TEGEL RESPONSE TO NZTGA CROSS-SUBMISSION

6 JULY 2022

1. Introduction

1.1 Tegel thanks the Commission for allowing it the opportunity to respond to new material in the NZTGA cross-submission dated 27 June 2022 (**Cross-submission**). A report from NERA responding to the Link Economics report of the same date is attached.

1.2 Confidentiality is requested for the information in this response that is contained in square brackets and highlighted in either yellow, green or red as follows:

(a) Confidential to Tegel but confidentiality waived in respect to NZTGA;

(b) Confidential to NZTGA;

(c) Confidential to Tegel.

2. Response

Para	NZTGA Statement	Tegel Response
4(c)	Tegel's submission that the relationship between Tegel and the growers is one of "mutual dependence" "*relies heavily on the Australian Competition Tribunal in the Port of Newcastle (PON) decision.*"	Tegel's submission was that the relationship of mutual dependence was **a matter of fact**, for reasons outlined in section 5 of NERA 3. While the submission observed that the Tribunal had come to a similar conclusion in PON[1], Tegel did not "*rely heavily*" on the Tribunal decision in making this submission.
5 & 6	NZTGA seeks to distinguish the relationship of coal producers and the Port in PON from the relationship between the growers and Tegel.	Mutual dependence can arise in different ways; while the characteristics of the Port and coal producers differ from the characteristics of Tegel and the growers, the key factual finding in PON was that the Port was just as dependent on the coal producers as an important source of revenue, as the coal producers were dependent on the Port as a key input for getting its product to market.[2] In NZTGA/Tegel the situation is the same – growers are dependent on Tegel for growing services and Tegel is dependent on growers providing it with grown chickens to keep its food

[1] Tegel Submission [2.4]

[2] Cross-submission [6(a)(iii)]

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		and processing plants operational and meet its obligations to supply downstream markets.
11	*The chicken processors were seen as having strong monopsony or oligopsony market power[3]. While there was some degree of interdependence between processors and growers this did not constrain the market power that processors held due to being monopsony or oligopsony purchasers of chicken growing services[4]. The growers did not have countervailing power[5].*	NZTGA refers to the Tribunal decision in VFF to imply that, as in that case, Tegel can exercise monopsony power and growers have no countervailing power. The VFF finding cannot be applied in NZTGA/Tegel because, as a matter of fact, Tegel cannot exercise monopsony power and growers have strong countervailing power. While the fact that Tegel is a large sophisticated commercial entity and the growers are smaller and less resourced are factors to consider, a key element of monopsony power is that "*the buyer can easily switch to alternative suppliers, sponsor new entry or self-supply* ***without incurring substantial sunk costs***".[6] As discussed below in response to [26] and [27] of the Cross-submission, Tegel cannot easily switch to alternative suppliers, sponsor new entry or self-supply, and any attempt to do so would incur substantial sunk costs.
24	*An imbalance of bargaining power between chicken processors and chicken growers is also present in New Zealand.*	The paragraphs of the Cross-submission preceding [24] refer to overseas examples, but the situation in New Zealand is very different. The is no imbalance of bargaining power in favour of Tegel as NZTGA claims. **[ ]** The clearest indicator that the risk/reward model in the current FMA is weighted strongly in the growers' favour is that while Tegel has been suffering losses since 2019, Tegel has observed that older farms with Tegel contracts have been selling at prices similar to, or higher than, a new build. This implies the existing contracts between growers and Tegel are very profitable for growers.
25	*If on a non-renewal or termination of contract a grower cannot reach agreement with Tegel,* **[ ]** *Each shed costs about* **[ ]***… Therefore, if a grower does not reach a deal with Tegel, their average* **[ ]** *investment per shed is lost. This point is also noted in ACCC decisions as a feature of chicken growing markets*	This statement is misleading for several reasons. The **[ ]** relate to sheds that will have reached the end of their economic lives. The growers agreed that their contracts with Tegel in relation to those sheds would terminate in **[ ]**, by which time they will have received

3 *VFF Chicken*, above n.2 at [109]-[113], [408].

4 *VFF Chicken*, above n.2 at [125]-[126].

5 *VFF Chicken*, above n.2 at [128].

6 *DAF/COMP* (2008) 38 www.oecd.org

Para	NZTGA Statement	Tegel Response
	that gives rise to an imbalance in bargaining power.	more than a normal return on and of their capital invested over the contract period. No grower whose contract terminates in [ ] faces loss of a [ ] per shed investment as claimed by NZTGA. [ ] is the cost of building a [ ] sqm shed today, not the investment made by the grower many years ago. The terminating contract sheds are much smaller [ ] than modern sheds. The grower's investment would be unlikely to have exceeded [ ] which will already have been recovered over the course of the contract. The NZTGA's claim of "*imbalance of bargaining power*" is therefore without substance. NZTGA also ignores the fact that Tegel's sunk costs are materially greater than those of growers, represented by its food mills and processing factories which are dependent on the growers.
26 & 27	*On the other hand, Tegel does have options if it has a shortage of capacity, it can look to build new farms, sponsor new sheds on existing farms (NERA suggests this is a two-three year process), approach Inghams growers in the Waikato (although the lead time of Inghams' growers coming off contract is unknown), reduce the number of days between runs so producing more through existing farms or raise prices. Any constraints are only on growing the business. Tegel would still achieve comparable profit from the business. Accordingly, the comparable options and bargaining power as between Tegel and individual growers are very different.*	None of these options could be achieved (if at all) without substantial sunk costs being incurred. **build new farms**: Tegel is in the business of food production and chicken meat processing. It has been loss-making for the last several years and reduced its capital expenditure accordingly. [ ] The cost of building a new farm to replace the [ ] would be significant. Using the cost estimate provided by NZTGA (which Tegel agrees with) that a [ ] to build today, the capital cost (assuming a land cost of $20 million) would be in the order of [ ] of that cost would be sunk. [ ] **sponsor new sheds on existing farms**: Tegel agrees that it may be possible cost-effectively to extend the lives of those NZTGA grower sheds that terminate in [ ] that are in good condition. Many sheds will however be too old and in too poor a condition to upgrade economically. Tegel has made clear to NZTGA members that it wishes to discuss the possibility of extending contracts that expire in [ ] on a case by case basis, including the scope and cost of work required to extend the economic life of a shed

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		and a fee structure [ ] that has regard to modern equivalent asset costs. [ ] **approach Inghams growers in the Waikato**: Tegel has no knowledge of when each Inghams' grower contract expires. However, if Tegel has an option to approach Inghams' growers when their contracts expire, it must follow that NZTGA members in Auckland and Christchurch are equally able to approach Inghams or Brinks in Auckland or Brinks in Christchurch to offer growing services to those companies. **reduce the number of days between runs**: While there is an ability to reduce the number of days between runs to increase production for short periods to manage short term fluctuations in bird growth or market demand, a consistent reduction is not a sustainable solution and would in any event result in only a minimal increase in production. **raise prices**: NZTGA's submission that in the absence of other alternatives, Tegel can simply raise it prices in downstream markets to maintain its profitability is astounding. NZTGA is aware that Tegel has not been profitable for several years. If it could have increased its wholesale prices to reduce its losses it would have done so. Tegel operates in a competitive downstream market and its wholesale prices are constrained by downstream competitors. Tegel has recently announced a price increase because of increased costs in labour, transport, grain, oil seed, fuel, logistics, insurance and utilities, but the price increase will not cover all of those cost increases.[7] It is not in dispute that if the Commission grants authorisation Tegel's costs will increase even further. [ ] It is of concern that NZTGA would think that an increase in price to end consumers as a result

7 https://www.nzherald.co.nz/business/major-chicken-supplier-tegel-hikes-prices-10-per-cent-amid-ukraine-war-fuel-costs/U5QI2ZCGFKZ3GVQXWPOY5TETFQ/

Para	NZTGA Statement	Tegel Response
		of authorisation was an appropriate option. On this ground alone authorisation must be declined. [ ]
46	[ ]	Tegel rejects NZTGA's allegations, which have no evidentiary basis, are improperly made, and should be withdrawn. [ ]
47	[ ]	[ ] [ ]
50 & 51	At para 3.11 Tegel submits [ ] This is a very surprising submission given that [ ]	[ ] A newly built shed is cheaper to operate and generally more efficient than older sheds. For all these reasons, Tegel believes bi-lateral discussions will achieve the most efficient outcomes in terms of both cost and quality. [ ]
52	[ ]	Tegel does not believe this is relevant to the application, but for the record rejects the NZTGA claim. [ ] The Cross-submission is also misleading by omission as it fails to disclose [ ]
54	[ ]	[ ]
73, 75 & 76	*A 10 year authorisation period has been standard for ACCC authorisation of chicken grower collective bargaining in recent years. The ACCC appears to have accepted a submission by the growers that a ten year term is necessary as increasingly chicken growing contracts are entered into for ten year terms because of the very high capital costs of establishing new chicken farms.* *In relation to NZTGA members:* [ ] *Accordingly, there will inevitably be the need for important negotiations in relation to a number of grower*	We are not dealing here with the establishment of new chicken farms. [ ]

<table>
<tr><th>Para</th><th>NZTGA Statement</th><th>Tegel Response</th></tr>
<tr><td></td><td>members in [ ]. It is convenient to ensure that the authorisation permits those negotiations to occur by way of collective bargaining.</td><td></td></tr>
<tr><td>74</td><td>The cost of new sheds are very expensive. In fact in relation to the most expensive sheds, it is normal practice to provide for a [ ] contract to ensure that the grower has the opportunity to recover the cost of the investment. Examples of NZTGA member Growers on [ ] contracts include:
[ ]</td><td>[ ] contracts are the exception.
Tegel understands that Inghams contracts, for instance, are for a 10 year term with a right of renewal for 5 years, while Brink's offers 5 year rolling contracts.

[ ]

The grower will have more than recovered the cost of their investment over that period.</td></tr>
<tr><td>81 & 82</td><td>Tegel suggests at para 5 that collective bargaining could lead to higher wholesale prices for chicken. This is unlikely. As discussed in para 7 below under the heading of allocative efficiency, grower prices are a small proportion of retail prices, collective bargaining will not increase the price for grower services above a competitive price and the price elasticity of chicken is low.</td><td>It is not disputed by NZTGA and its economists (nor for that matter by the Commission in its Draft Determination) that authorisation will result in increased revenue for growers and increased costs for Tegel.

Nor is it disputed that Tegel has been bearing losses since 2019 and is facing increased costs across its supply chain.

NZTGA argues that any increase in grower revenue following authorisation will be insignificant and can therefore be ignored. [ ]</td></tr>
<tr><td>88</td><td>Tegel submits at 6.5- 6.8 that [ ]</td><td>Tegel does not believe this is relevant to the application, but for the record rejects the NZTGA allegations, and the insinuation behind those allegations. They are untrue.

Tegel did not [ ]

Tegel did not [ ]</td></tr>
<tr><td>90</td><td>[ ]</td><td>[ ]
<table><tr><th>[ ]</th><th>[ ]</th><th>[ ]</th></tr><tr><td>[ ]</td><td>[ ]</td><td>[ ]</td></tr><tr><td>[ ]</td><td>[ ]</td><td>[ ]</td></tr><tr><td>[ ]</td><td>[ ]</td><td>[ ]</td></tr><tr><td>[ ]</td><td>[ ]</td><td>[ ]</td></tr><tr><td></td><td></td><td></td></tr></table></td></tr>
<tr><td>91</td><td>[ ]</td><td>The assertion that Tegel [ ] is untrue.

[ ]</td></tr>
<tr><td>97 & 98</td><td>Tegel has also suggested only a 12 month period of collective negotiation should be permitted. That is an unreasonable restriction especially</td><td>NZTGA's reference to [ ] is misleading. [ ]</td></tr>
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Para	NZTGA Statement	Tegel Response
	given the inevitable need for further negotiations in the lead up to the [ ]. *A 10 year authorisation period is very important in ensuring* [ ]	
99	*Limiting the authorisation to just a 12 month period would also encourage* [ ]	Tegel objects to, and rejects, NZTGA's allegations of [ ]
127	*Trading conditions are now improving through: (1) the easing of domestic COVID restrictions and international borders reopening, and (2) the IBD outbreak having been resolved and the Australian border reopened to New Zealand chicken meat. As a result, the period in which Tegel made losses is highly unlikely to be indicative of the next 10 years.*	Tegel (in line with most economic and business commentators) expects trading conditions to remain challenging following the COVID pandemic and its ongoing long term economic impact. Tegel continues to face significant pressure due to labour shortages, supply chain constraints and cost inflation which have forced it to increase wholesale prices. It is yet to recover to a profitable position. Trading conditions are forecast to remain difficult considering the broader economic outlook and the Russian invasion of Ukraine. [ ]
156 & 157	[ ][ ][ ]	This submission is extremely misleading. [ ]
169	[ ]	Tegel objects to the NZTGA implications that Tegel has [ ] These claims have no foundation in fact and must be withdrawn.
170	[ ]	As noted above, Tegel does not have the ability to exercise monopsony power. It has been trading at a loss since 2019 while its growers have been operating at high levels of profitability. It is facing increased costs [ ] The payoff for growers of collective bargaining will be increased revenue at Tegel's expense – that is agreed by all parties and the Commission.

3. Concluding comments from Tegel

3.1 The basic issue here is simple: NZTGA seeks authorisation to engage in what would otherwise be anti-competitive illegal cartel conduct. That cartel conduct can be authorised if there is clear public benefit, and the NZTGA claims benefits such as cost savings in negotiations and more efficient contracts.

3.2 In summary, it is Tegel's view that:

(a) The benefits for authorising this cartel are exaggerated at best and non-existent at worst;

(b) The ten-year period is grossly excessive;

(c) Tegel does not have the market power over its growers that the NZTGA says it has; and

(d) the costs are clear, and they will ultimately be borne by consumers.

4. Confidentiality

4.1 Confidentiality is requested for the information in this response that is contained in square brackets and highlighted in either yellow, green or red, on the basis that:

(a) the information is commercially sensitive and valuable information which is confidential to Tegel and the disclosure of which would be likely unreasonably to prejudice the commercial position of Tegel, or the person who is the subject to the information; or

(b) to make the information public would be likely to result in its disclosure or use for improper gain or advantage.

4.2 Tegel waives confidentiality in respect of the information highlighted in green in respect of NZTGA.

4.3 Tegel requests that it be notified if a request is made to the Commission under the Official Information Act 1982 for the release of the information for which confidentiality has been claimed and given an opportunity to provide submissions to the Commission on whether it should make disclosure prior to any such disclosure taking place.