TEGEL FOODS LIMITED

SUBMISSION IN RESPONSE TO COMMERCE COMMISSION DRAFT DETERMINATION DATED 13 APRIL 2022 ON APPLICATION BY THE NEW ZEALAND TEGEL GROWERS ASSOCIATION, ON BEHALF OF ITS MEMBERS, TO COLLECTIVELY NEGOTIATE WITH TEGEL FOODS LIMITED

20 MAY 2022

PUBLIC VERSION

Introduction and Executive Summary

1.1 This submission is made in response to the Commerce Commission's (**Commission**) Draft Determination published on 13 April 2022 (**Draft Determination**) 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 Unless otherwise defined in this submission, capitalised terms have the same meaning as used in the Draft Determination.

1.3 We attach a report from NERA *Review of Draft Determination in respect of NZTGA authorisation application* dated 20 May 2022 in support of this submission (**NERA 3**).

1.4 NZTGA seeks authorisation to:

(a) collectively discuss and negotiate with Tegel growing fees and other terms and conditions of chicken growing contracts, and for TGA members to discuss among themselves and exchange information in relation to these discussions and negotiations;

(b) enter into agreements collectively negotiated between Tegel and TGA, and

(c) give effect to agreements collectively negotiated, including provisions in relation to growing fees.

1.5 Tegel opposes the grant of authorisation described in (a) above for the reasons set out in Part 1 of this submission, namely:

(a) the relationship between Tegel and the growers is one of **mutual dependence**. There is no imbalance in bargaining power as NZTGA contends. Authorisation of collective bargaining would create an imbalance in bargaining power in favour of growers which, as explained in this submission and the NERA 3, will increase costs for Tegel and ultimately result in higher prices for consumers;

(b) the scope of the Proposed Authorisation (to collectively discuss and negotiate with Tegel growing fees and other terms and conditions of chicken growing contracts) is **too broad**. There is no evidence before the Commission of any specific terms in the Farm Management Agreements (**FMA**) that are harming or will harm efficiency. Nor has the Applicant shown that collective bargaining would cause a change in the terms compared to individual negotiation, what those changes would be, and that those changes would result in a public benefit;

(c) NZTGA asserts that as a matter of theory collective bargaining would result in more efficient and sophisticated contracts than a counterfactual of [ ] and simpler contracts. Neither of these theoretical assertions survive scrutiny:

(i) "Sophistication" is not a measure of economic efficiency. A sophisticated agreement may harm economic efficiency while a simple agreement may enhance it;

(ii) Collective negotiation does not *per se* lead to more efficient contract terms.

(d) the term of the Proposed Authorisation is too long. None of the factors cited by the Commission support a ten year period;

(e) the Proposed Authorisation is not likely to result in a benefit to the public which would outweigh the lessening of competition:

(i) [ ], the benefits estimated by NZTGA in relation [ ] must be ignored. As the Commission rightly observes, benefits of collective bargaining prior to authorisation being granted cannot be counted as a benefit of the authorisation;

(ii) the only other benefits quantified by NZTGA are alleged long-term transaction cost savings from collective bargaining compared to individual negotiation that are based on assumptions about the costs of collective negotiation and individual negotiation that bear no relationship to reality. Evidence which was not available when the application was made enables a fact-based comparison of the costs of the recently concluded collective negotiation with NZTGA and the costs of negotiating individual agreements shows that collective bargaining is likely to result in transaction cost increases rather than savings, resulting in a $3.6 million detriment from collective bargaining; and

(iii) collective bargaining will result in price increases for consumers.

1.6 While Tegel strongly disagrees that there are valid grounds for granting authorisation, it would nevertheless not oppose an amended application by NZTGA for authorisation for a period of 12 months to collectively negotiate [ ] only, as the interests of growers are likely to be aligned. [ ]

1.7 Tegel opposes the grant of authorisations described in (b) and (c) above on the basis that, as discussed in Part 2 of this submission, the Commission cannot authorise a person entering into a contract, or giving effect to a provision in a contract, when no such contract or provision exists:

(a) under section 61(6)(b) of the Commerce Act 1986 (the **Act**) the Commission cannot grant an authorisation unless it is satisfied that “the entering into **of the contract** … will, in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result or would be likely to result therefrom”;

(b) likewise, under section 61(c) of the Act, the Commission cannot grant an authorisation unless it is satisfied that “the giving effect to **the provision** … will, in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result or would be likely to result therefrom”; and

(c) it is not possible for the Commission to carry out the assessment required by section 61(6). The benefits of **the** contract or **the** provision must be assessed, and this cannot be done for a contract or provision that does not exist at the time of the determination.

PART 1: COLLECTIVE BARGAINING AUTHORISATION

Tegel/grower relationship in one of mutual dependence

2.1 The basis for the NZTGA's authorisation application is that there is a bargaining power imbalance in Tegel's favour:

> *"The limited number of chicken processors and the need to make significant long-term investments that confirm to the specific shed requirements of Tegel all create an imbalance of bargaining power between individual chicken growers and Tegel (in favour of Tegel)."*[1]

2.2 Castalia for NZTGA makes a similar claim:

> *The limited number of chicken processors and the need to make significant long-term investments that conform to the specific shed requirements of Tegel all create an imbalance of bargaining power between individual chicken growers and Tegel."*[2]

2.3 This is a mischaracterisation of the relationship which, as discussed at section 5 of NERA 3 is better described as one of mutual dependence.

2.4 The Australian Competition Tribunal (**Tribunal**) came to a similar conclusion in relation to a collective bargaining authorisation application by coal producers in respect to access to the Port of Newcastle under the equivalent provisions of the Australian legislation:

> *The nature of the economic relationship between the coal producers and PNO can be described as one involving mutual dependence in combination with potential for the transfer of economic value between PNO and coal producers. The coal producers are dependent upon the Port access services provided by PON to realise the value of export coat revenues, since the coal is transported to overseas markets via the Port. PNO is directly dependent upon the provision of Port access services in relation to export coal being transported to overseas markets for approximately 70% of its revenue…"*[3]

2.5 Similarly, growers are dependent on Tegel for the provision of growing services and Tegel is dependent on growers to provide grown chickens to process and supply to domestic and international markets. There is no imbalance in bargaining power as NZTGA contends.

2.6 Authorisation of collective bargaxining would create an imbalance in bargaining power in favour of growers which, as explained in this submission and the NERA 3, will increase costs for Tegel and ultimately result in higher prices for consumers.

The collective negotiation authorisation sought by NZTGA is too broad

3.1 NZTGA seeks authorisation to collectively discuss and negotiate with Tegel growing fees and other terms and conditions of chicken growing contracts, and for NZTGA members to discuss among themselves and exchange information in relation to these discussions and negotiations.

3.2 The scope of the authorisation sought by NZTGA is too broad. As the Tribunal held in *Port of Newcastle* an Applicant for authorisation to collectively bargain the terms of an existing agreement must satisfy three premises:

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[1] Application [1.23]

[2] Castalia Report 2 September 2021 p5.

[3] Application by Port of Newcastle Operations Pty Limited (No 2) [2022] ACompT 1 (**Port of Newcastle**) [238]

(a) the current terms are harming economic efficiency or giving effect to the current terms will harm economic efficiency;

(b) that collective bargaining would be likely to cause a change in the terms (in comparison to what would be achieved through bilateral negotiations); and

(c) the change would result in a public benefit."[4]

3.3 The Applicant has not met these requirements. There is no evidence before the Commission of any specific terms in the FMA that are harming or will harm efficiency. Nor has the Applicant shown that collective bargaining would cause a change in the terms compared to individual negotiation, what those changes would be, and that those changes would result in a public benefit. NZTGA simply asserts that as a matter of theory collective bargaining would result in more efficient and sophisticated contracts than a counterfactual of [ ] simpler contracts.[5]

3.4 Neither of these theoretical assertions survive scrutiny:

(a) "Sophistication" is not a measure of economic efficiency. A sophisticated agreement may harm economic efficiency while a simple agreement may enhance it;

(b) Collective negotiation does not *per se* lead to more efficient contract terms. As noted by the Tribunal:[6]

(i) more efficient terms are only likely where the individual requirements and preferences of the participants are aligned, and a common position of all participants can reasonably be expected to be agreed; and

(ii) in contrast, where the requirements and preferences of the group are not aligned, pressure from within the bargaining group to reach agreement may cause individuals to forgo their individual preferences in favour of a uniform approach (the "lowest common denominator") which would decrease economic efficiency.

3.5 The Commission in the Draft Determination accepts the NZTGA's assertion "*that collective bargaining is more likely than not to lead to more sophisticated and more efficient contracts particularly over the long term*".[7] In coming to this view the Commission compares collective bargaining with a counterfactual that without authorisation growers would accept individual contracts rather than [ ], and the efficiencies in the existing FMA would be lost absent authorisation.[8]

3.6 With [ ], that counterfactual is no longer tenable (if it ever was).

3.7 The evidence establishes that there is no likelihood that individual negotiation would result in the existing FMAs being replaced by "[ ] *simpler contracts*" or that that "*the existing efficiencies in the FMA would be lost absent authorisation*" as the Commission contends. To the contrary, there is no material difference [ ].

3.8 There is also no evidence before the Commission that collective bargaining of unspecified terms of the FMA will result in more efficient agreements than individual negotiation. As noted by the Tribunal[9], whether collective negotiation will be likely to result in more efficient outcomes than individual

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[4] Port of Newcastle [338]

[5] Application [5.7]

[6] Port of Newcastle [221]

[7] Draft Determination [135]

[8] Draft Determination [127]

[9] Port of Newcastle [221]

negotiation will depend on whether the individual requirements are aligned; where they are not collective negotiation is likely to lead to less efficient outcomes.

3.9 While Tegel strongly disagrees that there are valid grounds for granting authorisation it would nonetheless not oppose an amended application by NZTGA for authorisation for a period of 12 months to collectively negotiate [ ]

(a) [ ]

(b) [ ]

(c) [ ]

3.10 As discussed in section 7 of this submission, [ ] may be amenable to collective negotiation.

3.11 In contrast, [ ] are an example of an FMA term where collective negotiation is highly unlikely to result in more efficient outcomes than individual negotiation because the interests of growers are not aligned. [ ].

3.12 [ ]

3.13 [ ]

3.14 Collective agreement on [ ] is not feasible. Collective negotiation is not likely to result in any agreement, let alone a more efficient outcome than individual negotiation. [ ][10]

[ ]

[ ]

3.15 [ ]

3.16 As collective negotiation of provisions in an agreement will only lead to more efficient outcomes than individual negation where the interests of the negotiating group are aligned such that a common position in the interests of all members of the group can reasonably be expected to be agreed, it is incumbent on an applicant for authorisation to identify the specify provisions its wishes to collectively negotiate, and satisfy the decision-maker that, in relation to those provisions, the interests of the members of the collective are aligned.

3.17 The NZTGA application for authorisation does not do this. Its application to collectively discuss and negotiate with Tegel **all terms and conditions** of chicken growing contracts[11] cannot satisfy the statutory test and the application must be declined unless amended as discussed above.

The term of the proposed authorisation is too long.

4.1 The Commission considers it would be appropriate to grant the Proposed Authorisation for a period of ten years based on:

(a) its assessment of the likely benefits and detriments;

(b) the characteristics of the markets (particularly the prevalence of long-term capital investments); and

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[10] [ ]

[11] Application [1.19(a)(i)]

(c) the duration of the FMAs which are likely to endure for ten years.[12]

4.2 None of these factors support a ten year period:

(a) as discussed in sections 4 and 5 of this submission and NERA 3, the Proposed Authorisation will not result in any public benefit, and the longer the term of authorisation the greater the public detriment.

(b) the Commission is conflating the role of long-term contracts in underwriting long-term capital investments and the time required to negotiate those contracts. If collective bargaining is justified (which Tegel disputes) it is for the time period required for the negotiation, not the length of the contract; and

(c) it is not correct that the duration of the FMAs is likely to endure for ten years. As previously submitted, [ ]

4.3 Section 5 of NERA 3 discusses this issue in more detail.

Collective negotiation will result in increased prices for consumers

5.1 The Commission acknowledges that acting collectively, growers could use any greater bargaining power to extract more beneficial terms from Tegel, including higher growing fees, that Tegel may pass some or all of this cost increase into higher wholesale prices, which in turn may result in higher retail prices.[13]

5.2 NZTGA submits that any increased grower fees would be “sufficiently insignificant” and that downstream wholesale and retail prices would be no lower with individual negotiation than with collective bargaining.[14]

5.3 The Commission accepted that there was a real chance that growing fees would be higher under collective bargaining[15] but regarded any potential allocative efficiency detriments that would result from higher grower fees as likely to be relatively small because:

(a) a large proportion of grower fees are fixed, and are less likely to be passed through not Tegel’s wholesale prices than variable costs;

(b) competition in wholesale markets would constrain Tegel from passing on cost increases that weren’t incurred by rivals; and

(c) grower fees comprise a relatively small portion of Tegel’s total costs, so any increase is likely to be relatively small.[16]

5.4 Each of these assessments is flawed:

(a) as discussed at [3.1] and Appendix A of NERA 3, the Commission’s distinction between fixed and variable costs is unsound;

(b) according to the Application, Tegel has 50% market share in chicken production[17] followed by Ingham’s with 34%.[18] The Commission has previously granted a collective bargaining

[12] Draft Determination [185]

[13] Draft Determination [156]

[14] Draft Determination [159]

[15] Draft Determination [165]

[16] Draft Determination [166]

[17] Application [3.12]

[18] Application [3.17].

authorisation to Ingham's growers[19], so that both Tegel and Ingham's would be facing cost increases from collective bargaining, and both would be likely to pass those cost increases through in the form of higher wholesale prices. See also NERA 3 at [3.2]; and

(c) [ ]

The Proposed Authorisation will not result in any public benefit

6.1 The economic reports provided by the Applicant focus primarily on the benefits from [ ]. This is acknowledged by the Commission which notes that [ ][20] and the quantification of benefits is weighted heavily by [ ].

6.2 As [ ], the estimated benefits related to the [ ] must be ignored. As the Commission rightly observes, benefits of collective bargaining prior to authorisation being granted cannot be counted as a benefit of the authorisation.[21]

6.3 The only benefits remaining which are quantified in the Castalia Reports are assumed long-term transaction cost savings from collective bargaining compared to individual negotiation:[22]

> *"Collective bargaining is more likely to reduce the duration and costs of any negotiation period by allowing Tegel to engage in a single negotiation process, removing the duplication of negotiations and advisory costs for both parties. In particular, we consider that TGA's long-term transaction cost savings estimate of between $1 million to $3 million appears to be a reasonable estimate of the likely upper bound of these potential benefits and we have placed weight on this figure"*

6.4 The Commission has accepted Castalia's assumptions. Its preliminary view in the Draft Determination is that "*there are likely to be material cost savings from the Proposed Arrangement in relation to … long-term transaction costs savings.*[23] It considers Castalia's cost savings estimate of between $1 million to $3 million "*to be a reasonable estimate of the likely upper bound of these potential benefits, and we have placed weight on this figure*".

6.5 The assumptions made by Castalia on the costs of collective negotiation and individual negotiation bear no relationship to reality. Evidence which was not available when the application was made enables a fact based comparison of the costs of the [ ].

6.6 As explained in Tegel's Submission in response to the Statement of Preliminary Issues[24] [ ]

6.7 Individual negotiations resulted in [ ]. In contrast collective negotiation has resulted in [ ]; no agreement has been reached on [ ]

6.8 As shown in section 6 of NERA 3 (relying on Tegel inputs), collective bargaining is likely to result in transaction cost increases rather than savings, resulting in a $3.6 million detriment from collective bargaining. [ ], there are no quantified benefits of authorisation.

Narrower scope and term of collective bargaining arrangement

7.1 As discussed at [3.4(b)(i)], collective negotiation of some provisions in an agreement may lead to more efficient outcomes than individual negation where the applicant for authorisation can satisfy the

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[19] Application [1.11]

[20] [ ]

[21] Draft Determination [138]

[22] Draft Determination [116]-[117]

[23] Draft Determination [101]

[24] Tegel Foods Limited *Submission in response to statement of preliminary issues dated 8 October 2021* 5 November 29021 (**Tegel Submission**) [7.8]

decision-maker that the interests of the negotiating group are aligned such that a common position in the interests of all members of the group can reasonably be expected to be agreed.

7.2 Of the matters which [ ]

(a) [ ]

(b) [ ]

(c) [ ]

[ ] may be matters where a common position can reasonably be expected to be agreed, as the mechanisms will apply equally to all growers, and where collective negotiation for a limited period is likely to be beneficial.

7.3 Tegel would not oppose an amended application by NZTGA for authorisation for a period of 12 months to collectively negotiate [ ] only. 12 months would provide ample time for NZTGA to reach agreement on these matters; if agreement cannot be reached in that time agreement could not reasonably be expected to be reached, the ongoing significant costs of collective negotiation would not be justified, and no public benefit would flow from continued collective negotiation.

PART 2 – AUTHORISATION TO ENTER INTO AGREEMENTS AND GIVE EFFECT TO PROVISIONS

The Commission cannot give a "blank cheque" authorisation for the applicant to enter into contracts that have not yet been negotiated or to give effect to provisions which have not yet been drafted.

8.1 In addition to seeking authorisation for collective bargaining, NZTGA also seeks authorisation to:

(a) enter into agreements collectively negotiated between Tegel and NZTGA containing common terms relating to growing fees and other terms and conditions of chicken growing contracts, and

(b) give effect to provisions of agreements collectively negotiated between Tegel and NZTGA containing common terms relating to growing fees and other terms and conditions of chicken growing contracts.

8.2 The authorisation described in (a) falls under section 58(1) of the Act, which allows a person who wishes to enter into **a contract** to apply to the Commission for an authorisation to do so. The authorisation described in (b) falls under section 58(2) of the Act which allows a person who wishes to give effect to **a provision** of a contract to apply to the Commission for an authorisation to do so.

8.3 Under section 61(6)(b) of the Act, the Commission cannot grant an authorisation unless it is satisfied that "*the entering into **of the contract** … will, in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result or would be likely to result therefrom*". Likewise, under section 61(c) of the Act, the Commission cannot grant an authorisation unless it is satisfied that "*the giving effect to **the provision** … will, in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition that would result or would be likely to result therefrom.*"

8.4 Section 61(6) requires that the public benefit test be satisfied independently in relation to the contract which the applicant for authorisation wishes to enter into, and each of the provisions in a contract it wishes to give effect to. It follows that the specific contract or provision for which authorisation is sought, as the case may be, must be identified in the application, and the Commission must be satisfied the benefits of each independently outweigh the associated lessening of competition.

8.5 It is not possible for the Commission to carry out the assessment required by section 61(6). The benefits of **the** contract or **the** provision must be assessed, and this cannot be done for a contract or provision that does not exist at the time of the determination.

8.6 This is clear from previous authorisations granted by the Commission (other than *Ingham's* which in our view was wrongly granted):

(a) in NZ Racing Board,[25] authorisation was granted to enter into and give effect to specified provisions in arrangements between NZRB and Tabcorp described as the Betting Rules provisions, the Revenue Leakage provisions and the Qualified persons provisions. The Commission assessed the benefits and detriments of each of the specific provisions;

(b) in Nelson City Council,[26] authorisation was sought to enter into and give effect to ten specific provisions in two contracts. The Commission assessed the clauses collectively as they collectively had the effect of controlling prices. Authorisation was granted on condition that the agreement be amended; and

(c) in Infant Nutrition Council,[27] the Commission authorised the amendment of the definition of 'infant formula' in the INV Code, concluding the benefits of amending the definition outweighed the detriments.

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[25] New Zealand Racing Board [2016] NZCC 17 (**NZRB**)

[26] Nelson City Council and Tasman District Council [2017] NZCC 6

[27] Infant Nutrition Council Limited [2018] NZCC 20

8.7 In all cases, to determine whether the public benefits of the contract or provision outweighed the competitive detriment, the Commission assesses

(a) first, whether the provisions for which authorisation was sought were likely to breach the Act. As stated in NZRC "*In assessing an application, we first determine whether the conduct would likely lessen competition…If we do not consider a lessening of competition is likely, we do not have jurisdiction to further consider an application*";[28]

(b) secondly, *"the extent of the lessening of competition which arises from*"[29] the contract or provision in question by comparing the likely state of competition with the contract or provision and the most competitive, likely state of competition without the contract or provision;[30] and

(c) thirdly, the benefits of the contract or provision compared the detriments.

8.8 It is self-evident that it is not possible to apply the section 61(6) assessment to a contract (or a provision in a contract) that does not exist. For that reason, the authorisations sought to enter into any agreements collectively negotiated between Tegel and NZTGA in the future, and to give effect to provisions in those agreements must be declined.

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[28] NZRB [33]

[29] NZRB [64]

[30] NZRB [65]