, in the determination of the gazetted average growing fee, which is then used as a reference price in the bargaining between growers and processors to agree the negotiated average growing fee. The legislation therefore needs to be evaluated not only in comparison with market without the Act, but also against alternative methods of collective bargaining. In the absence of the legislation, the options for growers would be either to negotiate individual contracts with their processors, or to seek authorisation by the ACCC to collectively bargain with their processors.

In this chapter, the Authority has considered the likely structure of the broiler growing services market in Western Australia without the Act, as a counterfactual to what exists under the Act. The following chapter 4 then examines the impact of the Act and whether it is likely to improve net welfare in the State. While not central to the Authority's recommendations, gains and losses to various industry participants have been noted.

When examining the effectiveness of the Act, the Authority has been guided by the concept of economic efficiency. This has a very different meaning to technical efficiency in a production process, although this is a necessary part of economic efficiency. An industry or firm could be operating at maximum technical efficiency, but if it can only exist due to a subsidy from taxing other industries, and the gain in this industry is less than the loss in the others, then productive efficiency is not achieved.

While there are several different definitions of economic efficiency, the Authority refers to a situation where:

- firms operate with technical efficiency;
- no further policy changes or trades can occur that would make people better off; and
- firms continually update technologies and processes to drive costs down.

The second bullet point refers to allocative efficiency, which is the point at which the sum of benefits to producers and consumers is greatest. Markets that are not competitive (e.g. monopolies or monopsonies) have lower allocative efficiency than competitive markets, as there is an incentive to reduce output and raise prices relative to what they would be in a competitive market.

The third bullet point refers to dynamic efficiency – is the system in question providing incentives for firms to continually improve?

While free markets without government intervention often give the best economic efficiency outcome, this is not always the case. For example, where the conditions for economic efficiency do not exist, such as in the presence of a monopoly, regulation can offer a better outcome than leaving the market alone. Indeed, one of the Authority's primary roles is the regulation of monopoly infrastructure assets such as gas pipelines and electricity transmission and distribution networks.

The Authority noted in its draft report that there must be a clear case to justify regulatory intervention when other mechanisms are available to achieve the same objectives. The benefits of legislation, such as the *Chicken Meat Industry Act 1977*, must be shown to

outweigh the costs and those net benefits need to be unambiguously positive, with no alternative ways of more efficiently achieving those objectives.

3.2 Industry Structure without Collective Bargaining by Growers

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 relatively large number of sellers (the contract growers).
- 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.
- It is difficult for processors to raise the prices they charge to chicken meat retailers. This is because 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.

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.

However, it may be in the interests of growers, as well as processors, to have an arrangement whereby growers produce exclusively for one processor. On the one hand, processors need dependable large volumes of chicken meat and would therefore prefer to set up long-term contracts with competent growers. Growers also would want predictability about their future returns and would be willing to lock-in with one processor on a long-term basis, given sufficient returns on their investments. In addition, there are switching costs and risks to growers in moving to another processor.

The Authority noted in its draft report that some factors may limit the bargaining power of the processors, who have obligations to meet their supply contracts with retailers. It is difficult for processors to recruit new growers at short notice, or get existing growers to expand, due to the long lead time and difficulty in obtaining approvals (e.g. shire councils; health, safety and environmental approvals; obtaining water allocations). Further, it may not always be possible to increase the volume of imported chicken to meet any supply shortfalls. The loss of a grower could therefore put at risk a processor's contracted deliveries to retail customers and could adversely affect the commercial relationships between the processor and its retail customers, to the benefit of other processors.

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.

3.2.1 Industry Views

Growers

Broiler growers represented by the WABGA submitted that there are a range of factors that place growers 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. (WABGA submission on issues paper, Attachment 1, submission by Lanaubra Farms)

Further, the growers submitted 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 on issues paper, Attachment 1, submission by Lanaubra Farms)

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

The growers submitted 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 on issues paper, 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 on issues paper, Attachment 1, submission by Lanaubra Farms)

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 on issues paper, Attachment 1, submission by B J & R Enterprises)

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 on issues paper, Attachment 1, submission by Raintree County)

If the processing company believes the grower's 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 on issues paper, 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 on issues paper, Attachment 1, submission by ER and JF Terrace)

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 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 on issues paper, Attachment 1, submission by ER and JF Terrace)

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 on issues paper, Attachment 1, submission by Colleen Broad)

Processors

Processors claim that there is no longer an imbalance of power between processors and growers. Inghams Enterprises submitted that:

The Chicken Meat Industry Act's intention in the 1970s was to correct what was seen as an imbalance in the negotiating power between large well resourced processors and small poorly resourced growers and in so doing bring stability to a fledgling industry. In the 1970s and 1980s the Act probably achieved this quite adequately.

Today the poultry meat industry in Australia is a stable and relatively mature industry. Growers are large and well resourced having ready access to the best financial and legal advice. Growers have strong networking at both State and national level through grower bodies and associations and as such have strong negotiating power. This increase in grower negotiating power and industry stability has been acknowledged in all other States by legislation being repealed or changed to eliminate involvement in fees and contracts. The legislation was seen by grower, processor and the industry as a whole as being anti-competitive and counter-productive. (Inghams Enterprises submission on draft report, 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 on issues paper, 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 on issues paper, 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 on issues paper, 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 on issues paper, p3)

Further, 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 on issues paper, p2)

Other Views

The Department of Treasury and Finance submitted that the existing limits to processors' bargaining powers may be greater than that described in the draft report.

For instance, although there are a number of factors that tie growers to particular processors, there are also some examples of growers exercising countervailing power in their dealings with processors. The West Australian Broiler Grower Association (WABGA) noted that three growers left Inghams for Finesse Foods, following requests by Inghams for growers to convert their standard sheds to tunnel sheds."

The ACCC has noted that there is vigorous competition between processors. As well as competition between themselves, processors also face competition from alternative meat products at the retail level. The highly competitive nature of the chicken processing industry, and the mutual dependence between growers and processors, can potentially create incentives to facilitate grower and processor cooperation and limit damaging and costly disputes. (Department of Treasury and Finance, p9)

3.2.2 Authority Assessment

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 Bartter Enterprises, 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 Finesse Foods and 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.

Growers are generally located near other growers who supply the same processor and reasonably close to processing plants (within 50 km). This is largely due to the improved logistics and reduced transport distances and costs for 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.
- The Authority is aware that processors may also be reluctant to allow free movement of growers between processors – first, because growers can be difficult to replace; and second, because processors would be reluctant to get into a bidding war for growers in terms of growing fees.
- 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-Bartter 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.

Monopsony Markets

Given the small number of processors, and the difficulty that growers face in switching away from their own processor, then in the absence of regulation or collective bargaining

by growers, the market structure for chicken meat growing services could be described as a number of 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).

The Authority accepts that growers are geographically tied to their particular processors, with little or no alternatives to sell their product, or utilise their assets for other production, although the transfer of five growers from the two large processors indicates that some alternatives exist, if only to a limited extent.

A feature of a monopsony is that the buyer (the processor) is able to choose a combination of input (growing services) quantities and price, because they are so dominant in this market that their purchasing decisions affect the price of the product. If a buyer wants more quantity, then they will have to offer a higher price to attract a new entrant (assuming that the cheapest production has already been exploited and there are no new technologies that might drive the cost of production down). This contrasts with a more competitive market, where the buyer is too small to have any effect on price, but would choose quantity to maximise profits as best they are able.

However, this does not mean that the processor has free reign over the prices and quantities purchased. The combination that they choose must be consistent with growers' willingness to supply services. If they set too low a growing fee (especially in the long run) the processors will not get the quantity that they need.

From an economic efficiency perspective, the problem with a monopsony arises because buyers frequently have to pay the same price to all suppliers, which will give a strong incentive for the buyer to purchase less than the social optimum level. The need to pay the same price for all inputs can happen for a range of reasons, such as maintaining the morale of workers or a (legislated or authorised) collective bargain. Consider the simple example of a single employer in a small town and its purchasing of labour, which is a classic example of a monopsony market (**Box 1**).

Box 1. Effect of a Single Price in a Monopsony Market

A monopsonist employer initially hires 1,000 workers at \$10 per hour. To attract another worker, the employer would have to pay him/her \$11 per hour. If the employer has to pay all its workers the same amount, then the hiring of an additional worker would not just cost \$11, but \$1,011 (\$11 for the additional worker plus \$1 for each of the 1,000 existing employees.⁴² If the employer will only employ more people if the value they contribute is at least equal to its additional cost, then this extra employee would need to generate \$1,011 for the business to hire them, extremely unlikely for someone in the market for an \$11 wage.

The above example is a fairly extreme one designed to illustrate the concept, but the general point is that a monopsonist's costs rise much faster than the market price. Applied to the Western Australian chicken growing market and an industry-wide fee for a single buyer (processor), if the existing market growing fee was 70 cents per bird based on 36.4 million birds,⁴³ but a processor with 100 per cent market share (to simplify the example) has to offer 72 cents per bird to attract a new entrant into the industry to

⁴² Ashenfelter, O.C., Farber, H. and Ransom, M. R. (April 2010), "Modern models of monopsony in labour markets: a brief survey", *Princeton University, Industrial Relations Section, Working Paper No. 554*, p3.

⁴³ Based on the 1996-97 reported level of WA production, the last year reported by the Australian Bureau of Statistics (ABS, Cat No. 7215.0).

produce another 500,000 birds per annum,⁴⁴ then the cost to the processor would be \$360,000 (0.72 times 500,000 birds) to the new grower plus \$728,000 (\$0.02 times 36.4 million birds).

In other words, given uniform pricing, the processor would have to pay more to existing growers than to the new grower and the true additional cost to the processor is actually \$2.18 per bird (((\$360,000 plus \$728,000) divided by 500,000 birds). This gives the processor a powerful incentive to restrict output until the additional cost per bird⁴⁵ equals the revenue they receive for that bird, so output is restricted to well below the level from an efficient outcome.⁴⁶

In contrast, if technologies exist to continually lower the cost of production, then the industry would expand as more efficient producers at the margin would lower the price of all existing production to processors.

A monopsonist can increase profit by paying each of its suppliers differently depending on the price that their suppliers are willing to accept (price differentiation).⁴⁷ If there is a group of suppliers who will keep producing despite a large fall in price, the buyer will attempt to separate them from growers who might reduce output by a large amount for the same change in price. The growers who are insensitive to price will be paid a lower price than the ones who are sensitive to price. Of course to do so, the monopsonist must be able to prevent arbitrage between suppliers. In practical terms, this could be implemented by offering growers individual contracts, which specify that a grower cannot discuss their fee with other growers.

Price differentiation would improve economic efficiency as it would reduce the cost to processors to offer expanded levels of production. In the example above, the per-bird cost to the processor to expand would fall from \$2.18 to \$0.72, giving the processor much more incentive to expand.

However, under price differentiation, growers that were offered and willing to accept lower prices would lose relative to the single price case, as some of their income would effectively be transferred to processors. Growers that need a high price to stay in business and investors considering joining the industry, would gain from such a system.

If price differentiation (through individual contracts) is possible in South Australia and not in Western Australia, it might partly explain why imported chicken meat can be competitive at seemingly high transport costs. Bartter Enterprises estimate the transport cost per bird as \$0.22.⁴⁸ This, given the average fee in South Australia of \$0.6712 per bird for Inghams growers,⁴⁹ should lead to a much larger price for imported meat than the grower fee of \$0.715 per bird (for tunnel shed growers), or even the gazetted fee of \$0.8057, even allowing for the larger bird size in South Australia and production efficiencies from Inghams' South Australian plant. However, given the single fee and regional monopsonist

⁴⁴ Approximately the number of birds in the Cost of Production model in January 1998.

⁴⁵ The *marginal factor cost* in economic terms. This results in a *deadweight loss* in the market; that is, a decrease in the total welfare to society.

⁴⁶ Wetzstein, M. (2005), *Microeconomic Theory: Concepts and Connections*, p555.

⁴⁷ In economics terms, this relates to the *price elasticity of supply*, or the percentage change in output (for the grower in this case) for a one percent change in price. If output is less sensitive to price (inelastic), then the buyer will pay them less because they will only reduce production by a small amount despite a relatively large change in price.

⁴⁸ Bartter Enterprises submission on draft report, p13. Note that it is processed chicken meat that is transported, not birds, so the transport cost has been calculated back into a "per bird" basis.

⁴⁹ Inghams Enterprises submission on draft report, p8.

buyers in Western Australia, the marginal cost of expansion could be much higher than import parity.

Growers have expressed concerns that, if they were unable to bargain collectively, processors could take advantage of the growers being locked in with their capital by driving down growing fees so that they are just enough to cover growers' operating costs, but not all of their capital costs. The Authority notes that this might be possible in the short term, but in the long-term it is not a sustainable tactic, as no new growers would enter the industry without sufficient returns.

Final Findings and Recommendations

Market Structure in the Absence of Collective Bargaining

- 1) Western Australia's market for broiler growing services is dominated by two buyers (processors) and growers have limited opportunity to switch between processors or convert their broiler growing infrastructure assets for alternative uses. This can be described as a market with monopsony buyers.
 - The market structure is driven mainly by economic factors that make it cheaper for chicken meat to be processed by a few large companies rather than by many processors.
- 2) Monopsony markets lead to production that is lower than the economically efficient level, and also lead to processors capturing as monopsony profits part of what, in a competitive market, would be returns to growers.
- 3) Price differentiation (the payment of each grower individually on the basis of their willingness to supply) can lead to an increase in output relative to a market where all growers are paid the same fee. However, it is unclear whether processors would be able to implement such a system.

3.3 Market Structure with Authorised Collective Bargaining

3.3.1 *ACCC Assessment of the Costs and Benefits of Collective Bargaining*

An assessment of how the market would function without the Act can be gained from ACCC assessments of applications for authorisation of collective bargaining by chicken meat growers.

In its various decisions on collective bargaining authorisations and notifications for chicken growers (see Table 2.6), 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.
- Individual 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 and administration 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;⁵⁰ 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 Bartrter (then the third-largest of the national meat processors).⁵¹ The ACCC initially opposed the takeover on the grounds that it would

⁵⁰ The ACCC denied authorisation to a group of Victorian growers whose application included the right to collectively boycott their processor. The Department of Treasury and Finance is therefore incorrect in its submission on the draft report (p10), in which it stated that growers would be advantaged by being able to collectively boycott under authorised collective bargaining arrangements.

⁵¹ ACCC (27 February 2009), *Public Competition Assessment: Baiada Poultry Pty Ltd – Proposed Acquisition of Bartrter Enterprises Pty Ltd*.

substantially lessen competition in the markets for the supply of wholesale chicken. 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.

3.3.2 Impact of Collective Bargaining

Overall, the Authority considers that the structure of the chicken meat industry in Western Australia is similar to that in other States, with a similar balance of power between growers and processors. Accordingly, it considers that it is highly likely that, in the absence of the Act, growers would obtain authorisation from the ACCC for collective bargaining, if they were to seek it.

Allowing growers to collectively bargain with the processor (e.g. under an arrangement authorised by the ACCC, or through a legislative mechanism such as that under the WA Act) could create a different model – that of a bilateral monopoly (a single buyer and a single seller). In a bilateral monopoly:

- the monopoly seller (i.e. grower group) will seek to achieve a price (growing fee) above the competitive level; and
- the monopoly buyer (processor) will seek to achieve a price (growing fee) below the competitive level.

However, growers note that due to the inability to collectively boycott, their bargaining position is weak, so the market under authorised collective bargaining probably still operates in a manner consistent with a monopsony.

The Department of Treasury and Finance noted that the chicken meat industry is not the only industry in which there is an imbalance of market power between growers and processors and that several other industries have made use of collective bargaining arrangements under the ACCC to address such problems.

The perception or existence of an imbalance of market power between growers and processors is common to many primary industries.⁵² Many of these industries are dominated by a few large processors and a large number of growers....

Following the removal of industry specific legislation, the ACCC has approved collective bargaining arrangements in a range of industries including:

- Australian dairy milk industry;
- Tasmanian vegetable growing industry;
- Victorian potato industry;
- Victorian dried vine fruit industry; and
- Queensland citrus industry.

(Department of Treasury and Finance submission on draft report, pp5-6.

A relevant factor is that processors in the other States do seem to be able to practice some form of price differentiation, particularly for new entrants into the industry. Growers in some eastern States markets are paid partly on the basis of the condition and age of their assets. Processors have noted that the industry is expanding rapidly elsewhere in Australia and that while collective bargaining is still common, new entrants are almost always offered individual contracts.⁵³

⁵² Griffith, G. (2000), "Competition in the food marketing chain", *Journal of Agricultural and Resource Economics*, vol.44, no.3, pp1333-367.

⁵³ Generally an initial 5-year contract with a 5-year extension if certain terms and conditions are met.

Final Findings and Recommendations

Market Structure with Authorised Collective Bargaining

- 4) The ACCC has assessed the balance of power between processors and growers in other States and has in most cases authorised collective bargaining arrangements by growers, but not collective boycott rights.
- 5) If there were no *Chicken Meat Industry Act 1977*, Western Australian broiler growers would most likely receive ACCC authorisation for collective bargaining should they seek it.
- 6) Authorisation for growers to collectively bargain would provide growers with some degree of countervailing power in negotiations with processors, but not to the extent of creating a bilateral monopoly situation. The market would remain essentially monopsonistic.

3.4 Investment Hold-up

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.⁵⁴ 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.

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.

In order for growers to have sufficient confidence to make capital investments, they require sufficient certainty that they will be able to recover those costs over a period of time, including a rate of return commensurate with the level of risk they are undertaking. It is possible that collective bargaining, by increasing the bargaining power of growers, can provide them with greater input into their contract terms and conditions, which would give them more confidence to make large capital investments.

⁵⁴ 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.

In a growing market investment hold-up is unlikely to be a problem. If new capacity is to be attracted to the industry, processors must offer new entrants sufficient assurance that the new entrant will be able to make a sufficient return on their investment over the life of that investment. Growers have expressed concern that returns promised initially by processors to encourage growers to invest will be later revoked when contracts are renegotiated (known as “bait and switch” tactics). However, while this behaviour might produce some short-term gains for the processor, if processors want to continually attract new production, then it is not a sustainable long-run strategy.

The Authority has noted that long-term contracts are available to some growers. The entry of large investment fund management companies into the chicken growing sector is a new development.

- The ProTen farm in Serpentine is one of six broiler farms across Australia managed by ProTen Ltd. ProTen farms have long-term growing contracts with Baiada, typically 15 years.⁵⁵
- Another example is Rural Funds Management Limited (RFM), which manages a portfolio of farming and agricultural enterprises for investors, including 16 broiler farms in NSW and Victoria. RFM has established 20 and 30-year broiler growing contracts with Baiada.⁵⁶

Another key point to make is that investment hold-up can also occur on the processing side of the market. In deciding whether or not to expand in the processing sector, processors face capital investment decisions that are expensive and long term (such as expanding, upgrading or building new processing plants). Once the plant is in place, if growers have sufficient bargaining power, then they could conceivably increase prices to the point where it is worth the processor keeping the plant operating, but at a rate of return much lower than anticipated at the time the investment decision was made.⁵⁷ Given that processors are likely to face more infrequent investment decisions than growers – but much larger in terms of industry impact – the impact on processors needs to be carefully assessed.

Currently, evidence suggests that Western Australian output is not expanding and is under significant pressure from interstate imports (see section 2.3.3). In such a situation, there is likely to be a reluctance to invest by both growers and processors. Rather than a hold-up issue, it could be a general reluctance to invest due to uncertainty about future production levels and returns.

3.5 Experience in Other States

In assessing the alternatives to the average price regime in Western Australia, the Authority has reviewed recent developments in other States, where chicken meat industry legislation is no longer applied. The Department of Treasury and Finance noted that:

It is important to note that in no other Australian jurisdiction does legislation provide for the determination of an average fee that is to be paid to growers.

Despite the existence of the chicken industry legislation in a number of other jurisdictions, there appears to have been a trend away from using the provisions of this legislation, in

⁵⁵ www.proten.com.au; *ProTen Ltd Consolidated Financial Statements for Year Ended 30 June 2010*, p18.

⁵⁶ www.ruralfunds.com.au

⁵⁷ Processors would be better off keeping the plant operating as long as they are covering their variable costs and some of their fixed costs, rather than shutting the plant down and covering none of their fixed costs.

favour of ACCC authorisation. (Department of Treasury and Finance submission on the draft report, p4)

The experience in other States can be judged by a number of criteria, including the number of disputes and arbitration cases between growers and processors. A nother indicator is the level of growth in the chicken meat sector – if there is significant expansion in the growing sector, then this would indicate that growers are willing to invest capital in the industry on the basis of the fees and contract terms and conditions they have been offered.

3.5.1 Queensland

The Queensland government is currently reviewing the State's *Chicken Meat Industry Committee Act 1976*. A discussion paper was released on 16 September 2010.⁵⁸ The Queensland government has accepted the recommendation of the 2009 Webbe/Weller review of Queensland's boards, committees and statutory authorities to abolish the Chicken Meat Industry Committee (**CMIC**).

The CMIC's functions are to facilitate negotiations between processors and growers; facilitate dispute resolution, where required; make recommendations on minimum conditions for contracts and other issues; represent growers and processors; and provide information. However, it must not make recommendations on growing fees or how the fees are determined.

The review will assess the costs and benefits of the following options:

- removing the legislation;
- transferring the functions of the CMIC to a non-statutory, industry-run company, with an authorisation under Part 4 of the *Trade Practices Act 1974* to collectively negotiate; or
- continuing with the existing arrangements.

Chicken meat production has increased in Queensland (from 94,000 tonnes of chicken meat produced in 2000-01 to 156,000 tonnes in 2008-09). The number of growers has decreased from 120 in 1997-98 to 93 growers currently.⁵⁹

The discussion paper notes that there has been an absence of formal disputes between growers and processors in Queensland.

While there have been disagreements between growers and processors around contracts, in the last five years none of these disagreements have escalated into a dispute that has required action from the CMIC.⁶⁰

3.5.2 South Australia

The South Australian legislation (the *Chicken Meat Industry Act 2003*) did not have a price-setting role, but appointed a Registrar whose functions were to facilitate negotiations; gather, maintain and publish information on growing costs; and maintain a register of growing agreements. The Act was repealed on 21 August 2009. Since then,

⁵⁸ The State of Queensland, Department of Employment, Economic Development and Innovation (2010), *Review of the Chicken Meat Industry Committee Act 1976: Discussion Paper*.

⁵⁹ Source: *op.cit*, p6.

⁶⁰ Source: *op.cit*, p11.

one group of 18 growers has been granted authorisation by the ACCC to collectively bargain with their processor (Inghams Enterprises).

South Australia has seen considerable growth in its chicken meat industry in recent years (from processing around 40 million birds per annum in 2004 to around 70 million birds per annum currently). In 2004, the \$130 million Inghams processing plant in northern Adelaide received a \$7 million grant from the federal government as part of the \$45 million structural adjustment fund in response to the closure of the Mitsubishi Motors factory in South Australia. There has been considerable recent investment in new chicken growing facilities; for example, in the Murray Bridge area, which has 62 sheds in operation, approval has been given for the construction of another 83 sheds, with approval of up to 52 further new sheds pending.⁶¹

The resolution of disputes between growers and processors is carried out according to the processes set out in the contracts (cited in the Inghams submission on the draft report). The South Australian government has no involvement in the resolution of disputes. Inghams have informed the Authority that they have had no cases of mediation or arbitration with their growers in South Australia.

The Department of Treasury and Finance cites evidence from the recent South Australian government review of that State's chicken meat industry legislation that, due to the mutual dependence between growers and processors, the level of disputes in that State has been low.

*"While there was some mention of disputes the overall impression was that, again due to market forces, any disputes which tended to be of an operational nature were negotiated at an early stage and resolved without the need to use mechanisms under the [SA Act]. The SA Act provides a safety net for growers, however similar measures are already provided under the dispute resolution provisions in the individual contracts or alternatively by action under the Trade Practices Act 1974."*⁶²

The Department of Treasury and Finance submission concludes that:

*While the South Australian review recognised that some stakeholders believe that ACCC authorisations were less likely to provide two-way negotiation, it concluded that "elements of requiring written negotiation agreements and inherent provision for mediation suggest that ACCC authorisation is likely to protect the interests of growers just as well as the Act".*⁶³

*The South Australian Review also found that "given the sophisticated nature that the industry appears to be developing into, it is apparent that market forces and commercial strategies are required for the future, rather than restrictive government regulation".*⁶⁴

3.5.3 New South Wales

Legislation is still in force in NSW (*Poultry Meat Industry Act 1986*), but the Poultry Meat Industry Committee established under that Act has no price setting role. The NSW Farmers Federation submission to the review of the Act recommended that the Act be strengthened to include a prescribed methodology on determining a standard growing fee.

⁶¹ Source: Department of Primary Industries and Resources of South Australia (PIRSA), September 2010.

⁶² Department of Treasury and Finance submission on draft report, citing Brown, N. And Baldock, N. (2009), "*Chicken Meat Industry Act 2003, Review of Operation*", Department of Primary Industries and Resources of South Australia.

⁶³ *Op.cit.*

⁶⁴ *Op.cit.*

The recent review of the NSW *Poultry Meat Industry Act 1986* summarised 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 growers' five year contracts were due to expire and had to be renegotiated. The review noted that:⁶⁵

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.⁶⁶

3.5.4 Victoria

The Victorian *Broiler Chicken Industry Act 1978* is still in force, but is not used. The Victorian Broiler Industry Negotiating Committee is no longer operating. Five grower groups have ACCC authorised collective bargaining arrangements.

The Victorian Farmers Federation (**VFF**) bargains collectively on behalf of broiler grower groups in Victoria. The submission by the VFF 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.⁶⁷

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...

According to the VFF website:⁶⁸

The VFF successfully negotiated significant fee increases for the majority of members in 2008, which increased the average member's gross payment from processors by approximately \$10,000 to \$15,000 per annum.

The improved contract terms provide growers with long-term security and assist growers to negotiate improved finance arrangements. The VFF was again instrumental in negotiating new five year contracts for Baiada and Inghams growers and are now seeking similar contracts for Bartter, La Ionica and Hazeldene growers in 2010. The additional value of these negotiations is estimated at \$20,000 per member.

The *Victorian Code for Broiler Farms* was introduced in September 2009 and sets out the environmental standards for those wishing to expand or establish new broiler farms.⁶⁹

⁶⁵ State of NSW through Industry and Investment NSW (May 2010), *Statutory Review of the Poultry Meat Industry Act 1986*, p6.

⁶⁶ One court case was the Yarrabee Chickens case, which was determined by the Federal Court of Australia in April this year. The Court ruled in favour of the grower in 18 out of 20 breaches of contract (Yarrabee Chicken Pty Ltd vs Steggles Ltd, FCA 394, 27 April 2010). The dispute lodged with the Poultry Meat Industry Committee was referred by the Committee for mediation and is currently still in arbitration.

⁶⁷ 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.

⁶⁸ <http://www.everyfarmerneedsthevff.com/index.html>

The Code was developed in consultation with industry and has been incorporated into the Victorian Planning Provisions and all planning schemes in Victoria. Compliance with the Code is mandatory and applies to the planning, design, assessment, approval, construction, operation and management of broiler farms in Victoria. Since the introduction of the Code, 15 new farms have been approved.⁷⁰ Chicken meat production in Victoria has been increasing by around 2.5 per cent a year since 2004-05, although production in 2009 was reduced due to the loss of the Inghams processing plant in Somerville due to fire in January 2009.

Final Findings and Recommendations

Experience in Other States

- 7) Review of the experience in other States, where grower fees are not regulated, indicates that some of these regions (especially South Australia and Queensland) have shown considerable growth in their chicken meat growing sectors and that the incidence of formal disputes between growers and processors is low, given the large number of growers.

⁶⁹ <http://new.dpi.vic.gov.au/agriculture/animals-and-livestock/poultry/code-broiler-farms>

⁷⁰ Source: <http://www.getfarming.com.au>

4 Impact of the Act

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

In assessing the legislation, the Authority has had regard to the Western Australian Government's guidelines for legislative review.⁷¹ 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.

Strong justification is required for regulatory intervention: the benefits of regulation must clearly outweigh the costs, including the costs of any unintended consequences. Further, the focus is on total welfare gains (or losses) to society and not on transfers of wealth between different parties, although such transfers are noted where they occur.

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 over 85 per cent of the chicken consumed by Western Australian consumers. Growers on prescribed form agreements currently produce around 38 million chickens per year, so that the Authority estimates that total payments to these growers are between \$23 million and \$26 million a year.⁷² Restrictions to the industry can be considered to be major restrictions, which warrant a detailed analysis and public benefit test.

4.1 Restrictions Under the Act

There are three main restrictions to competition under the Act, administered by the Chicken Meat Industry Committee.

1) Average Price Regime

- The Act allows for the Committee to determine the gazetted 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 gazetted average price should be determined (s.24(2)(b)). The methodology for determining the gazetted average price is set out in the second schedule of the *Chicken Meat Industry Act Regulations*.
- The Act specifies a model based on the costs of production of a notional efficient broiler farm which is used to determine the gazetted average price.

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)).

⁷¹ Government of Western Australia (November 2001), *Public Interest Guidelines for Legislation Review*, Competition Policy Unit, Department of Treasury and Finance.

⁷² Inghams Enterprises submitted that grower payments were closer to \$34 million per year, although this would equate to a price per bird of 89.47 cents per bird, well above the gazetted price.

- 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 gazetted 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.
- 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 agreement) 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.

4.2 Effect of the Act on Market Structure

The Authority considers that the operation of the restrictions under the Act gives rise to a market structure closer to the bilateral monopoly described in section 3.3.2, as it gives the growers significantly more bargaining power than under ACCC collective bargaining authorisation. In such a market, unlike most other markets, no unique arrangement exists where all participants maximise their profits given the constraints that they face. Each participant can increase their profits at the expense of the other party, with the eventual outcome determined by the strength of their respective bargaining positions.

The level of production in a bilateral monopoly relative to a monopsony market is unclear, with the net impact depending on production technologies and each participants bargaining strength. A common solution is for the participants to agree on the quantity that maximises the joint profits and then negotiate over the shares of the profits. An example is negotiations between players’ associations and team owners in professional

sports salary negotiations. The two parties agree on the number of players in the league and then negotiate over player salaries.⁷³

Under such an arrangement, price differentiation between growers and/or groups of growers and a consequent potential improvement in economic efficiency, becomes less likely. Price differentiation might not be possible under ACCC-authorized collective bargaining, but is almost impossible under the Act.

In addition to a normal bilateral monopoly market is the role of the gazetted fee from the notional model which, depending on the level of fee determined, has the potential to significantly strengthen one of the parties bargaining position. There are then two key questions. Firstly, if the Act, particularly its price setting functions, is to continue, is the model efficient in the sense that it does not unduly favour one party or the other?

The second question is if the production (economic efficiency) impact of a bilateral monopoly relative to a monopsony is unclear at best, does the Government have an interest in favouring one party in the bargain for no net gain to society? These questions are examined below.

4.3 Independence of the Committee

If the average price regime which underpins the Act is to work effectively, it is essential that the average price be determined through equal input by both growers and processors.

The framework for determining the average price provides the opportunity for balanced input by both growers and processors. The composition of the Committee is aimed at equal representation by growers and processors. The model and the methodology for determining each parameter are documented, so that model inputs and the calculation of the growing fee can be scrutinised by any of the parties. One processor also has a broiler farm, so is familiar with the production costs. Similarly, growers and processors both have the opportunity to contribute to the review of the model every three years.

4.3.1 Industry Views

Inghams Enterprises have expressed the view that the Committee, because of its structure, cannot be considered to be independent.

Examination of the structure of the CMIC reveals that it is comprised of two processor representatives, two grower representatives, two independent representatives and a Chairman as required by the Chicken Meat Industry Act 1977. It is however important to note, that with regard to the two independent representatives, one is an Executive Officer of the Western Australian Farmers Federation (Inc), while the other is a farmer in the wheat belt and on the board of Regional Development Australia. It is Ingham's opinion (whilst in no way suggesting they act in any way that is inappropriate) that the aforementioned independent representatives cannot be deemed as independent as there are obvious conflicts of interest. (Inghams Enterprises submission on draft report, pp6-7)

Inghams Enterprises submitted that it has objected to the setting of the growing fee by the Committee and has voiced this objection by abstaining from voting on the gazetting of the growing fee and since October 2009 declining to nominate a representative of the company to the Committee.

⁷³ Wetzstein, M. (2005), op.cit., p561.

Bartter Enterprises submitted that it would also be possible under the legislation for a processor who is outside the Act to be appointed to the Committee and gain a competitive advantage over growers whose growers are on prescribed agreements. (MJA report, p8, attachment to Bartter Enterprises submission on draft report).

4.3.2 Authority Assessment

The processors contend that, in practice, the Committee is not independent and that the processors' input into the notional model is given less weight than that of the growers.

In investigating these concerns, the Authority's Secretariat has met with representatives of growers and processors on the Committee, as well as the independent members and the Secretariat of the Committee.

The Act requires that the two independent persons on the Committee, who are appointed by the Minister for Agriculture, are not themselves processors or growers and do not have a relationship with, or a pecuniary interest in the affairs of, a processor or a grower, that would prevent them from exercising independent judgement.⁷⁴

In practice, the appointment of the independent members is carried out in consultation with the Department of Agriculture. The Authority recognises that this could lead to a perception of bias (although not necessarily an actual bias) in favour of farming interests. The two current independent members both have farming backgrounds. Discussions with processors and growers indicated that historically, the independent members have tended to vote in support of the growers. However, the Authority notes that the task of the independent members is made difficult by the limited input into the Committee by the representatives of the processing companies, which can result in an unbalanced presentation of information.

In addition to requiring that independent members on the Committee have no connection with chicken meat growing or processing, the perception of bias could be removed by making the appointment of the independent members more independent. This could be achieved, for example, by the appointment of a single arbitrator by the Treasurer (rather than the Minister for Agriculture) or through an independent body such as the Institute of Arbitrators and Mediators Australia.⁷⁵

In terms of the review and maintenance of the model, this was formerly carried out by the Department of Agriculture, but is now done by the grower representatives on the Committee. Both sides have the opportunity to query any of the model inputs and methodology and Inghams provide the cost estimates from their own farm into the model. Both parties also have the opportunity to contribute to the review of the model every three years. However, the processors have submitted that they do not trust the calculation of the growing fee. The processors have since 2007 abstained from voting on the gazetted fee. Regardless of the validity of the processors' concerns, it is clear that the notional model has not achieved "buy-in" by both sides of the negotiations.

The Authority's Secretariat has met with the independent members and has no doubts about their professionalism and integrity. However, it is important that all parties perceive that the process is independent.

⁷⁴ *Chicken Meat Industry Act 1977*, section 7(2).

⁷⁵ In the Poultry Meat Industry Committee in New South Wales, one of the two independents appointed by the Minister must be skilled in negotiations, arbitration or dispute resolution.

The Authority concludes that, in order to address these issues, it would be essential to remove any perception of bias regarding the determination of the average growing fee or dispute resolution by the Committee. This could be achieved by appointing an independent body or party (not associated with growers or processors) to review the model, re-develop the model (depending on the outcome of the independent review) and maintain the model.

Final Findings and Recommendations

Independence of the Committee

- 8) There is disagreement between processors and growers regarding the validity of the mechanism for determining the average grower fee under the Act. This has led to a breakdown in the functioning of the Chicken Meat Industry Committee, with the processors no longer participating in the gazetted fee determination process.
- 9) If the Committee is to continue in a price-setting role, to remove any perception of bias it is important that any independent representatives on the Committee are appointed by an independent process, for example, a single independent professional arbitrator appointed by the Treasurer.

4.4 Efficiency of the Notional Model

4.4.1 Industry Views

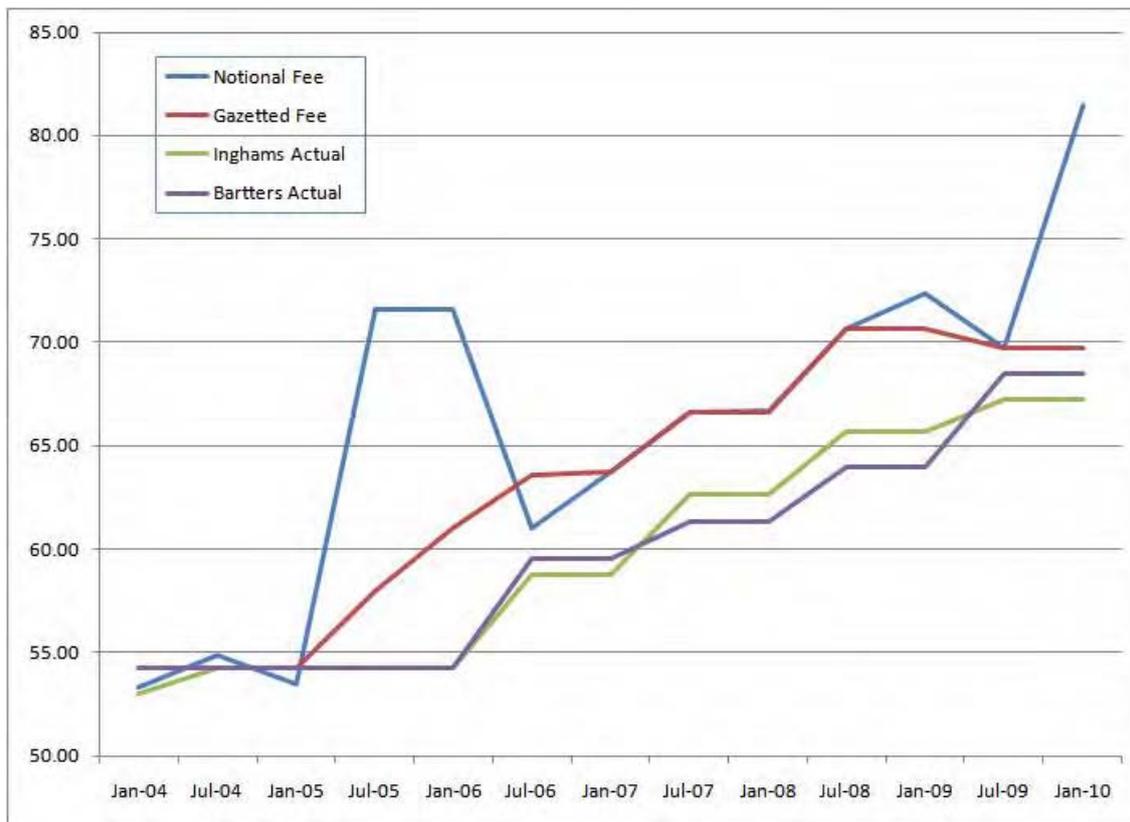
Growers

The WABGA submitted that the fee setting mechanism has encouraged cost efficiency in the Western Australian grower industry 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).

Further, the WABGA submitted that the actual payments that growers receive are consistently lower than the gazetted average price (see Figure 4.1). The growers submitted 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 on issues paper, pages 9 and 19)

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.

Note: The notional fee is the fee that is calculated from the notional cost model. The gazetted fee does not always equal the notional fee, as it is determined by the Committee, taking into account the output of the notional model, but also other factors and views of industry participants. The most recent increase in the notional fee (to 80.57 cents) is largely due to increases in the cost of capital, because of increases in the 10-year Commonwealth bond rate. This increased fee was gazetted on the 25 June 2010.

The WABGA also submitted 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 c cents per bird. (WABGA submission on issues paper, p19)

WABGA also provided estimates to the Authority showing that growing fees in Western Australia were below the national average for conventional sheds and around 2 cents per bird above the national average for tunnel sheds.

Table 4.1 Average Growing Fees 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
Growing fee (cents per bird)	67.13	67.23	69.43	67.42

Source: WA Broiler Growers Association

Processors

The processors do not accept that the growing fee determined by the notional model represents an efficient cost of production. Inghams Enterprises submitted that the divergence between the gazetted and actual fees demonstrated that the notional cost model did not produce an efficient price.

The fact that Ingham's current grower fee is set at 69.50 cents per bird for conventional shedding and 71.50 cents per bird for tunnel shedding, while the latest Notional Model and subsequent gazetted grower fee is currently set at 80.57 cents per bird means that the gazetted fee is currently sitting 12.7% higher than the actual fee. This cannot be reflective of an "Efficient Notional Model". The only logical conclusion is that the gazetted of the grower fee is being used to artificially inflate the actual grower fee and being done very effectively... (Inghams Enterprises submission on draft report, p5).

Barter Enterprises also submitted that the values for several inputs into the model were too high. Barter's consultants reviewed the model and concluded that:

- the wages of a chicken meat farm manager used in the Farm Fee model are 55.7% higher than the median wage of a chicken meat farm manager as reported in the 2006 Census;
- chicken meat farm labourer wages included in the Farm Fee model in 2007 are 88.9% higher than the median wage reported in the 2006 Census for the same job classification;
- there appears to be an asymmetric response to input price changes in the farm fee model. Increases in input prices are incorporated into the farm fee model. However, a similar adjustment is not made when input prices decrease;
- adjusting the operating cost component of the growing fee to reflect changes in input prices results in an operating cost component that is, on average, 4.2% lower per review period than the operating cost component derived using the Farm Fee model; and
- by maintaining the real value of broiler growing inputs between July 2007 and July 2009, and including a productivity factor, the operating cost component of the growing fee would be \$0.10 per broiler lower than that reported in the farm fee model.

(MJA report, p3, attachment to Barter Enterprises submission on draft report)

The processors argued that grower fees and earnings in Western Australia were higher than in other States. Inghams Enterprises provided a comparison of its grower fees and returns to growers in each State and submitted that earnings for WA growers were on average 11.91 per cent higher than in other States.

Table 4.2 Comparison of Inghams Enterprises Grower Fees and Earnings

State	Grower Fee (Cents per Bird, Tunnel Shed)	Earnings (\$ per m ²)	Percentage Difference to WA Earnings (per m ²)
Western Australia	71.50	77.76	0%
Queensland	67.50	68.81	-13.00%
New South Wales	69.69	67.73	-14.81%
Victoria	73.60	75.11	-3.53%
South Australia	67.12	66.75	-16.49%

Source: *Inghams Enterprises submission on draft report, p8.*

Inghams submitted that the grower fee in Western Australia would need to be 7.5 cents lower than the current fee to make earnings per square metre the same as the average earning for growers in other States.⁷⁶

Bartter Enterprises provided confidential information to the Authority on its grower fees in different States and submitted that:

the fee paid to growers in Western Australia, as determined by the Farm Fee model, is significantly higher than the fee paid to growers in other States. While this may be indicative of genuine cost differentials between regions, for example because of the need for concrete shed floors in Western Australia, such factors may not account entirely for the cost differential. (MJA report, p12, attachment to Bartter Enterprises submission on draft report)

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 4.3 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 on issues paper, p3)

Table 4.3 Size of Inghams Enterprises Operations in Western Australia

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

Source: *Inghams Enterprises submission on issues paper, p3.*

The WABGA commented to the Authority on the claims by Inghams regarding the reduction to the size of Inghams' operations, maintaining 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.

⁷⁶ Average earnings for growers in other states is \$69.6 per m². If growers in WA earned this amount, the implied grower fee would be 64 cents/bird (= 71.5 cents/bird ÷ \$77.76 per m² x \$69.6 per m²).
71.5 cents/bird – 64 cents/bird = 7.5 cents/bird.

Current Cost Accounting

Inghams Enterprises submitted that the inflated growing fee from the notional model is largely due to the use of current cost accounting.

The Notional Model was developed and is updated by the growers in Western Australia, with no input from processors, and based on the “current cost accounting” method. Current cost accounting is a form of inflation accounting and in the past has been a method used in countries with hyper inflation. Current cost accounting attempts to revalue old assets at replacement cost and in so doing account for inflation. This method, whilst in vogue in the past decade, is now long outdated. It has several disadvantages which include:-

- i) Manipulation of asset values.
- ii) Is susceptible to fair value and market variables.
- iii) Requires many factors to be considered in order to be accurate.
- iv) Is time consuming.
- v) Ultimately is a method that is complex and difficult to understand intuitively.
- vi) A Notional Model as opposed to a processor / grower model is no longer relevant.
- vii) The Notional Model is flawed in several areas.

The Notional Model currently put forward by the growers is, as stated, flawed in a number of areas. It is not representative of the facilities used in Western Australia and it is irrelevant. Fees should be negotiated on a processor / grower basis.

Further when compiling the Notional Model template, as assets have been re-valued, provision for depreciation and repairs and maintenance on current asset values in effect results in “double dipping”. This therefore artificially inflates the actual cost of broiler growing. Escalating land and property values in Western Australia that are far in excess of inflation only exacerbate the situation. (Inghams Enterprises submission on draft report, pp4-5)

Other Views

The Department of Treasury and Finance supported the view that the current “average price” regime is imposing costs that were not fully considered in the Authority’s draft report:

[A]dditional costs that might be considered include:

- whether the average price regime is preventing the development of alternative contracts and pricing arrangements that may promote efficiency and innovation in the Western Australian chicken meat industry; and
- whether the average price regime is increasing the costs of national processors doing business in Western Australia relative to other jurisdictions.

(Department of Treasury and Finance submission on draft report, p11)

4.4.2 Authority Assessment

The following section outlines the Authority's views on key disagreements between processors and growers regarding the model.

Efficiency of the Model

A key question, raised by processors, is how the notional model can be considered to be efficient when the actual price paid to growers is consistently below the gazetted fee (as shown in the graph presented by WABGA in Figure 4.1).

The Department of Treasury and Finance also commented on the difference between the gazetted and actual fees paid to growers.

The Act sets the notional gazetted growing fee based on the notional cost of production model (currently 80.57 cents per bird). While the Act is explicit that the notional fee be paid to growers (clause 16(1)), there is allowance for 'market factors' that allow for variations from the gazetted fee (clause 15(2)(c)). However, the WABGA describe the operation of the gazetted fee as:⁷⁷

On the gazettal of the Notional Model Fee, both processors will negotiate their individual fees based on this Notional Model reflecting the individual productivity and model size. This approach is a policy of shared responsibility between grower and processor to ensure an outcome that does not put the economical viability of either party at risk.

Both growers and processors described the operations of the gazetted fee as that the fee is never paid (current estimates are in Table 4.1), but is a default position in case negotiations break down. Effectively, growers could enforce the gazetted fee, so there is a powerful incentive for processors to settle for below the gazetted fee, even if it meant this was higher than would be paid in a bilateral negotiation. This is also helped by the growth and expansion provisions and the difficulty in removing growers from the pool for inefficiency (see below).

The Authority notes that, given that the growers would wish to bargain collectively, the growers' bargaining position must allow for the most expensive growers, or more correctly, the growers who need a high price to keep producing. This could be inefficient growers, but could also include growers who have just entered the industry.

If the Act were not in place, but collective bargaining occurred, processors would be willing to pay existing growers up to the cost of replacing growers with new production. That is, they would be willing to pay up to the cost of an efficient new entrant, which could be imports rather than local production. It would make little sense to replace existing production with more expensive new production. Under a collective bargaining arrangement this efficient new entrant price would flow through to all growers.

Processors may wish to be able to implement individual contracts for existing growers, but it is unclear whether they would be able to induce existing growers from collective bargaining. Under ACCC bargaining, a higher fee required to induce a new entrant into the industry could pass directly to existing growers; however, the Act increases the probability of the flow-through.

The effect of the average price regime is therefore to strengthen the bargaining position of the growers in this process, meaning that the growers' position is more likely to be agreed

⁷⁷ WABGA (July 2008), Review of the Notional Model, p9.

upon under negotiation than the processors. It also means that any price increase at the margin is more likely to flow through to existing growers, thereby raising the marginal cost of expansion.

It is therefore important that, if an average price regime is to exist, it represents the efficient costs of a new entrant. However, the Authority is not in a position to make a definitive judgement about whether the model represents an efficient new entrant or not. Therefore, if the Act is to continue to have a price setting function, the model should be reviewed and updated by an independent party (e.g. a consultant) appointed by the independent arbiter to reflect the cost of an efficient new entrant.

The independent party could also consider any other changes to the notional model, including productivity incentives, which might improve the incentives of both sides. This might include payment on an alternative basis (e.g. marketable bird weight) rather than a per bird basis, if the independent party concludes that this would better reflect the costs and benefits of both parties.

The cost of this review and update of the model should be borne equally by the growers and processors. While the work would be independent, both growers and processors should have the opportunity to input into the process and query model assumptions. The independent arbiter would make a final decision on any disagreements.

The problem with this method is that it requires the estimation of the costs of an efficient new entrant, which involves making averaging assumptions rather than being able to consider the individual circumstances of the next most likely entrant. The independent party would have to second-guess any productivity gains the new entrant might make that would drive the new entrant fee downwards, although removing the growth and expansion provisions would mean that the efficient production is more likely to occur than under the current arrangements.

This brings into question whether the notional model is an improvement on a market without the Act, as the true test would be the cost of actual expansion. The Authority notes interstate imports appear to be placing a price cap on local prices, regardless of the notional fee.

Growers have argued that the model acts as a deterrent to unscrupulous behaviour by processors, who are able to leverage their market power to reduce prices to growers, particularly once growers have committed large amounts of capital. However, the Authority accepts that processors are reliant on their growers as well and have no incentive to push returns so low that efficient growers might leave the market. Additionally, in a growing market such behaviour would limit the processor's ability to attract new entrants.

Perhaps most importantly, there is no evidence that the Act improves allocative efficiency relative to a monoposony market, or a market where the growers had ACCC authorised collective bargaining. Given the stagnation of the industry over the past decade compared with other States, the Authority considers it highly likely that it has been detrimental to dynamic efficiency of the industry.

Current Cost Accounting

The processors have been particularly opposed to the use of current cost accounting in valuing assets in the model. In their view, it is inefficient for growers who have old assets and have purchased their land many years ago to be paid on the basis of the current costs of their assets and land (particularly as land values have increased substantially in

the areas around broiler farms). The use of current cost accounting has been a matter of longstanding debate between the growers and processors.⁷⁸ The Committee commissioned independent advice on the valuation of the parameters in the model in September 2006 from the accounting firm GreerSullivan, which endorsed the approach used in the model, including the use of current cost accounting.⁷⁹

In the notional model:

- plant and equipment are valued at their written down replacement cost (their current cost net of accumulated depreciation), which is assumed to be 50 per cent of the current cost;
- the rate of return on plant and equipment 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;
- capital assets are fully depreciated over the life of the asset. Asset lives vary between 8 and 40 years, depending on the type of asset;
- land is valued at the average value of land suitable for broiler growing within each grower group (taking into account the planning and location constraints that apply to the establishment of a broiler farm);
- the rate of return on land is assumed to be 4 per cent (this rate has remained the same for all the model reviews);
- there is no depreciation on land or site works.

The processors would ideally like to pay growers on the basis of the actual condition of their assets and the extent to which they have paid off their land.⁸⁰ That is, they would like to be able to price-discriminate between their growers on the basis of their actual costs (which monopolists or monopsonists are able to do).

The Authority notes that the consultants GreerSullivan, who were engaged by the Committee, concluded that current cost accounting was appropriate for the Committee's purposes. However, GreerSullivan only looked at current cost accounting from an accounting standards perspective and not the impact such a method would have on the Western Australian chicken meat industry.

As discussed above, the true bargaining position by growers and processors in any bilateral negotiation is likely to be determined by the cost of an efficient new entrant, which will be valued in current cost terms. The key question, if the price setting function of the Act is to continue, is whether the notional model reflects this efficient new entrant. The above section makes several recommendations to improve the current system if the price setting function of the Act is to continue.

However, if there are growers who, with little reinvestment, have been able to keep assets running well past the notional asset life implied in the model,⁸¹ then it will give the growers excess returns. The consultant reviewing the notional model should examine this issue.

⁷⁸ For example, the matter was raised as a concern by processors in a determination on the growing fee by W.H. Crawford F.C.A. in April 1982 (cited in Attachment 5 to the submission by WABGA to the issues paper).

⁷⁹ This advice is also contained in the WABGA submission to the issues paper, Attachment 5.

⁸⁰ See last two paragraphs of Inghams Enterprises quote on p50.

⁸¹ From the 50 per cent write-down on the current cost of plant and equipment.

Comments on Model Inputs

The Authority has examined the model and its inputs for a series of years from 1993 to the current year. In the draft report, the Authority noted that the notional farm used as the basis for determining the costs of production appears, generally, to define the inputs that would be required for an efficient broiler operation that meets the regulatory requirements for the industry (a large farm with tunnel sheds, concrete floors, etc).

The Authority has not reviewed the model in full as to whether it is efficient in the sense that it represents the most efficient way of producing broiler growing services as it has no expertise to do so. The Authority has considered the single growing fee and current cost accounting in more detail as it believes that these factors have a much greater impact on the broiler growing market. If such a model is to continue then it should be reviewed by an independent consultant. Nevertheless, the Authority notes the following points of interest.

There have been differing views regarding the appropriate value of some of the model inputs.

- The Authority noted in the draft report that the labour costs assumed in the model appeared high (the model assumes labour costs for a full-time farm hand of \$90,526 in July 2010, compared to the current Western Australian average annual earnings of \$57,000).
 - Bartter Enterprises submitted that the salaries assumed for the farm manager and labourers were above the average wages for those categories in the 2006 Census (Bartter Enterprises submission on draft report, p20).
 - However, the WABGA argue that wages must be high enough to attract appropriately qualified staff into the industry (when they would be equally qualified to seek employment in the mining sector).
 - The WABGA also submitted graphs comparing total labour costs per bird for different chicken meat operations that showed that labour costs in Western Australia were below the national average, which is around 19 cents per bird for tunnel and conventional shedding around 23 cents per bird for free range (see WABGA submission on draft report, p6). The graphs showed that in some cases (such as for Inghams conventional shedding), Western Australian labour costs were the lowest in Australia.
- The Authority also queried the inclusion of a \$200,000 allowance for a worker's cottage. However, this can be explained by the need for permanent housing for workers, who are required to be on site 24 hours a day to be available for pickups and deliveries.
- The submission by Bartter Enterprises noted a number of instances where input values applied in the model appeared high relative to the input prices at the time.
- The model inputs include current cost estimates of inputs from the average of all growers (excluding outliers), including inefficient growers.⁸² This is likely to push costs higher in the model than the efficient new entrant.
- On the other hand, the Authority noted in the draft report that the rate of return on capital used in the model appears to be low relative to other industries.

⁸² WABGA, Review of Farm Model 2008, p14.

- 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.⁸³

⁸³ 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).

Final Findings and Recommendations

Efficiency of the Notional Model

- 10) The current system of average price setting is likely to substantially improve the growers' bargaining position relative to a market with authorised collective bargaining by growers, making the situation more like a bilateral monopoly.
 - The long-term efficiency impact of a bilateral monopoly over a monopsony market is unclear, with the main impact being a transfer of income from processors to growers.
- 11) The notional model aims to determine the costs of a notional efficient broiler operation. It is important that, if the price setting function of the Act is to continue, the model fee represents the fee that growers would be competing against in a market without the Act (the efficient new entrant).
- 12) If the growers are successful in negotiating a price close to their preferred bargaining position, then the impact on production (relative to a market with authorised collective bargaining) is unclear.
 - However, the Authority considers that the incentives under the Act to improve dynamic efficiency (i.e. to improve the productivity of the industry over time) are less than would be the case without the Act.
- 13) If the Act is to continue then the model should be reviewed and updated by an independent party (e.g. a consultant) appointed by the independent arbitrator to reflect the cost of an efficient new entrant.
- 14) The consultant should carefully examine useful asset lives in the model to ensure that growers are not compensated for the same asset more than once.
- 15) The Act requires clarification to reflect the actual relationship between the notional model fee, the gazetted fee and the average negotiated fee.
- 16) Current cost accounting could be used to value the efficient new entrant in a deregulated market, so can be used to value the notional efficient new entrant. However, the inputs to this calculation should not include an average of all existing growers.
- 17) The cost of this review and update of the model should be borne equally by the growers and processors.

4.5 Barriers to Entry and Exit in the Growing Sector

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 by new growers, or to prescribe how existing farms expand and thereby could hamper competition in the growing sector over the long term.

The 2004 NCC National Competition Policy Assessment of the Act concluded that:

The first right of refusal provision does not ultimately restrict entry into chicken growing because processors are free to not renew contracts with any existing grower (or, subject to contractual rights and obligations, to terminate a contract), and to contract with a new grower entrant to maintain growing capacity.⁸⁴

However, in the draft report the Authority recommended that, in the event of the legislation being retained, the regulations on growth expansion should be repealed. The Authority took the view that these regulations were likely to restrict competition by acting as a barrier to entry into the growing sector and that the costs of these restrictions were likely to outweigh the benefits. The Authority noted that no other jurisdictions have similar provisions for controlling entry into the growing sector.

4.5.1 Industry Views

Inghams Enterprises supported the Authority’s draft recommendation.

The control and approval of shedding does not encourage competition or improved efficiencies. It restricts the potential entry into the chicken meat industry of better equipped and more technologically advanced production systems that can produce more efficient, better quality, better yielding birds. This in turn results in higher quality, safer and cheaper chicken for the consumer. (Inghams Enterprises submission on the draft report, p14)

Bartter Enterprises 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)

⁸⁴ National Competition Council, *National Competition Policy Assessment 2004*, Chapter 14, p14.9.

The WABGA also concurred with the Authority's draft recommendation.

[T]his regulation has served the purpose in ensuring one of the most effective and efficient models in relation to size in Australia is WA. Amazingly again, super farms, i.e. 300,000 birds plus, are the order of the day. Without this regulation uniform growth that has occurred would not have been possible. (WABGA submission on draft report, p5)

4.5.2 Authority Assessment

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.

Economies of Scale

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.

In contrast to the dynamic efficiency arguments, 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 m² in 1992 to around 10,500 m² in 2010.⁸⁵ 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 m²), but beyond

⁸⁵ WABGA submission on issues paper, Figure 7 on p15.

this point there is a need for additional management and labour resources, which causes a jump in unit production costs. However, more information would be needed on the costs of production to establish the extent to which unit production costs are reduced as farm size increases.

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).

Counterbalance to Incentive of Processors to Seek Excess Capacity in the 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 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 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.

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. The processors submitted that there is currently a shortage of growers in the market. Further, there are other 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. In the absence of these legislative constraints on entry, 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.

Despite substantial increases in farm size, industry production has stagnated over the past decade and imports have increased (Bartter Enterprises submission on draft report, p18). This suggests that the economies of scale encouraged by the Act do not increase productivity as much as the dynamic efficiency being obtained in chicken meat industries in other States without such regulation.

The Authority therefore considers that these regulations should be repealed.

Final Findings and Recommendations

Regulations on Participation in Growth Expansion

18) 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.

4.6 Impact of the Act on Growth in Investment and Output

The Authority has received evidence from both growers and processors throughout this inquiry that there is a reluctance by growers to invest in new tunnel sheds. That is, there appears to be a hold-up issue in the industry, even under the current legislation (see section 3.4 for a discussion of investment hold-up). Another consideration is the impact of the Act on investment by processors.

4.6.1 Industry Views

Growers submitted that processors use their bargaining power in contract negotiations to try to get growers to convert to tunnel sheds, while growers are reluctant to make significant investments without contractual assurance of sufficient returns on those investments.

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 on issues paper, 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, 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 on issues paper, Attachment 1, submission by ER and JF Terrace)

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 on issues paper, Attachment 1, submission by Redmond Pty Ltd)

Inghams Enterprises submitted that:

The average condition of Ingham grower shedding is far below that of the eastern States. Very little advantage has been taken of any new technological advancement in broiler shedding within the last 10 to 15 years. (Inghams Enterprises submission on draft report, p13).

Inghams Enterprises has also informed the Authority that it will face some major investment decisions in its processing and other facilities.⁸⁶

Inghams Western Australia has a processing facility based in Osborne Park and a feed mill, hatchery and broiler farm based in Wanneroo. These facilities are under increasing pressure from urbanization. At some stage, depending on these and other pressures, a decision will need to be made regarding the future of these facilities. These decisions will be based on commercial viability and risk. The current legislative framework is making Western Australia less attractive for investment and it is therefore placing the continuation of and any possibility for expansion or relocation of Inghams Western Australia operations at risk.

4.6.2 Authority Assessment

As was shown in Figure 2.1 and Figure 2.2 in section 2.3.3, over the past decade there has been a decrease in the number of growers, an increase in the average size of broiler farms, but almost no increase in the total shed area by Bartter and Inghams growers, with the exception of one large (16 shed) farm on an individual contract with the Bartter group.

The figures suggest that small, inefficient farms have left the industry, with the remaining (more efficient) farms expanding in size. This would indicate improving efficiency if the existing farms were able to meet growing demand for chicken meat.

Confidential evidence from Bartter indicates that Western Australian chicken meat production has not grown substantially over the past decade and has not kept pace with other States. Bartter Enterprises estimates that 14 per cent of Western Australian consumption is serviced by imports from interstate.⁸⁷

This, combined with the lack of expansion in total shed area over this period, indicates that there is reluctance to invest in new capacity by both processors and growers, which has not been resolved by the current legislation.

In this regard, while the Act could potentially solve any hold-up issue for growers, it may contribute to a hold-up in investment in the processing sector. Inghams Enterprises has informed the Authority that it will need make a decision on whether or not to further expand their processing plant in Osborne Park, or to build a new processing facility, or to increase its imports from South Australia.

⁸⁶ Greig Smith, Inghams Enterprises, pers.com.

⁸⁷ Bartter Enterprises submission on draft report, MJA attachment p18.

Section 3.3.2 describes the bilateral bargaining that takes place between processors and growers regarding the capturing of returns by the two parties, and that the main impact of the Act in the short run is that the growers are likely to capture a greater share than if the Act were not in place. This means that growers could reduce processors' return on capital to below what the processor desires, but it is still worthwhile for processors to keep producing as long as they are getting some return. That is, fixed costs have little impact on production decisions.

However, in the long run where major investment decisions are involved, fixed costs and return on capital become critical. If processors felt that the current fee did not give them a satisfactory return on their current plant, they would be more reluctant to invest in new capital.

Obviously growers are aware of the looming investment decision for Inghams and it is in their interest for the investment to go ahead, so they would factor this into their bargaining position. However, processors also face a risk of "bait and switch" behaviour from growers; i.e. growers under the Act could potentially raise growing fees above those anticipated at the time of the processor's investment decision, resulting in lower than expected returns on capital. This adds additional risk to the project, making the investment less likely than would otherwise have been the case.

Evidence from RFM and ProTen (p37) indicates that processors are willing to offer long-term certainty for growers. Additionally, as noted above, there are multiple investment decisions by growers and if processors engaged in such behaviour, they would find that they would not be able to attract any new capacity into the industry in the future.

In contrast, processing investment occurs much less frequently, so such concerns will not factor as strongly in the processing investment decisions. Further, because of the concentration in processing capacity, this single decision would have a very large impact on the industry in Western Australia.

However, this is only one of a range of factors that the processor will take into account in making the investment decisions. It will have to consider risks regarding transport costs and the potential gains in scale efficiencies by its competitor in Western Australia before ceasing production in Western Australia and relying solely on imports. Conversely, scale and efficiencies in its South Australian plant and growing capacity might mean that the investment in Western Australia might not occur regardless.

In conclusion, while there are other factors that may be reducing the incentives to invest in Western Australia, such as rising costs due to competition from the mining industry and production efficiencies in processing in Inghams' South Australian plant, the Authority considers that the Act has been a contributor in the stagnation of investment and production in Western Australia.

Greater independence of the model (section 4.4) would help offset the impact of the Act on processor investment decisions, but it is unclear whether this would be enough to remove the risk entirely. In particular, any standard fee lessens the chance of innovative individual arrangements that might benefit both parties.

Final Findings and Recommendations

Growth in Investment and Output

- 19) The Authority considers that the Act is likely to deter future processing investment in Western Australia, although it is only one of a range of factors that will influence investment decisions.

4.7 Growth in Productivity

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. Other productivity measures may be driven by consumer preferences or retailer demands; for example, the percentage of breast meat, or the number of marketable birds. Productivity improvements could be the result of improvements in housing facilities, feed quality, medicines, genetic stock, or management practices.

The pool payment systems set out in the contracts to growers provide some incentive for growers to achieve productivity improvements, as the payments structures reward growers who achieve higher productivity relative to growers who achieve lower productivity. The performance measures include some productivity indicators (such as feed conversion ratio, bird weight, mortality), but may not capture all of the productivity factors (e.g. percentage of breast meat).

Processors claim that their preference for tunnel sheds is based on the higher productivity of tunnel sheds compared to conventional sheds. It is easier to achieve accurate temperature control in a tunnel shed than in a conventional shed, and there is evidence that high temperatures can lead to a lower meat yield, in particular the breast meat.⁸⁸

This is not to say that tunnel sheds will always perform better than conventional sheds.

- WABGA provided comparisons to the Authority showing that, with good management, conventional sheds can achieve higher productivity than tunnel sheds, particularly if tunnel sheds are not stocked at their full capacity (see Table 4.4 below). The top pool payment for one of the grower groups is often achieved by a conventional shed owner.
- In the draft report the Authority noted that, based on the notional cost model, the move to tunnel sheds has not resulted in marked improvements in productivity, with a 29 per cent increase in input costs required to achieve a 24 per cent increase in the number of marketable birds. However, the Authority accepts that the measurement of productivity in chicken meat production is complex and that all productivity factors would need to be taken into account to draw any conclusions. Further, there is no data on productivity performance in other States to make any comparisons of the relative productivity of Western Australia. The Authority has therefore not further examined productivity for this report.

⁸⁸ For example, Dagher, N. J. (2009), "Nutritional strategies to reduce heat stress in broilers and broiler breeders", *Lohmann Information*, 44(1):6-12, which cites several other studies with the same finding.

Table 4.4 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

Source: WA Broiler Growers Association

However, it is most likely that tunnel sheds will, on average, achieve better productivity than conventional sheds. Tunnel sheds provide a more controlled environment for raising birds than a conventional shed (assuming both are well functioning and well managed). New entrants and expansions to the industry are exclusively tunnel sheds and the notional model of an efficient new entrant is based on a large tunnel shed operation. Even if the move towards tunnel sheds is driven by the processors, this is because processors are of the view that this technology is the best means of achieving the requirements set by retailers.

The Act has not provided the contractual security or financial incentives needed by growers to invest in new tunnel shedding. Thus, to the extent that tunnel shedding improves productivity, this means that productivity improvements could have been higher if incentives to invest had been greater.

The Authority also notes that dynamic efficiency in an industry can be harmed if disproportionate levels of resources are directed by industry participants on improving their bargaining outcome, rather than on improving efficiency.

4.8 Impact on Imports

This section examines the relationship between the Act and the level of imports of chicken meat from interstate.

4.8.1 Industry Views

Bartter Enterprises submitted that the falling cost of importing chicken meat from interstate provides a limit to growing fees in Western Australia. Bartter submitted that the cost of transporting chicken from South Australia has fallen, from over 40c per bird in 1975 to a 10-year average from 2000-2010 of around 22c per bird, and that the current gazetted fee exceeded the landed cost of imported broilers from South Australia (Bartter Enterprises submission on draft report, p12-14)

Bartter Enterprises submitted that:

- Western Australia's share of national broiler production between 2005 and 2010 has decreased by 2.4% from the 1987-1997 average of 10.02%; and
- between 2008-2010, processors imported approximately 14.0% of all chicken meat consumed in Western Australia.

(MJA report, p2-3, attachment to Bartter Enterprises submission on draft report)

Inghams Enterprises submitted that:

Since legislation was removed in the eastern States, the poultry industry in these States has expanded and flourished to the extent that in excess of 250 tonnes per week of poultry meat is flooding into Western Australia. (Inghams Enterprises submission on draft report, p15).

4.8.2 Authority Assessment

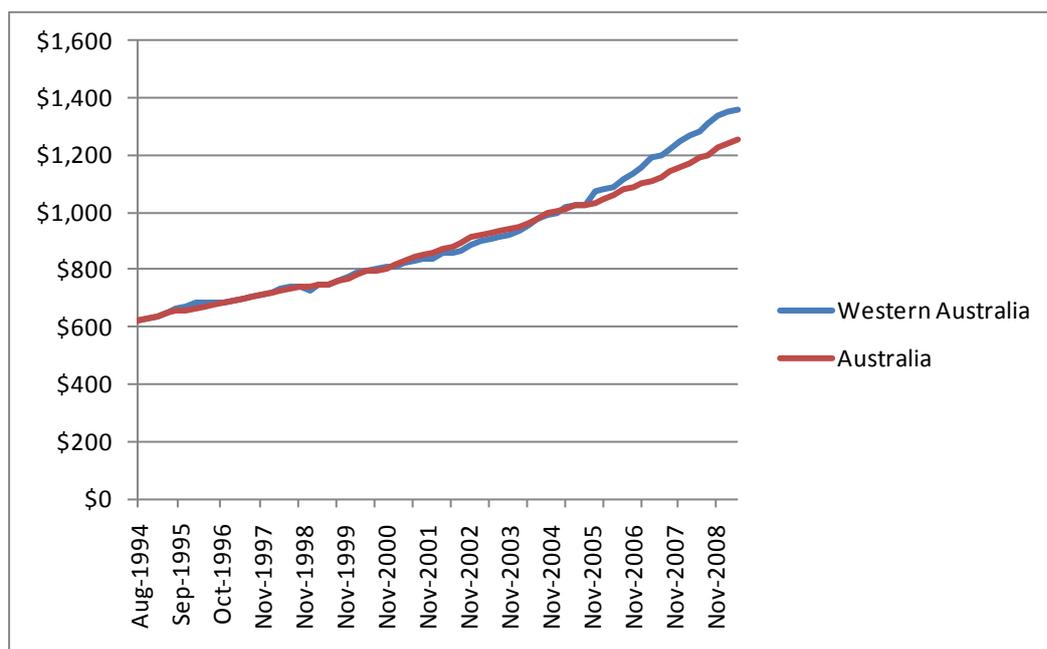
Bartter Enterprises (p18) notes that imports now account for around 14 per cent of Western Australian chicken meat production, whereas a decade ago there were little or no imports. The impact of the price setting functions of the Act is likely to worsen this situation, although it is unclear how large the effect will be.

As noted in Section 4.2.1 above, the effect of a monopsony buyer is to reduce its purchase of broiler growing services to below the economically efficient level. If processors are able to price discriminate in other States, this will give further incentive to import rather than produce domestically.

The Act formalises a single price, even if the negotiated average price is different from the gazetted fee. It lessens any chance of price differentiation and reduces the chance of industry expansion. However, it is unclear whether this situation will change greatly if the price setting functions of the Act were repealed.

Nevertheless, there are substantial economic forces that impact on this industry and almost every other non-mining industry in the State. The Western Australian economy has grown rapidly in recent times, with the Gross State Product growing by 46.1 per cent from 2000-01 to 2008-09, compared with 26.3 per cent for the rest of Australia. Rapid expansion in the State's resources industry has been responsible for much of this growth (ABS Cat.No. 5220.0).

Demand for labour and other materials from the mining sector has pushed up costs for the remainder of the economy, but these other sectors may not have experienced the same increase in demand as has mining. The result has often been a squeeze on costs and/or the ability to source required labour and materials at lower cost levels. Both growers and processors cited pressure from the mining industry, particularly for labour, as constraints on their current businesses.

Figure 4.2 Average Weekly Full-Time Adult Earnings for Australia and Western Australia

Source: Australian Bureau of Statistics, Catalogue No. 6302.0

Additionally, with the help of a \$7 million Federal Government subsidy, Inghams Enterprises has recently invested in a \$130 million (1.2 million birds per week) processing factory in South Australia. It is believed that this has given the company substantial efficiencies and has made imports even more competitive.

The example of milk products indicates that cost differentials can lead to interstate imports, despite refrigeration requirements and the large distance between Western Australia and other States. While no data for interstate trade exist, a selection of high-value eastern States produced cheeses, yogurts and sour cream (amongst other products) are available in Western Australian supermarkets. This indicates that, for value-added products, shipping from the eastern States is very competitive with local production. However, for low-value added market milk, local production is preferred.

Against this argument is that much of the imported product is fresh chicken meat and not a high value added product, indicating that the structure of the industry is encouraging imports over local production.

Overall, there are currently difficulties for any industry in Western Australia and chicken meat growing and processing is no exception. These factors could mean that the industry could contract regardless of what is being caused by the Act, or would be caused by its removal.

Final Findings and Recommendations

Impact of the Act on Imports

- 20) The Act is likely to have favoured imports over expanding local production, compared to what would be the case under authorised collective bargaining, by facilitating grower fees above the minimum efficient cost. However, higher costs in Western Australia, driven by the mining industry, are also likely to have played a role in reducing the relative competitiveness of chicken meat production in this State.

4.9 Impacts on Retail Chicken Meat Prices

A further question is whether a higher growing fee, if this were to result from the implementation of an average price regime, would be passed on to consumers in the form of higher chicken meat prices.

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.

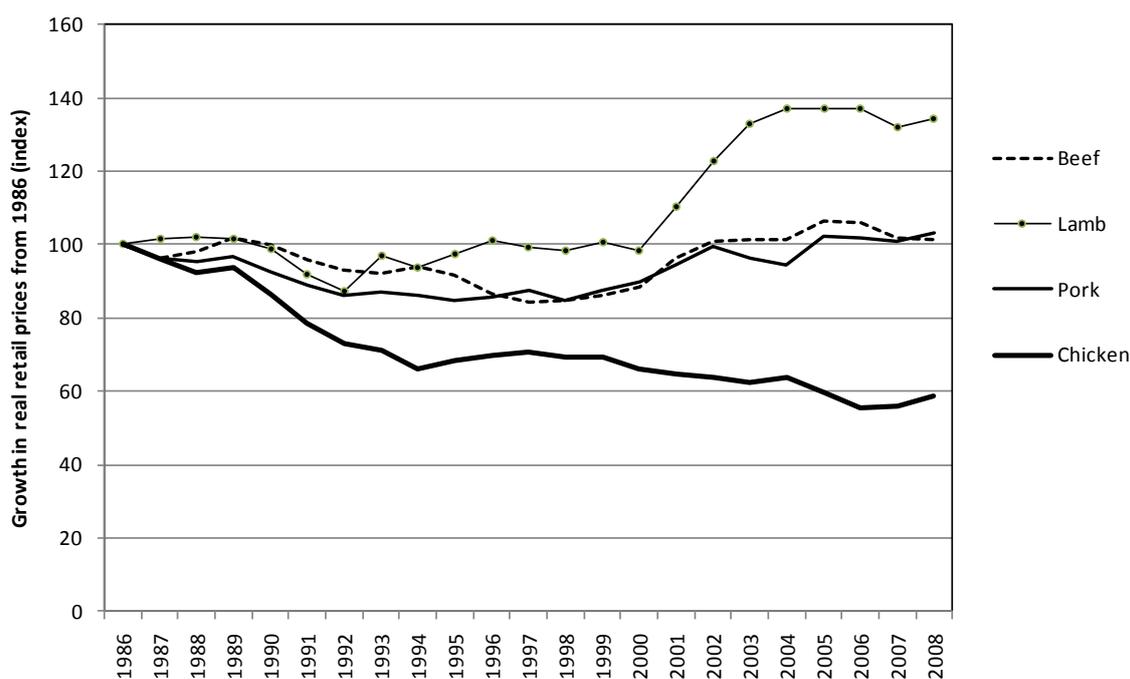
- Since the amendments to the Act following the National Competition Policy review in 1997, prescribed form agreements are not compulsory, and growers in Western Australia have the ability to enter into individual contracts with their processor. As indicated in Table 2.4, seven growers in Western Australia are on individual contracts.
- As discussed in section 2.3.4, there is a countervailing pressure on retail chicken meat prices due to a competitive retail sector, with large retailers able to exert some market power on processors.
- The bargaining power of growers is also limited by the potential for imports of chicken meat from interstate.
- The growing fee is small in relation to the retail price for chicken. The gazetted growing fee of 80.57 cents per bird is around 10 per cent of the retail price of whole chickens in the supermarkets, while the actual fee paid to growers of around 71.5 cents is less than 9 per cent.

- WABGA submitted that the growing fee represents 10.7 per cent of the average cost of production of processed chicken meat (WABGA submission on issues paper, p9).
- However, Inghams submitted that in 2009-10 the grower fee was 18.66 per cent of their broiler production costs, which Inghams considered as significant (Inghams Enterprises submission on draft report, p8).

However, the Authority also notes that there is the potential under the Act for considerable costs to be passed through to consumers, if the gazetted price were to be enforced (an extra \$4 million per year due to the most recent increase in the gazetted fee).

Chicken meat prices have risen much more slowly over the past three decades than the prices of other meats, which indicates substantial expansion in supply relative to other industries, most likely through productivity gains. It also means that any productivity gains have largely been passed through to consumers through lower prices (relative to other meats). This is shown in Figure 4.3, which shows that chicken meat retail prices have declined in real terms since 1986, while beef and pork prices have remained relatively constant over this period and lamb prices have increased.

Figure 4.3 Growth in Real Retail Prices (Dollars of 2008) Since 1986 for Beef, Lamb, Pork and Chicken Meat



Given this historical pattern of productivity pass-through to consumers, the Authority considers that, even though the cost of broiler growing services is a relatively small part of the retail price of chicken, any reductions in the growing fee would be largely passed through to consumers, with processors and retailers gaining through increased throughput.

While the impact on individual retail prices of changes in the Act might be small, the total benefit to consumers could be considerable.

Final Findings and Recommendations

Impact on Retail Chicken Meat Prices

- 21) Any price efficiencies resulting from reforming the *Chicken Meat Industry Act 1977* are likely to be passed through to consumers in the form of lower prices.

4.10 Prescribed Form of Agreement Between Processors and Growers

In the draft report, the Authority's draft finding was that 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.

- The prescribed form agreements provide a statutory basis for minimum terms and conditions in growing agreements, which can be referred to in dispute resolution by the Committee.
- 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 arguments for and against the prescribed form agreements mirror those associated with the average price regime.

- The growers are of the view that the prescribed form agreements provide them with some protection regarding the minimum terms and conditions of their contracts, supported by the dispute resolution and arbitration powers of the Committee under the legislation.
- The processors, on the other hand, maintain that the prescribed form agreements stifle innovation and efficiency improvements, in that they prevent other forms of contracts from emerging, which could have advantages over the prescribed form contracts. Further, the processors argue that the current dispute resolution framework is not sufficiently independent and is biased in favour of growers.

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.

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

The Authority's assessment of alternatives to the prescribed form agreements is on the basis of its earlier recommendations, that any dispute resolution mechanism under revised legislation would be independent.

Alternative Approaches

In the absence of the Act, it is likely that growers would be offered standard form contracts by their processors setting out the terms and conditions of the growing agreement. Parties would be reliant on the dispute resolution processes in those contracts and associated protections under Australian contract law to ensure the specified terms and conditions are fulfilled.

The balance of bargaining power between growers and processors, if there is no collective bargaining, means that growers can be vulnerable to the erosion of their terms and conditions, particularly at the time of contract renewal. Regulatory intervention can be used to provide additional protection to growers regarding their contractual rights.

- One justification used by the ACCC for authorisation of collective bargaining is to protect growers from processors' misuse of their greater bargaining power in the negotiation and execution of contracts.
- In some States, statutory committees deal with issues of contract terms and conditions (but not price).
 - The Queensland Chicken Meat Industry Committee can make recommendations to growers and processors regarding the minimum conditions of their agreements and other issues affecting their industry and can refer disputes about agreements to arbitration. However, it cannot make recommendations or provide information to growers or processors about growing fees or how they are determined.
 - There is a question as to whether such a committee needs government involvement. As noted in section 3.5.1, the Queensland government has decided to abolish the committee and the current review of the Queensland legislation is considering whether to transfer the functions of the committee to a non-statutory, industry-run company, with an authorisation under Part 4 of the *Trade Practices Act 1974* to collectively negotiate.
 - The NSW *Poultry Meat Industry Act Regulation 2008* prescribes the matters that must be addressed in growing agreements (but not the details on how those matters should be addressed, or the fees that should be paid to growers).
- In the United States, where growers negotiate individual contracts with their processors, the US Department of Agriculture (**USDA**) 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.⁸⁹ 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).

Regulation could provide additional protection to growers by legislating the minimum terms and conditions to be included in growing agreements. However, such provisions

⁸⁹ 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.

would need to be independently reviewed to ensure that they meet best industry practice. Also, in line with earlier recommendations on the independent mediation and arbitration of disputes, the costs of resolving disputes in relation to legislated minimum contract terms and conditions would be higher than under the current regime.

A more important question is whether such protections are necessary, given the protections that are available in other legislation relating to business contracts. The Authority has sought advice on this matter, which has indicated that there are likely to be sufficient protections available under the *Trade Practices Act 1974* and the *Fair Trading Act 1999* for both growers and processors in their contractual dealings. The provisions in the prescribed form agreement reflect fairly standard terms and conditions that would be expected in a contract between growers and processors, so it is difficult to justify separate legislation particular to the chicken meat industry, compared with any other industries involving contracts between parties.

The Authority's view is that collective bargaining may be effective in providing growers with greater input into the terms and conditions of their contracts. There may also be a role for an industry-based committee to develop a code of conduct regarding the matters that should be addressed in contracts, but the Authority's view is that such a committee would not require government involvement or legislation.

The Authority's view, therefore, is that prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements, as there are sufficient protections available under Australian contract law.

Final Findings and Recommendations

Prescribed Form Agreements

- 22) Prescribed form agreements are not necessary to provide additional protection to growers regarding the minimum terms and conditions of growing agreements as there are sufficient protections available under Australian contract law.

4.11 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).

4.11.1 Industry Views

The Department of Treasury and Finance submitted that the costs of data collection and updating of the model should be taken into account.

While these costs are provided free of charge, a more useful comparison would be to compare the administration costs associated with running and updating the model with the costs of negotiating contracts and grower prices in the absence of an average price setting regime. (Department of Treasury and Finance submission on draft report, p12)

4.11.2 Authority Assessment

The Authority notes that in addition to the acknowledged administration costs under the current regime, there are also likely to be substantial hidden costs, in terms of the time involved by industry participants, for example, in attending and preparing for meetings, and maintaining and updating the cost of production model.

As indicated in section 4.4.2, the Authority is of the view that the average price regime, to be workable, would need to be administered and reviewed by a body independent of growers and processors.

While it is difficult to assess the amount of time and degree of expertise required to maintain and review the model, the Authority estimates that independent administration of the model could cost over \$23,000 per year (assuming three hours per week at a cost of \$150 per hour, which is the hourly rate for a junior accountant, engineer or economic analyst). A full independent review of the model (every three years) by an economic consultancy or accounting firm could cost between \$50,000 to \$100,000.

In the absence of the Act, the administration costs associated with the Chicken Meat Industry Committee would be avoided. However, if growers were offered individual contracts, they would each need to incur additional administration costs associated with negotiating individual contracts with their processor. As noted by the ACCC, collective bargaining between growers can reduce administration costs by avoiding the duplication of administrative activities involved in negotiating individual contracts.

The administration costs under an authorised collective bargaining arrangement would be similar to those under an amended legislative regime (i.e. with independent model administration and arbitration mechanisms).

- A model may well be used in an authorised collective bargaining arrangement as a tool to assist with negotiations over growing fees. However, the Authority would recommend that such a model also be independently maintained and reviewed if it is to achieve acceptance by both parties to the negotiation.
- There are some additional costs associated with the application process for ACCC notifications and authorisations (costs of preparing the application, and application fees of \$1,000 for notifications, \$7,500 for authorisations, and \$2,500 for applications for revocations or substitutions of existing authorisations). These would be incurred at the start of the arrangements, which are usually granted for periods of three to six years.

Final Findings and Recommendations

Administration Costs

- 23) Administration costs under the current regime are low, but would increase significantly if the fee model were to be independently administered and reviewed.
- These higher administration costs are likely to be similar to those under authorised collective bargaining arrangements.
- 24) Administration costs under individual bargaining would be higher than under collective bargaining, due to the duplication of administrative tasks.

4.12 Dispute Resolution and Arbitration Costs

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.

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”.⁹⁰

4.12.1 Industry Views

Growers’ Views

The WABGA submission on the issues paper and individual growers’ letters as part of that submission 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 growers 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 on issues paper, 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 on issues paper, Attachment 1, individual growers submissions, BJ & R Enterprises).

⁹⁰ Department of Agriculture (December 2003), *Review of the Chicken Meat Industry Act 1977*, p5.

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. (WABGA submission on issues paper, Attachment 1, individual growers submissions, ER and JF Terrace)

The WABGA 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 growers oppose the repeal of the Act, citing evidence from other States that the loss of such legislation would lead to a large number of legal disputes between growers and processors. The WABGA submission on the issues paper listed 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 on issues paper, 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.

Processors' Views

The processors maintain that the arbitration process under the Act was ineffective, due to the disengagement of processors from the Committee. Bartter Enterprises submitted that:

In an effective arbitration process, discussions should not break down to the point where one side disengages from the process entirely. However, the inability of processors to influence the CMIC's deliberation process has become so pronounced that processors have "abstained from participating in the CMIC meetings and fee review process" (Bartter, 2010, p.2) altogether. (MJA report, p7, attachment to Bartter Enterprises submission on draft report)

The processors agreed with the growers that there are strong incentives under the current legislation for the parties to avoid arbitration by the Committee. As noted by Inghams Enterprises:

...there is a substantial incentive in the current legislative process for processors to settle on a grower fee in fear of paying the higher gazetted fee. (Inghams Enterprises submission on draft report, p12)

Inghams submitted that the deterrent effect of the legislation derived from the threat of the gazetted fee being enforced.⁹¹ The current gazetted price is 9.07 cents per bird higher than the actual fee paid to Inghams growers. Assuming an annual production of 38 million

⁹¹ Inghams Enterprises submission on the draft report, p12.

birds per year by growers under the Act, this would amount to \$3.45 million per year.⁹² Inghams submit that this cost “is much higher than the cost of mediation and arbitration under authorised collective bargaining.”

Bartter’s consultants reviewed the dispute resolution mechanism contained in the Act and concluded that it was inconsistent with best practice procedures (consistent with the principles of arbitration set out in the *Commercial Arbitration Act 1985*).⁹³

The processors submitted that individual contracts contained sufficient arbitration and dispute resolution provisions. Inghams Enterprises set out in its submission the dispute resolution process that is included in its national broiler chicken growing agreement (see pp9-10 of Inghams submission on draft report). In summary, in the event of a dispute between a grower and the processor, the parties in Western Australia are required to:

- notify the other party of the dispute in writing;
- use their best efforts to resolve the dispute within seven days of notification;
- if the dispute is not resolved within seven days, appoint a mediator (or if they can’t agree on a mediator, have one appointed by the Chairman of the Law Society of Western Australia);
- agree in writing on the mediation terms and procedures (or if they can’t agree, use rules and procedures provided for by the Supreme Court of Western Australia);
- if mediation fails, appoint an arbitrator (or if they can’t agree, have one appointed by the Chairman of the Law Society of Western Australia). The arbitrator must not be the same person as the mediator. The parties must agree to the arbitrator’s decision being final and binding;
- bear their own costs of dispute resolution, share equally the costs of mediation and bear their share of the costs of arbitration as determined by the arbitrator; and
- agree that they will not refer a dispute to any committee or other body established under [Chicken Meat Industry] legislation.

Inghams Enterprises noted that:

...there is nothing in the legislation preventing the processor or grower from challenging the decision of the [Committee] in the courts which would escalate the costs of arbitration through this process further. (Inghams Enterprises submission on draft report, p12)

Bartter Enterprises disagreed with the Authority’s draft finding that arbitration and dispute resolution costs under the Act were likely to be lower than those under authorised collective bargaining arrangements.

The ERA’S finding is based on the assumption that dispute resolution under the Act will achieve similar outcomes to arbitration under the *Commercial Arbitration Act 1985*. However, there is evidence to demonstrate that the Act does not provide effective and efficient dispute resolution mechanisms. (MJA report, p6, attachment to Bartter Enterprises submission on draft report)

MJA argued that under the arbitration mechanisms contained in ACCC authorised collective bargaining arrangements, arbitrators:

⁹² Inghams assume 50 million birds per year, but this figure includes growers who are on agreements outside the Act.

⁹³ MJA report, p2, attachment to Bartter Enterprises submission on draft report.

- have stricter selection requirements than those established for the selection of independent Committee members, in that arbitrators may be agreed by both parties or appointed by the Institute of Arbitrators or Mediators Australia; and
- are bound by the principles set out in the *Commercial Arbitration Act 1985*.

Other Views

The Department of Treasury and Finance submitted that the current regime does not eliminate disputes:

[H]aving an average price regime does not eradicate disputes between growers and processors. Of the four recent disputes taken to the Committee for adjudication, two concerned the derivation of the average price model. (Department of Treasury and Finance submission on draft report, p14)

4.12.2 Authority Assessment

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 model. This provides a deterrent effect on all parties against entering into disputes involving excessive demands that diverge too far from the model. As a result, the arbitration costs under the Act have been minimal.

However, if the deterrent effect of the gazetted fee is too strong (as claimed by processors), this can result in a fee that is too high (see section 4.4).

The Authority accepts that the current mechanism cannot be said to be effective if one party to the negotiations has withdrawn from the process. In line with the earlier recommendation to increase the independence of the Committee and the administration of a model, the Authority recommends that any dispute resolution through the Committee should involve the appointment of an independent arbitrator (e.g. by the Institute of Arbitrators and Mediators Australia). This would involve additional costs.

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. However, collective bargaining arrangements can provide scope for the sharing of arbitration costs between growers.

The Authority has examined the experience in other States to determine the level of formal disputes and arbitration (either through industry committees or the court system). Evidence has been provided by growers regarding numerous disputes with processors over contract negotiation (which can often be long, hard fought and difficult) and grower payments, often involving delays in contract renewal or the threat of non-renewal of contract. However, the Authority has found that relatively few cases have been escalated to formal arbitration by industry committees or the courts, considering the number of growers in each State (see review of other States in section 3.5).

If the Act were repealed, the arbitration and dispute resolution processes would be those specified in individual contracts. It is essential that these are consistent with best industry practice and provide sufficient protection to growers regarding their returns and contract

terms and conditions. However, the Authority's view is that such provisions can be successfully agreed between grower groups and processors in contract negotiations and that collective bargaining by grower groups can help to ensure that grower concerns are addressed.

Final Findings and Recommendations

Dispute Resolution and Arbitration Costs

- 25) The dispute resolution and arbitration mechanisms under the current legislation are low cost, but are not operating effectively. Appointment of an independent arbitrator to resolve disputes would be highly desirable, even though it would increase costs.
- 26) Dispute resolution under authorised collective bargaining arrangements or individual contracts requires independent, best practice dispute resolution processes in order to avoid substantial legal costs to industry participants.

4.13 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.⁹⁴

The transaction costs associated with an amended legislative regime (incorporating an independent pricing model) is likely to be similar to that under an ACCC authorised collective bargaining arrangement, since both approaches involve collective negotiations by growers with their processor.

It is difficult to quantify the savings in transaction costs associated with the current legislation (or an amended legislation), relative to what they would be under a market without the Act and based on individual contracts. The benefits of lower transaction costs 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.

However, if the Act and Committee were reformed as suggested in sections 4.3 and 4.4, the administrative cost of the Act would increase dramatically. This would lessen the advantage of the Act over commercial mediation and arbitration on a case-by-case basis. The Authority has not examined the exact costs of each method, but the Act would likely retain some advantage, although a reduced one over the Authority's view in the draft report.

⁹⁴ For example, ACCC (21 April 2010) determination on collective bargaining by chicken meat growers in Victoria.

Final Findings and Recommendations

Transaction Costs

- 27) It is likely that collective bargaining, under ACCC authorisation or through a legislative mechanism that includes an independent pricing model, would result in similar savings in transaction costs relative to individual agreements.

5 Options for Reform

The Authority considers that the *Chicken Meat Industry Act 1977* must be substantially reformed or repealed. The chicken meat industry in Western Australia has stagnated over the past decade, partly due to the current Act, and future key investment decisions by processors are in doubt due to the current arrangements. While the Act does allow growers to capture a greater share of returns than if it were not in force, it does not result in any gains to wider society.

The Authority concludes that the existing arrangements should not be continued. In the absence of effective competition, two options exist for reforming the arrangements:

- 1) Option 1 – Reform the Act and the Committee; or
- 2) Option 2 – Repeal the Act.

5.1 Option 1: Reform the Act and Committee

This option reforms the Committee to a form that would give the industry outcome that would best improve economic efficiency. This is outlined in Chapter 4, but would include:

- Replacing the existing chairman and independent members with an independent chairperson, such as a professional arbitrator.
- Removing the regulations on participation in growth expansion, as recommended in the draft report.
- Implementing a less restrictive mechanism for removal of growers from the pool for poor productivity performance.
- The independent chair would commission a consultant to review and update the model based on an efficient new entrant.
- The consultant would need to determine new efficiency mechanisms and consider alternative bases for payment to growers (e.g. per weight rather than per bird).
- The model would be maintained and updated by the independent consultant and reviewed periodically by another independent party.
- The cost of the independent review and administration of the model would be paid for equally by the processors and growers. It would increase the cost of the Act substantially from the current model. However, it is still likely to be cheaper than frequent mediation and arbitration that would arise in the case where review and administration of the model is not independent.
- The gazetted fee would continue to be a default position that could be enforced by the Committee if negotiations between growers and processors broke down. The Act would be changed to reflect this role for the gazetted fee from the current legislation.
- The Committee would continue to administer prescribed form agreements, with the final decision on the content of the agreement to be decided by the independent arbitrator if the two parties could not reach a decision.

5.1.1 *Different Gazetted Fee for Different 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.

5.1.2 *Price Flexibility*

The capacity for processors to offer above the negotiated average fee should exist. This is because some growers are on land that is very valuable for other purposes (e.g. housing) and if only offered the negotiated average fee, might decide that they would be better off by leaving the industry and selling their land. However, if the cost of expanding production in a new operation is exorbitantly high, the processor might be better off to offer the existing grower above the adjusted gazetted fee to stay in production without affecting the rest of the group.

Final Findings and Recommendations

Differences in Productivity between Grower Groups

- 28) If an average price regime were to be retained, the model should allow for the determination of different average fees for each grower group to reflect the specific demand and supply conditions within each group.

5.2 Option 2: Repeal the Act.

The second, and processor preferred, option is to repeal the Act. The Western Australian industry would move towards the structure of those in other States with a mix of individual contracts and authorised collective bargaining.

- The growers would most likely seek and gain ACCC Authorisation to bargain collectively, which means an average price still might exist, which would give a bias against expansion.
- Nevertheless, with the backstop of the gazetted fee removed, processors may be able to offer higher fees for new capacity without affecting the price that they pay to the collective growers.

- Protections to industry participants regarding contract terms and conditions would be the same as those available to contracting parties in other industries under the *Trade Practices Act 1974* and the *Fair Trading Act 1999*.

5.3 Summary of Costs and Benefits of the *Chicken Meat Industry Act 1977*

Overall, the benefits of *Chicken Meat Industry Act 1977* in its current form do not outweigh its costs. The single fee based on the notional model, given a monopsonistic market for broiler growing services provides a disincentive for processors to expand. The Authority is of the view that this, together with rising costs and increasing import competition, is a major reason why there has been very little expansion in total shed area or meat production over the past decade.

Two options have been considered by the Authority: Option 1, which is to reform the Act; and Option 2, to repeal the Act.

Overall, the Authority considers that Option 2 is preferred. The reasons for this are:

- Intervention in private markets requires a compelling case that Government involvement can improve the outcome from a whole-of-community perspective.
- In this case, while there are substantial gains and losses to the growers and processors, there is no evidence that the Act has a net benefit for society. There is no clear reason why Government should favour one party or the other in such a situation.
- The Authority accepts that just as growers are dependent on processors, processors are also dependent on growers and must offer a commercial return to ensure production and growth.
- Repealing the Act will make reinvestment in the State by processors more likely, although not certain.
- The growers have some protection from potential ACCC authorisation of collective bargaining. Also, processors have an incentive to retain efficient growers, as the potential replacement cost could be much higher. In this regard, imports would become much less attractive once the single fee is removed.
- Regardless of how closely the reformed notional model under Option 1 is to the true efficient cost of expansion, the price setting function of the Act does nothing to prevent the efficiency loss arising from the concentration of production amongst two major processors.
- Under Option 1, if barriers to entry are removed, the negotiated price could not exceed the price paid to the actual next efficient new entrant and imports, regardless of what the notional model said.
- If the Act were repealed, while there is no certainty, there is a greater probability that processors will be able to separate the cost of the next possible expansion from prices paid to existing growers (i.e. to price differentiate) than under the Act. This would lower the cost of expanding the industry and favour local production over imports.
- The Authority considers that the hold-up issue and bait and switch tactics by processors on growers would be much less successful in a growing market, because if processors were unscrupulous in offering poor contracts once initial

capital investments had been made, potential new growers considering entering the industry would become aware of these practices and the processors would fail to get the expansion they needed.

Final Findings and Recommendations

Costs and Benefits of the Act Compared to Alternative Approaches

- 29) The benefits of the *Chicken Meat Industry Act 1977* are unlikely to outweigh its costs.
- 30) There are likely to be alternatives available for strengthening the bargaining power of growers, such as authorised collective bargaining, that would not have the costs associated with the Act.
- 31) The *Chicken Meat Industry Act 1977* should be repealed.

5.4 Implementation Issues

The Authority notes that if the Act is repealed adjustment costs may be incurred, especially for those who have just entered the industry and have incurred high debts on the expectation of a revenue stream based on the prices derived from the notional model under the Act. The adjustment costs have been considered by the Authority in reaching its final recommendations. In making its decision the Authority has had to consider likely aggregate costs to society as a whole.

The Authority accepts the growers' argument that they have few alternatives for their production facilities. The Authority does note, however, that some growers own land that has considerable value as residential land. Nevertheless, the Authority accepts that not all growers have such options and it is possible that, if the Act is repealed, some growers could be financially disadvantaged during the transition.

However, the Authority notes that processors are dependent on growers and it is not in a processor's interest to force the price down so low that some technically efficient growers would leave the industry. If a processor were to drive price down to a level that bankrupted an indebted grower, the processor would have to replace that production, which, unless the grower were particularly inefficient, could be more expensive than the lost production.

The experience in South Australia, Queensland and Victoria has shown that, despite considerable grower concerns in these States preceding the move away from industry regulation, new contracts have been signed and new capital investment has been attracted to both the growing and processing sectors.

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>Environmental 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 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
NCC	National Competition Council
NCP	National Competition Policy
TPA	<i>Trade Practices Act 1974</i>
USDA	United States Department of Agriculture
VFF	Victorian Farmers Federation
WABGA	Western Australian Broiler Growers Association