



TEGEL FOODS LIMITED

**SUBMISSION IN RESPONSE TO STATEMENT OF PRELIMINARY ISSUES
DATED 8 OCTOBER 2021**

5 NOVEMBER 2021

PUBLIC VERSION



1. Introduction

- 1.1 This submission is made in response to the Commerce Commission's (**Commission**) Statement of Preliminary Issues published on 8 October 2021 (**SoPI**) in relation to an Application for Authorisation of a Restrictive Trade Practice from the New Zealand Tegel Growers Association Incorporated (**NZTGA**) dated 15 September 2021 (**Application**) to allow it to engage in collective bargaining with Tegel Foods Limited (**Tegel**) on behalf of its members.
- 1.2 Tegel opposes the grant of authorisation. The restrictive trade practice for which NZTGA seeks authorisation is not likely to result in a benefit to the public which would outweigh the resulting lessening of competition; to the contrary it would have clear public detriments.
- 1.3 Unless otherwise defined in this submission, capitalised terms have the same meaning as used in the SoPI.
- 1.4 We attach a report from NERA in support of this submission (**Second NERA Report**).

2. Jurisdictional threshold

- 2.1 NZTGA has applied for authorisation under s 65AA(2) and (3), or alternatively s 58(1) and (2), of the Commerce Act 1986 (**Act**). The Commission is consulting on whether it has jurisdiction under these sections to authorise the Proposed Arrangement.
- 2.2 The Commission does not have jurisdiction to authorise the Proposed Arrangement under s 65AA(2) and (3) because it does not relate to or support a response to COVID-19. The events giving rise to the application occurred before the arrival of COVID-19 in New Zealand.
- 2.3 Sections 65AA-65AE set out temporary new processes for authorisation applications made "*during epidemic period*".¹ The provisions have short term application, expiring "*at the close of the 6-month period that starts on the date on which the Epidemic Preparedness (COVID-19) Notice 2020 expires*".²
- 2.4 As explained in Tegel's submission in response to NZTGA's provisional authorisation application dated 30 September 2021 (**Tegel's First Submission**), the purpose of the temporary provisions was to provide a quick response to the effects of the COVID-19 emergency and to mitigate unnecessary and potentially longer-term impacts on society arising from the pandemic. Accordingly, the Commission can only authorise conduct under these temporary provisions if it relates to or supports a response to COVID-19.
- 2.5 The history of and context for the Application is summarised in sections 2 and 4 of Tegel's First Submission. It is self-evident from this history and context that the Application does not relate to or support a response to COVID-19, and therefore authorisation cannot be granted under s 65AA(2) and (3).
- 2.6 Lane Neave submit³ that the fact that there is a Bill before Parliament proposing to introduce a new provision for interim authorisations which is in the same terms as s 65AD, but not limited to the epidemic period, means that s 65AD must be interpreted as not limited to COVID-19 situations.
- 2.7 In fact, the reverse must be the case. Until the Bill is enacted, the Commission does not have the power to grant provisional authorisation for reasons other than a COVID-19 response.

¹ Section 65AA - section heading.

² Section 65AA(1)(b).

³ Lane Neave NZTGA Provisional Authorisation Application – Cross-Submission 26 October 2021 [18] – [21] (**NZTGA Cross-submission**)



3. Heterogeneity of growers

3.1 Tegel's contract grower farms are in three different geographic locations, Auckland, New Plymouth and Christchurch. In Christchurch and New Plymouth, the farms are close to the hatchery, feedmill and processing factory, all of which are in the same locality. In Auckland the hatchery is in Drury, the feedmill is in Takanini and the factory is in Henderson, while growers are located from Henderson in the north to the Waikato in the south.

3.2 [REDACTED]
[REDACTED]



3.3 [REDACTED]
[REDACTED]



3.4 [REDACTED]
[REDACTED]

3.5 [REDACTED]

3.6 [REDACTED] [REDACTED]



3.7 


3.8 


3.9 




3.10 [REDACTED]
[REDACTED]

3.11 [REDACTED]

3.12 [REDACTED]

4. The Farm Management Agreement

4.1 Most of Tegel's contracted growers are parties to a *Farm Management Agreement – Grower Owned and Operated (FMA)* [REDACTED]. A copy of one grower's FMA is at Appendix B to the Application, [REDACTED].

4.2 [REDACTED]

(a) [REDACTED]

(b) [REDACTED]

(c) [REDACTED]

(d) [REDACTED]

(i) [REDACTED]

(ii) [REDACTED] [REDACTED] [REDACTED]

(iii) [REDACTED]

(e) [REDACTED]

5. [REDACTED]

5.1 [REDACTED]

(a) [REDACTED]

(b) [REDACTED] [REDACTED] [REDACTED]

(c) [REDACTED]

(d) [REDACTED]

(e) [REDACTED]

(f) [REDACTED]



5.2 [REDACTED]⁴

5.3 [REDACTED]

[REDACTED]

5.4 [REDACTED]

5.5 [REDACTED]

5.6 [REDACTED]

5.7 [REDACTED]⁵

6. With the Proposed Arrangement (the Factual)

6.1 NZTGA submits that if the Proposed Arrangement is authorised:

- (a) it will engage in collective negotiations, discussions, exchanges of information, and enter into, and give effect to, agreements or provisions collectively negotiated with Tegel; or
- (b) if Tegel chooses not to negotiate with NZTGA, the growers would discuss their positions as a collective before negotiating individually with Tegel.

6.2 NZTGA's factual assumes "*that NZTGA collectively negotiates an updated agreement with Tegel after the authorisation. The update would allow the parties to amend clauses in the existing agreement that are unclear and could give rise to future disputes.* [REDACTED]."⁶

6.3 [REDACTED]

6.4 The factual is very different from that described in the Application.

6.5 [REDACTED]

6.6 [REDACTED]

6.7 [REDACTED]

⁴ [REDACTED]

⁵ [REDACTED]

⁶ Castalia *Public benefits and detriments of collective bargaining by Tegel's chicken growers* 2 September 2021 at 22 (Castalia Report).



7. Without the Proposed Arrangement (Counterfactual)

7.1 NZTGA submits that, without the Proposed Arrangement, *“the Farm Management Agreement would unlikely persist in its current form beyond the short to medium term and [] likely be replaced by a simpler agreement that is individually negotiated but based on a standard form agreement.”*⁷

7.2 The Commission is therefore exploring:

- (a) whether Tegel and the growers are likely to abide by the terms of the FMAs;
- (b) whether Tegel and the growers are likely to enter into individually negotiated contracts with substantially the same terms as the current FMAs' terms;
- (c) whether Tegel and the growers are likely to enter into individually negotiated contracts with terms that substantially differ from FMAs' terms; and
- (d) TGA's submitted counterfactual: Tegel and the growers are likely to enter into individually negotiated, standard form contracts.

7.3 Castalia postulates two alternative counterfactual scenarios⁸:

- (a) negotiation of a new three-year agreement for all NZTGA members following authorisation, with three yearly renegotiations; or
- (b) negotiation of a new agreement for all NZTGA members five years from the date of authorisation.

7.4 Tegel's view is that the likely counterfactual is:

- (a) the FMAs will continue in force in accordance with its terms until it expires, unless:
 - (i) a grower agrees to vary its terms; or
 - (ii) a grower's contract is not renewed under the terms of the FMA; and
- (b) to the extent that a grower agrees to vary the FMA during its term, the variation will be individually negotiated, recognising the individual circumstances of each grower.

⁷ Application [5.1].

⁸ Castalia Report at Table 3.1.



Tegel counterfactual: the FMAs will continue in force until expiry, and any variations will be individually negotiated

- 7.5 The FMA will remain in force for all growers (other than those whose contracts are not renewed under the NRN process) in accordance with its terms until it progressively expires in relation to old, middle aged and more modern sheds as set out in Table 7.
- 7.6 Tegel must continue to abide by the terms of the FMA. It has no termination rights. A failure by Tegel to abide by its terms would be a breach of contract. It would entitle growers to seek damages or other remedies, such as specific performance.
- 7.7 Tegel has no ability to compel a grower to agree to vary or terminate the FMA. A grower would only agree to vary the FMA if it is in its interests to do so; the default position is that the terms of the FMA will continue to apply unamended.
- 7.8 [REDACTED]
- 7.9 [REDACTED]
- 7.10 Tegel has made clear to NZTGA that it does not intend to engage in collective negotiation with it in the future (because a one size fits all solution is not appropriate due to the heterogeneity of the growers) but it is happy to discuss BAU matters (which do not require authorisation).

NZTGA's counterfactuals are highly unlikely

- 7.11 NZTGA asserts that, without an authorisation, the FMA “*would be replaced by a simpler agreement that is individually negotiated but based on a standard form agreement.*”⁹ Those new agreements [REDACTED]¹⁰ According to Castalia, this will either take the form of a new three year agreement for all NZTGA members following authorisation, with three yearly renegotiations; or negotiation of a new agreement for all NZTGA members five years from the date of authorisation.
- 7.12 As explained above, Tegel cannot impose changes on the growers. [REDACTED]
- 7.13 In addition, and a grower has no incentive to [REDACTED]
- 7.14 We note that Castalia does not explain how Tegel could [REDACTED], or why growers would agree to do so.
- 7.15 [REDACTED]
- 7.16 [REDACTED]
- 7.17 [REDACTED]
- 7.18 [REDACTED]¹¹

8. The likely effect of the Proposed Arrangement on competition between TGA's growers

- 8.1 NZTGA submits that the authorisation would not result in any detriment of losses in allocative, productive or dynamic efficiency. In particular, NZTGA submits that existing growers are less likely to

⁹ Application [5.27].

¹⁰ [REDACTED]

¹¹ [REDACTED]



innovate with the lower prices in the counterfactual so that the arrangements are likely to produce dynamic efficiency gains.¹²

8.2 However, this overlooks that fact that, in the absence of the Proposed Arrangements, the FMA will continue to incentivise the majority of growers to innovate and maintain (or improve) their performance so as to [REDACTED] under the FMA.

8.3 [REDACTED]

9. The likely effect on competition between Tegel and other chicken meat processors

9.1 TGA submits that the “*authorisation would not result in any detriment of losses in allocative efficiency resulting from higher consumer prices for chicken*”. This is on the basis that the growing fee per bird is relatively insignificant, and a higher growing fee from collective bargaining would not flow through into increased prices for consumers.

9.2 However, as explained in Tegel's First Submission, [REDACTED]

9.3 [REDACTED]

10. NZTGA claimed public benefits

Transaction costs savings

10.1 NZTGA claims collective bargaining would result in a public benefit by significantly reducing transactions costs.

10.2 Tegel's view is that NZTGA has at best overstated transaction costs savings and at worst the alleged cost savings from collective negotiation are non-existent. The cost savings quantified by Castalia are speculative. As discussed in section 8 of this submission neither of Castalia's two counterfactual assumptions have any foundation.

10.3 As the Second NERA Report observes¹³ “*heterogeneity among growers means that the transaction costs of reaching agreement with Tegel would be shifted by collective bargaining rather than avoided,*” referring to Stephen King's observation¹⁴ that “*the bargaining group substitutes internal costs of coordination for external bargaining costs*”.

10.4 As discussed in section 8, the most likely negotiation scenario in the counterfactual would involve [REDACTED]

10.5 In contrast, reaching a collectively agreed outcome with the growers on specific issues is often difficult, if not impossible, due to the diversity of the grower group. The growers have different requirements depending on the age of their sheds, and scale and circumstances of their farms and are too diverse for a “one size fits all” solution. [REDACTED]

10.6 [REDACTED]¹⁵

10.7 [REDACTED]

10.8 [REDACTED]

¹² Application [8.31].

¹³ Second NERA Report at [17].

¹⁴ Stephen P. King (2013) “Collective Bargaining by Business: Economic and Legal Implications” *UNSW Law Journal* 36(1) at 131.

¹⁵ [REDACTED]



Wealth transfers

- 10.9 The Commission is considering the extent to which any changes in the distribution of wealth between Tegel and TGA's growers could amount to public benefits or public detriments (including any discounts on benefits).
- 10.10 TGA alleges that the grant of authorisation will result in a public benefit, being the prevention of a transfer of "*functionless monopoly rents*" from growers to Tegel which would be caused by a reduction in growing fees in the counterfactual. It is alleged that such a wealth transfer is a public benefit given that Tegel is ultimately wholly-owned by Inoza Foods, Inc, a privately owned company registered in the Philippines.
- 10.11 The first thing to note is that there is no evidence of any transfer in favour of Tegel. The evidence suggests the opposite.
- 10.12 Castalia has assumed a reduction in the [REDACTED] from individual bargaining of [REDACTED]¹⁶¹⁷¹⁸.
- 10.13 However, Castalia also note [REDACTED]¹⁹. It follows that the claim of a wealth transfer to Tegel is without foundation.
- 10.14 Even if there were a transfer to Tegel, it would not amount to the transfer of a "*functionless monopoly rent*" as alleged by NZTGA.²⁰ It is well established that "*if there are circumstances in which the exercise of market power gives rise to functionless monopoly rents, supranormal profits that arise neither from cost savings nor from innovation, and which accrue to overseas shareholders, we think it right to regard these as an exploitation of the New Zealand community and to be counted as a detriment to the New Zealand public.*"²¹
- 10.15 The NZTGA/Castalia argument is:
- (a) Tegel has "*greater market power where growers negotiate individually*";²²
 - (b) if growing fees are higher under individual negotiation that "*is the result purely of Tegel's greater market power*";²³
 - (c) this is "*equivalent to a 'functionless monopoly rent'*";²⁴
 - (d) [REDACTED]²⁵
 - (e) [REDACTED]²⁶

¹⁶ [REDACTED]

¹⁷ [REDACTED]

¹⁸ [REDACTED]

¹⁹ [REDACTED]

²⁰ Application [8.11–8.19]; Cross-submission at [117].

²¹ See, for instance *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560 at [48]-[49].

²² NZTGA cross-submission at [121].

²³ At [120].

²⁴ At [117].

²⁵ [REDACTED]

²⁶ [REDACTED]



- 10.16 As NERA explains in the Second NERA Report “*supranormal profits are profits above a ‘normal’ (competitive) rate of return*”,²⁷ and, any transfer “*given Tegel’s current financial situation would not cause Tegel to attain supranormal profits.*” According to NERA, as Tegel is operating at a loss, any reduction in growing fees would help to fund its operating costs and could not amount to supranormal profits.
- 10.17 The cost of Tegel’s operations and how they are funded is therefore highly relevant to whether its revenues exceed its total costs and amount to earning supranormal profits. If Tegel’s revenues do not exceed its costs (as is the case) there can be, as NERA state, no monopoly rents. A reduction in growing fees will not, therefore, constitute “*a wealth transfer from New Zealanders without any corresponding exchange of value as set by a competitive market.*”²⁸

Efficiency benefits from collective bargaining

- 10.18 Castalia claims a public benefit from authorisation on the basis that the FMA is a sophisticated and efficient contract and “*in the counterfactual the sophistication of the FMA is unlikely to be maintained, and over time the contract will evolve to a simpler form.*”²⁹
- 10.19 As we have shown, there is no likelihood that this will occur. The comparison Castalia makes is a fiction, and the claimed public benefit an illusion.

11. Public detriments

- 11.1 The authorisation sought would be inconsistent with the [REDACTED] in the FMA.
- 11.2 NZTGA submits “*there is in fact no intrusion on contractual rights*”.³⁰ NZTGA claims:

[REDACTED]³¹

- 11.3 The mere fact that one party is appointed by a number of persons to represent each of them in a [REDACTED] does not amount to collective negotiation, or an intention that the [REDACTED] be collectively negotiated. [REDACTED]³² While Lane Neave has been appointed to act for all the NRN growers, it has made it clear³³ it is acting for each grower individually. It must therefore follow that NZTGA’s submission that the FMA contemplates collective negotiation simply because each grower has appointed the same representative, must fail.

11.4 [REDACTED]

11.5 [REDACTED]

11.6 [REDACTED] [REDACTED]

11.7 [REDACTED]

11.8 [REDACTED]

²⁷ Second NERA Report at [26].

²⁸ *Godfrey Hirst* at [39].

²⁹ Castalia Report at [3.5.3].

³⁰ NZTGA cross-submission at [43].

³¹ [REDACTED]

³² [REDACTED]

³³ Cross-submission at [78]-[83].



END



Appendix 1 – variation agreement

[REDACTED]