

Draft Determination

Note: This is a draft determination issued for the purpose of advancing the Commerce Commission’s decision on this matter. The conclusions reached in this draft determination are preliminary and take into account only the information provided to the Commission to date.

This is a draft determination under the Commerce Act 1986 in the matter of an application for authorisation of a restrictive trade practice. The application is made by:

Waikato - Bay of Plenty Chicken Growers Association Incorporated

The Commission: Dr Mark Berry
Sue Begg
Elisabeth Welson

Summary of application: The Waikato - Bay of Plenty Chicken Growers Association Incorporated, on behalf of its members, has applied for authorisation to collectively negotiate the terms and conditions for its members to supply chicken growing services to Inghams Enterprises (NZ) Pty Limited.

Determination: On the basis of the information provided to date, the Commerce Commission’s preliminary decision is that it should grant authorisation for the application.

Date of determination: 23 November 2017

Confidential material in this report has been removed. Its location in the document is denoted by [].

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Introduction

1. On 20 September 2017, the Commerce Commission (the Commission) received an application from the Waikato - Bay of Plenty Chicken Growers Association Incorporated on behalf of its members (The Applicant or the Association) under section 58 of the Commerce Act 1986 (the Act) for the authorisation of potential restrictive trade practices.
2. All of the members of the Association are farmers who provide chicken growing services to the chicken processor, Inghams Enterprises (NZ) Pty Limited (Inghams). The Association, on behalf of all its current and any future members, is seeking authorisation to collectively bargain with Inghams the terms and conditions under which its members supply chicken growing services to Inghams. The details of the proposed collective bargaining arrangements are discussed below.
3. Members of the Association would be free to opt out of any collective process and negotiate with Inghams individually, if they so wished. The Association is not seeking authorisation for any collective boycott activity.
4. We are considering the Application under the streamlined authorisation process.¹
5. We are releasing this draft determination to provide interested parties with an opportunity to comment before we make our final determination.

Draft determination

6. The Commission's draft determination is to grant authorisation to the Application.
7. The collective bargaining proposed by the Applicant would likely interfere with the normal competitive process of competitors independently negotiating the price and terms that they would offer their services for. Because of this interference, we consider there is a real chance that the Proposed Arrangements would lessen competition. However, our preliminary view is that the Proposed Arrangements will, or will be likely to, result in a benefit to the public which would outweigh the lessening in competition.
 - 7.1 The collective bargaining proposed in the Application would likely result in public benefits by reducing the transaction costs of multiple individual growers arranging supply contracts with Inghams.
 - 7.2 Any detriments from collective bargaining are unlikely to be significant since growers and Inghams would be able to opt out of any collective arrangements and contract individually, if they so wished. As a result, any potential detriments from collective bargaining are likely to be outweighed by the likely public benefits.

¹ See Commerce Commission, *Authorisation Guidelines* (July 2013) for further information on our streamlined process.

Next steps

8. We invite written submissions on the draft determination. Submissions should be received by us on or before 8 December 2017.

Background

Parties to the arrangements

Members of the Waikato - Bay of Plenty Chicken Growers Association Incorporated

9. The Association was formed in 1984 and since this time it has been an advocate for, and a representative of, all the chicken growers who supply services to Inghams (or its predecessor). At present the Association has 33 members who operate 37 farms in and around the Waikato and the Bay of Plenty regions and all of these farms provide chicken growing service to Inghams exclusively.
10. The Association advised that its members tend to be small-to-medium enterprises and its primary objective is to provide support to these individual growers, particularly regarding their relationship with Inghams.² In this respect, the objectives of the Association include:³
 - 10.1 maintaining, promoting and advancing the interests and welfare of its members;
 - 10.2 encouraging high service standards and practices in the chicken growing industry;
 - 10.3 acting on behalf of its members in negotiating contracts with Inghams; and
 - 10.4 promoting a higher standard of training within the chicken growing industry.

Other relevant parties

Inghams Enterprises (NZ) Pty Limited

11. Inghams is one of the largest chicken processors in New Zealand and its main processing facility is located at Ngarua, near Waitoa. Inghams estimates that it supplies about one-third of all chicken meat processed in New Zealand.⁴
12. Inghams is a subsidiary of Inghams Enterprises Pty Limited, which is based in Australia. In both New Zealand and Australia, Inghams Enterprises Pty Limited operates a vertically integrated business, with the exception of chicken growing services which it contracts out to independent growers.

² Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [1.13(e)].

³ Rules of the Waikato - Bay of Plenty Chicken Growers Association Incorporated retrieved from the Companies Office at www.societies.govt.nz/cms on 26 October 2017.

⁴ Inghams Prospectus Initial Public Offering of Ordinary Shares (21 October 2016) at page 8. Retrieved from <http://ingham.co.nz/> on 7 September 2017.

13. At present, Inghams obtains chicken grower services from the 37 growing farms currently operated by the 33 members of the Association. To date, Inghams has never obtained growing services from a grower who was not a member of the Association or who was located outside of either the Waikato or the Bay of Plenty regions.

Other chicken processors in New Zealand

14. In addition to Inghams, there are two other main chicken processors in New Zealand: Tegel Group Holdings Limited (Tegel); and Van Den Brink Poultry Limited (Brinks). Like Inghams, both Tegel and Brinks outsource the chicken growing services they require to independent growers.

14.1 Tegel is the largest chicken processor in New Zealand and it has processing facilities in Auckland, New Plymouth and Christchurch. Tegel processes over half of all the chicken meat sold in New Zealand.⁵ At present, Tegel obtains chicken grower services from approximately 93 growing farms.⁶

14.2 Brinks is a private company and it has two processing facilities in South Auckland (at Karaka and at Tuakau) and one near Christchurch. At present, Brinks obtains chicken grower services from approximately [] growing farms.⁷

Other grower associations

15. It is relatively common in both New Zealand and Australia for chicken growers to be involved in an industry association. Much like the Association, the purpose of these industry associations include:⁸

15.1 the provision of technical knowledge, advice and expertise in connection with chicken growing;

15.2 providing assistance with regulatory matters (such as obtaining resource consents); and

15.3 organising industry seminars and social events.⁹

⁵ Tegel, Annual Report 2017. Retrieved from www.tegel.co.nz/ on 27 September 2017 at page 10.

⁶ Tegel, Annual Report 2017. Retrieved from www.tegel.co.nz/ on 27 September 2017 at page 9.

⁷ Commerce Commission interview with Brinks (17 October 2017).

⁸ The industry associations representing chicken growers who provide services to Tegel include the New Zealand Tegel Growers Association Incorporated; the Canterbury Poultry Meat Producers' Association Incorporated; the Auckland Meat Chicken Growers Association Incorporated; and the Taranaki Broiler Chicken Growers Association Incorporated. Brinks Growers Association Incorporated represents the chicken growers who provided services to Brinks.

⁹ For example, see Rules of The New Zealand Tegel Growers Association Incorporated dated 17 May 2006 retrieved from the Companies Office at www.societies.govt.nz/cms on 26 October 2017 and the Rules of the Brinks Growers Association Incorporated dated 22 October 2012 retrieved from the Companies Office at www.societies.govt.nz/cms on 26 October 2017.

Background to the arrangements

16. Chickens that are raised for consumption are called broiler chickens. The Application relates to the growing of broiler chickens which are then processed for consumption by consumers. The growing stage is one of the three main production stages in the broiler chicken industry. These three stages are:
 - 16.1 the breeding process and the hatching of day old chicks (DOCs);
 - 16.2 the growing of broiler chickens from DOCs to a specified weight; and
 - 16.3 the processing of broiler chickens into chicken meat products.

17. Attachment A includes a diagram with the different production stages in regards to Inghams. We understand that it is standard industry practice in New Zealand, and in other parts of the world, for processors (like Inghams) to outsource the growing stage to independent growing service providers.¹⁰ Processors and chicken growers typically enter into supply contracts in which the processor supplies the grower with DOCs to be reared to the desired specifications of the processor. In addition, it is the processor that supplies the other key inputs into the growing process (which includes the feedstock and the necessary medications) as well as also determining:
 - 17.1 the number of DOCs that will be supplied (or 'placed') in the growing sheds of the contracted grower;
 - 17.2 the date on which the DOCs will be placed;
 - 17.3 the weight (and therefore the date) at which the chicken will be collected (or 'caught') from the grower; and
 - 17.4 the number of growing cycles (or 'run rate') that each grower undertakes each year.

18. In addition, processors also determine whether a DOC would be grown to standard (or 'commercial') specifications or to 'free range' specifications. As with the other criteria, it is the processor who determines the number of commercial and free range chickens that will be grown and this assessment is based on consumer demand.
 - 18.1 The equipment and labour used by a grower to rear commercial and free-range broiler chickens are very similar. The key differences between free range farming and commercial farming is the minimum amount of 'open space' that the chicken must be able to access, as well as the necessary doors to allow the bird to exit the shed to the open space.

¹⁰ For example, see Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [3.7]; Commerce Commission interview with Brinks (17 October 2017); and Commerce Commission interview with Tegel (6 October 2017).

18.2 Demand for free range chicken meat has been increasing and so some processors have been encouraging commercial growers to modify their sheds so that more 'free range' chickens can be reared. However, increasingly, we understand that many growing sheds are now built to be dual purpose, or 'convertible'. This means that the shed can easily switch from rearing commercial chickens to free range chickens (and vice versa) without any modifications to the shed.¹¹

Past supply arrangements between the growers and Inghams

19. As indicated by the diagram in Attachment A, Inghams controls the growing stage of the production process but it has always outsourced its growing requirements to growers and it has never obtained the services of a grower who was not a member of the Association.
20. The Applicant advised that for the past three decades the Association has represented its members in contract negotiations with either Inghams or its predecessor.
21. During the most recent negotiations, the Association determined that its members would potentially be in breach of the Act if it collectively negotiated the fees and terms of supply that its members would provide chicken growing services to Inghams for.
22. The previous supply contracts between Inghams and the 33 growers have now expired but the parties have agreed that these contracts remain in place while they discuss potential future arrangements. However, these discussions have been suspended until the Commission makes a determination on the Association's application to collectively bargain with Inghams on behalf of its members.¹²

Arrangements for which authorisation is sought

23. The Applicant has requested authorisation under sections 58(1) and 58(2) of the Act to collectively negotiate the terms and conditions for its members to supply chicken growing services to Inghams. Specifically, the Applicant is seeking authorisation for a period of 10 years to:¹³

(a) collectively bargain with Inghams in relation to:

(i) growing fees and other terms and conditions of chicken growing contracts;

(ii) adjustment and review of growing fees and other matters arising from time to time under/or in relation to terms of chicken growing contracts; and

¹¹ For example, see Commerce Commission interview with Inghams (9 October 2017); and Commerce Commission interview with Tegel (6 October 2017).

¹² We note that the Commission is empowered to grant authorisation for contracts entered into prior to it issuing a determination. However, pursuant to section 59B of the Act, authorisation does not prevent conduct that occurred prior to the authorisation from constituting a contravention of the Act.

¹³ Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [1.10].

(iii) resolutions of disputes which from time to time arise under chicken growing contracts or otherwise arise between Inghams and a grower or growers; and

(b) enter into agreements collectively negotiated between Inghams and the Applicant relating to the matters described at subparagraph (a) above; and

(c) give effect to agreements collectively negotiated between Inghams and the Applicant relating to the matters described at subparagraph (a) above,

In all cases as the representative of the Current Growers and future growers

Growers who elect not to negotiate collectively will be free to opt out of the collective process and negotiate with Inghams individually.

24. The Applicant is not seeking authorisation to engage in any collective boycott activity.
25. We have not considered each of the above arrangements separately in our analysis. In practice, we view the arrangements as providing the Association with the ability to collectively bargain on behalf of its members.¹⁴

Collective bargaining in other jurisdictions

26. The Applicant submitted that, although the legislative framework is different in Australia, collective bargaining in the chicken growing industry is common practice in Australia and it has been repeatedly authorised by the Australian Competition and Consumer Commission (the ACCC).¹⁵ The Applicant considers that the Proposed Arrangements are no different to those arrangements that have been authorised in Australia.
27. In the past, the ACCC has recognised that collective bargaining between chicken growers can lessen competition but that it can also have public benefits. Because of these benefits, the ACCC has regularly authorised independent chicken growers to collectively bargain in groups with a processor since the industry was deregulated in the 1990s.¹⁶
- 27.1 The public benefits from collective bargaining that the ACCC has identified include:
- 27.1.1 transaction cost savings as collective bargaining removes the need for individual negotiations between growers and processors; and
- 27.1.2 improved input into contracts resulting in efficiencies. The ACCC has acknowledged that when negotiating with large suppliers, small businesses can be at a disadvantage, in terms of resources and experience of negotiating in complex commercial environments.

¹⁴ For the purposes of this report we have referred to these as the Proposed Arrangements.

¹⁵ Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [1.9].

¹⁶ For example, see ACCC, Authorisation A91534 to the Victorian Farmers Federation in respect of collective bargaining by Victorian chicken meat grower groups with the processor they supply (16 June 2016); and ACCC, Authorisation A91417 to the NSW Farmers' Association in respect of collective bargaining with chicken, turkey and duck meat processors (25 June 2014).

Collective bargaining is one way in which growers can seek to redress this disadvantage and it enables growers to be better informed of market conditions, allowing them to develop more efficient contracts with processors.

- 27.2 The detriments from collective bargaining that the ACCC have assessed tend to be limited when compared to the public benefits. This is largely because:
- 27.2.1 participation in collective bargaining has been voluntary for both the processor and the grower. To this extent, more efficient growers have the option of negotiating separately and are able to seek terms and conditions that might better reflect their individual circumstances;
 - 27.2.2 the bargaining groups have not proposed any collective boycott activity; and
 - 27.2.3 the level of competition between individual growers tends to be low as processors typically offer standard form contracts to growers which limits the scope for growers to compete with one another.

How we assess restrictive trade practice authorisations

- 28. Section 27 of the Act prohibits contracts, arrangements or understandings containing a provision that has the purpose, effect, or likely effect, of substantially lessening competition in a market.
- 29. Upon application under section 58 of the Act, we can authorise conduct that may otherwise breach section 27 of the Act. However, we must be satisfied that such conduct would be likely to result in benefits to the public that outweigh the detriments arising from the likely lessening of competition.
- 30. In assessing an application, we first determine whether the relevant provision contained within an arrangement would be likely to lessen competition.¹⁷ If we do not consider that a lessening of competition is likely, we do not have jurisdiction to further consider an application and, consequently, will not go on to consider the public benefits of the conduct.
- 31. If we consider that the relevant provision contained in an arrangement would be likely to lessen competition we will authorise the conduct if we are satisfied that the public benefits are likely to outweigh the detriments from the arrangement. If we are not so satisfied, we will decline to grant authorisation.

¹⁷ Any lessening of competition need not be substantial. Commerce Act 1986, s 61(6A).

Relevant market

32. When we consider an application for authorisation of potentially restrictive trade practices, we assess the competitive effects of those practices in respect of the relevant market(s) in New Zealand.¹⁸
33. Determining the relevant market(s) requires judgement as to whether, for example, two products are sufficiently close substitutes (as a matter of fact and commercial common sense) so as to provide significant competitive constraints on each other. Markets are defined in a way that best isolates the key competition issues that arise from an application.
34. In general, the more closely substitutable two products are, the closer the competition and the greater the competitive constraint between the products.
35. The Applicant submitted that, similar to previous assessments by the Commission, the relevant market should be the market for broiler chicken growing services in the Waikato and Bay of Plenty regions.¹⁹ The main reason for this regional growing market is that growing farms tend to be located within close proximity of processing plants due to animal welfare considerations.
36. The Commission's preliminary view is that the relevant market is the market for broiler chicken growing services in the Waikato and Bay of Plenty regions (the Waikato BoP chicken growing market). This is because:
- 36.1 broiler chicken growing services are discrete from other forms of farming as the sheds and equipment that growers operate are customised to broiler chicken growing services and dedicated to rearing DOCs to a specified weight. To this extent, a chicken growing shed can not be used to rear another production animal such as cattle or pigs. Further, the equipment and labour used by a grower to rear commercial and free-range broiler chickens is very similar such that it is appropriate to assess these services as part of the same product market; and
- 36.2 animal welfare considerations mean that broiler chickens are not transported long distances from the growing farm to the processor, which tends to limit the extent of the geographic market. As a result, growing farms tend not to be located more than a two hour drive from a processor.²⁰
37. At present, there are 33 current members of the Association, operating 37 farms, and all supply growing services in the Waikato BoP chicken growing market. All of the

¹⁸ Commerce Act 1986, s 3(1A): "the term market is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them".

¹⁹ Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 2008).

²⁰ For example, see Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [3.31(e)];

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37 farms are located in the Waikato and the Bay of Plenty regions, although the majority of these farms are located within the Matamata-Piako District. Not one of the 37 farms has ever provided their growing services to any other chicken processor and Inghams does not purchase any growing services from any other farms.

With and without the proposed arrangements

38. When assessing the likelihood of a lessening of competition arising from an arrangement, the Commission compares the likely state of competition with the arrangement and the most competitive, likely state of competition without the arrangement. By assessing the relative state of competition in each of these scenarios, the Commission can determine whether the restrictive trade practice is likely to result in a lessening of competition.
39. Our preliminary view is that the status quo is unlikely to continue either with the Authorisation or without it. Without the Authorisation, it is likely that Inghams would negotiate supply contracts directly with each individual grower. With the Authorisation, the difference would be that, with collective bargaining authorised, it is likely that both Inghams and the Association would engage in collective bargaining to the extent that both parties consider such discussions to be useful. Direct negotiations with growers would therefore occur when both parties did not consider collective bargaining to be useful.

With collective bargaining

40. With the Proposed Arrangements, the Association would be permitted to collectively negotiate the terms and conditions according to which its members (or a subsection of its members) would supply chicken growing services to Inghams.
41. Growers that elect not to negotiate collectively would be free to opt out of the collective arrangements and negotiate with Inghams individually.²¹
42. The Applicant considers that, in the without scenario, there would be a large imbalance in bargaining power between individual growers and Inghams. In its view, there would be significant scope for the exercise of market power by Inghams, given its position as a monopsony purchaser of services in the Waikato BoP chicken growing market.²² The Applicant considers that one of the main reasons for collective bargaining is to offset this power imbalance between growers and Inghams.
43. If the proposed collective bargaining arrangements were to be authorised, Inghams advised that it would have no objections to discussing potential supply arrangements with the Association. However, this is only because authorisation has not been

²¹ Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [1.11].

²² Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [5.15].

sought for the growers to impose restrictions on each other's ability to negotiate and enter into individual agreements with Inghams.²³

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Without collective bargaining

44. The Commission agrees with the Applicant's submission that the status quo is unlikely to continue. The Commission considers that, without the Proposed Arrangements, it is likely that growers and Inghams would enter into individual supply contracts, with the terms and conditions of these contracts to be negotiated between the individual grower and Inghams.
45. The Association submitted that, without an authorisation, its members would be prohibited from collectively discussing and negotiating the fees and terms they would supply their chicken growing services to Inghams for, as such behaviour would likely constitute an infringement of the Act. Therefore, the Association would not be able to represent its existing members in any contract negotiations with Inghams. Given this, the Applicant submitted there would be two potential without scenarios:²⁶
- 45.1 Inghams might negotiate the fees and conditions for the supply of chicken growing services with each grower individually; or

²³ Submission from Inghams to the Commerce Commission on the Waikato BoP Chicken Growers Association's authorisation application (9 November 2017).

²⁴ [

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²⁵ [

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²⁶ Clearance Application from the Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [5.3].

45.2 Inghams might offer the growers' contracts which are essentially 'standard form' with little scope for growers to negotiate variations to the standard terms or conditions.

46. Inghams advised that, without collective bargaining, it would
[

46.1

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47. [

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Whether the proposed arrangements would lessen competition

48. The Application seeks authorisation on the basis that section 27 of the Act might apply to the Proposed Arrangements. An arrangement may be authorised under section 61(6) if it is of net benefit to the public.

49. If we consider that an arrangement would be likely to lessen competition we will go on to assess whether the conduct would, in all the circumstances, result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition. If the benefits outweigh the lessening of competition, we may grant authorisation.

50. In an authorisation context, we must also determine the extent of the lessening of competition that would result from the arrangement.²⁸

51. With the Proposed Arrangements, the Association would seek to collectively negotiate the supply contracts (including the relevant fees and charges) that its

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²⁸ *New Zealand Vegetable Growers Federation (Inc) v Commerce Commission (No.3)* (1988) 2 TCLR 582.

members would, potentially, enter into with Inghams. Therefore, the Proposed Arrangements would likely interfere with the normal competitive process of competitors independently negotiating the price and terms on which they would offer their services to a purchaser.

52. The Commission's preliminary view is that, when compared to individually negotiated supply contracts, collective bargaining would have the potential to raise the (quality adjusted) price²⁹ paid by Inghams for chicken growing services. To this extent, we agree with the Applicant's submission that the Proposed Arrangements would likely lessen competition in the Waikato BoP chicken growing market.
53. Nevertheless, while there is a real chance of a lessening of competition, we consider that the extent of any lessening of competition as a result of the Proposed Arrangements would likely be small. This is primarily because, in the Commission's view, it is unlikely that there would be a material difference in the contractual outcomes between Inghams and growers under the Proposed Arrangements compared to the contractual outcomes without the Proposed Arrangements.
54. []with the Proposed Arrangements, Inghams stated it would only discuss potential supply arrangements with the Association as long as there were no conditions or restrictions on a grower's ability to individually discuss or negotiate their growing contract with Inghams.³⁰
55. []

Assessment of benefits and detriments

56. We will grant authorisation if we are satisfied, on the evidence before us, that the restrictive trade practice will in all the circumstances result, or will be likely to result, in a benefit to the public outweighing the lessening in competition arising from the restrictive trade practice.
57. In making this assessment, we have regard to the quality of the evidence available and make judgements as to the weight to be given to the evidence.
58. In *Godfrey Hirst* the Court of Appeal noted that in determining whether to grant authorisation the Commission must consider a broad range of benefits and

²⁹ Price in this regard refers to all dimension of competition including quality, the level of service, or any other element of competition valued by buyer.

³⁰ Submission from Inghams to the Commerce Commission on the Waikato BoP Chicken Growers Association's authorisation application (9 November 2017).

detriments. This includes any efficiencies and may include non-economic factors in appropriate cases.³¹

59. In particular, the Court of Appeal indicated that in making an authorisation decision the Commission is to have regard to efficiencies when weighed together with long-term benefits to consumers, the promotion of competition, and any economic and non-economic public benefits at stake in the relevant market. In assessing these various factors, the Court stated that “[w]here possible these elements should be quantified; but the Commission and the courts cannot be compelled to perform a quantitative analysis of qualitative variables.”³²
60. The Commission’s approach is to quantify benefits and detriments to the extent that it is practicable to do so,³³ but, as the Court of Appeal in *Godfrey Hirst* noted, this must not be allowed to obscure the Commission’s primary function of exercising a qualitative judgment in reaching its final determination and “...making what is an essentially evaluative judgment on any application”.³⁴ The Court re-emphasised the guidance given in *New Zealand Bus Ltd v Commerce Commission*, where it was stated:
- It is true that some data will be weighed or considered in deciding whether the law is violated and some will not. Yet all the suggestions about more systematic ways to inform that judgment are merely techniques, or hand tools. In short, this Court should not allow a kind of false scientism to overtake what is in the end a fundamental judgment which is required by the Act itself.
61. As the Court recognised, “[t]he Commission cannot be expected to render all relevant factors in quantitative terms. Nor should its qualitative judgment be reserved as a mere backstop”.³⁵ The Commission will take into account both qualitative and quantitative factors when making a decision.³⁶
62. As to the weight that can be given to qualitative factors, we note the Court’s guidance that “[q]ualitative factors can be given independent and, where appropriate, decisive weight; it follows that non-quantifiable factors need not assume a merely supplementary function in a largely arithmetical exercise, as supposed in contemporary practice.”³⁷

³¹ *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560 (CA) at [24] and [31].

³² *Godfrey Hirst* (CA) at [36].

³³ *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429 (CA) (AMPS-A CA) at 447 and *Air New Zealand and Qantas Airways Limited v Commerce Commission* (2004) 11 TCLR 347 (Air NZ No 6) at [319]. *Ravensdown Corporation Ltd v Commerce Commission* High Court, Wellington.

³⁴ *Godfrey Hirst* (CA) at [35].

³⁵ *Godfrey Hirst* (CA) at [37].

³⁶ In *Godfrey Hirst* (CA), the Court cautioned that, in light of the statutory scheme, the Commission’s approach was not to be dominated by a quantitative analysis of the nature described at [91] – [97] of *Godfrey Hirst v Commerce Commission* (2011) 9 BLC 103, 396, (HC).

³⁷ *Godfrey Hirst* (CA) at [38].

Preliminary view

63. On the evidence before us, our evaluative judgement is that the Proposed Arrangements would likely result in a benefit to the public outweighing the lessening of competition arising from the Proposed Arrangements.

Benefits arising from the arrangements

64. Our preliminary view is that there are likely to be public benefits from the Proposed Arrangements as collective bargaining would likely reduce some of the transaction costs associated with growers contracting with Inghams. However, the savings are unlikely to be as high as those estimated by the Applicant.

Transaction cost savings

65. The Applicant submitted that the Proposed Arrangements would result in public benefits as collective bargaining would reduce the transaction costs involved with 33 growers (in regards to 37 farms) each individually negotiating supply arrangements with Inghams.
66. Even under the most conservative estimates, the Applicant considers that the Proposed Arrangements would result in substantially lower transaction costs than what would be incurred, by both growers and by Inghams, in any other likely form of contracting. Based on historical annual negotiation costs and estimates, it estimates these transaction cost savings would be approximately [] per annum.
67. The Commission considers that there are likely to be benefits from collective bargaining (compared to individual bargaining) as a result of the reduction in transaction costs. In this instance, all the industry participants that the Commission contacted to date, including a range of growers and processors, considered that collective bargaining had the potential to deliver savings in cost and time, although this would depend on the extent of individual negotiations Inghams undertakes, how contested these negotiations were, and how often any contracts had to be renegotiated.³⁸
68. However, our preliminary view is that, while significant, any cost savings estimate from authorising the Proposed Arrangements is likely to be lower than the annual amount submitted by the Applicant.
69. Historically, the growers and the Association have had annual negotiations with Inghams and the Applicant's estimates are based on any future negotiations continually on an annual basis. However, the Commission understands that [] the Applicant's estimate of the cost savings from the Proposed Arrangements are likely to be higher than the likely benefits the Commission expects would occur in the with

³⁸ For example,
[]].

the arrangement scenario.

Impact of wealth transfers

70. The Applicant submitted that a reduction in returns to Inghams' foreign-owned parent company, Inghams Enterprises Pty Limited, as a result of paying higher prices for growers, should be considered a reduction in a public detriment which would accrue without the Proposed Arrangements. In the Applicant's view, any arrangement that reduces the wealth transferred from the New Zealand growers to Inghams' foreign shareholders should be treated as a reduction in a public detriment.
71. We typically consider changes to the distribution of wealth between suppliers and customers as neutral.³⁹ However, certain wealth transfers may be relevant to our benefits and detriments assessment when the transfer is between New Zealanders and non-New Zealanders. Nevertheless, when considering the direct effects of any transfers we also consider the effects on non-New Zealanders that may ultimately feed back to New Zealand.⁴⁰ In this case that would include the potential pass through to New Zealand consumers.⁴¹
72. We consider that any wealth transfers arising from the Proposed Arrangements would be either positive or neutral. However, given the conclusion we have reached that the overall benefits of the Proposed Arrangements outweigh the detriments, it is not necessary for us to consider the likelihood or magnitude of any such beneficial wealth transfers.

Detriments arising from the arrangements

73. In undertaking our assessment of detriments, we have considered the extent to which allocative inefficiencies may arise as a result of price and quantity changes due to the Proposed Arrangements. We have also considered the potential for any productive or dynamic inefficiencies to arise from the Proposed Arrangements. To date, no party or person we have interviewed has identified that there would be other potential detriments that may arise from the Proposed Arrangements.

Loss of allocative efficiency

74. In general, when the price of a product increases, the quantity of that product demanded by customers will decrease, as some customers switch to less preferred alternatives or merely purchase less. Either way, the net result is that resources are allocated less efficiently.
75. The size of this allocative efficiency loss depends, to a large extent, on the extent of the expected price increases following the Proposed Arrangements. All else being equal, the higher the expected price increases, the larger the expected allocative

³⁹ Commerce Commission, Authorisation Guidelines (July 2013) at [53].

⁴⁰ Commerce Commission, Authorisation Guidelines (July 2013) at [54-55].

⁴¹ The Commission has not been provided with any information on which it could estimate the degree of pass through.

efficiency loss. Conversely, small or negligible price increases tend to reduce the potential for a loss in allocative efficiency.

76. The Applicant submitted that there are likely to be limited, if any, detriments from the Proposed Arrangements. In its view, a public detriment could arise from the Proposed Arrangements only if the arrangements were to lead to the final consumer of broiler chicken meat paying a higher retail price. The Applicant considers this is unlikely to happen because:

76.1 the price paid for growing services only accounts for a small percentage of the final retail price of chicken meat.⁴² It therefore considers that it would take a large change in the price paid for growing services to have any impact on consumer behaviour and this is unlikely to result from the Proposed Arrangements; and

76.2 Inghams would continue to have significant countervailing power in any negotiations with the Association such that it would be very difficult for it to increase the fees that growers are currently paid.

77. As above, our preliminary view is that there is potential for higher prices for growing services as a result of independent growers collectively negotiating their supply arrangements with Inghams.

78. Nevertheless, any detriments that would result from higher prices under the Proposed Arrangements would likely be small.

[]

78.1 Inghams submitted that it was not opposed to any proposed authorisation as long as the Proposed Arrangements did not restrict its ability to negotiate individually with a particular grower, if it wished to.⁴³

[]

44

78.2

⁴² For example, the Applicant estimated that growing fees account for only [] of the wholesale price of chicken meat. Clearance Application from Waikato-Bay of Plenty Chicken Growers Association Incorporated (20 September 2017) at [8.1(d)]. This is consistent with pricing estimates in other jurisdictions. ACCC Authorisations A40093/A90931, Victorian Farmers Federation in relation to collective bargaining by chicken meat grower groups with their nominated processors in Victoria (2 March 2005).

⁴³ Submission from Inghams to the Commerce Commission on the Waikato BoP Chicken Growers Association's authorisation application (9 November 2017).

⁴⁴ []

Other potential detriments

79. Our preliminary view is that the Proposed Arrangements are unlikely to result in a loss of either productive efficiency or dynamic efficiency.
80. Productive efficiency losses may be relevant if the Proposed Arrangements reduced each individual grower's incentive to minimise their growing costs. However, because growers would be able to opt out of the Proposed Arrangements, the more productive and efficient growers would be able to negotiate directly with Inghams (and vice versa⁴⁶). To this extent, the Proposed Arrangements are unlikely to remove the incentive of growers to minimise their growing costs.
81. Dynamic efficiency losses may be relevant if the Proposed Arrangements reduced each individual grower's incentive to innovate and to develop more efficient farm management practices to grow broiler chickens. Again, because growers would be able to opt out of the Proposed Arrangements, individual growers would still have an incentive to innovate and improve their farm management practices; the more innovative growers would likely be able to negotiate directly with Inghams (and vice versa) and extract the direct benefits from this innovation.

Balancing benefits and detriments

82. In this case, we have taken a more qualitative approach to our assessment based on the guidance of the Court of Appeal in *Godfrey Hirst*.
83. On a qualitative basis, the Commission's preliminary view is that any competitive detriment from the Proposed Arrangements would likely be limited. This is primarily because the Proposed Arrangements allow for growers to opt out of any collective arrangements negotiated by the Association meaning that more efficient growers would be free to arrange their own terms and conditions with Inghams, if they so wished.
84. Further, Inghams, as the only purchaser of growing services in the Waikato BoP chicken growing market, []with the Proposed Arrangements compared to without the Proposed Arrangements.

⁴⁵ []

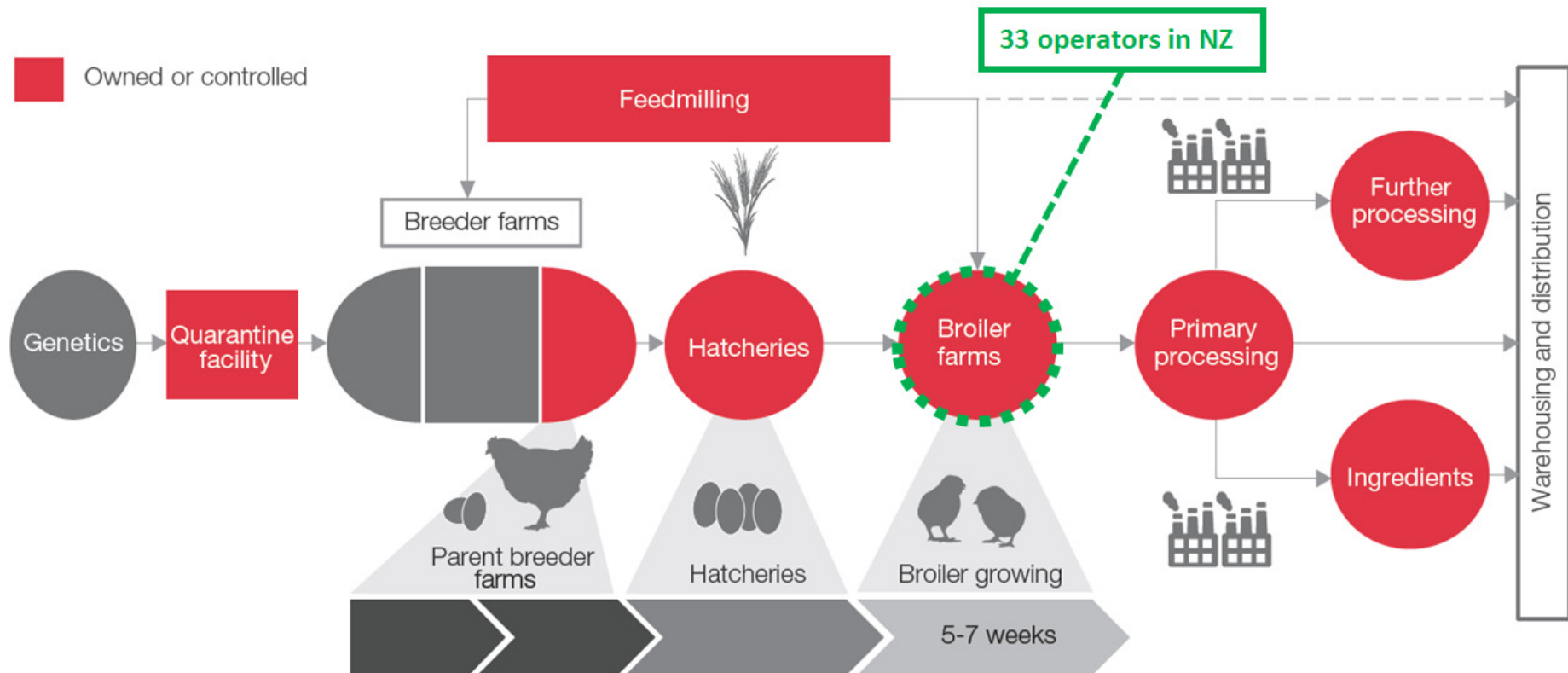
⁴⁶ For example, the Proposed Arrangements might reduce Inghams incentive to change how it allocates the market's growing capacity (such as sponsoring a farm conversion to free range) but Inghams would have the ability to negotiate with an individual grower, if it so wished.

85. With limited detriment, any material public benefits that would be attributable to the Proposed Arrangements would likely outweigh this detriment. Our preliminary view is that the Proposed Arrangements would likely result in public benefits when compared to the scenario without the Proposed Arrangements since:
- 85.1 without the Proposed Arrangements, it is likely that each member of the Association would negotiate individually with Inghams. Each grower, as well as Inghams, would be faced with costs (and time) to arrange and enter into individual contracts; and
- 85.2 with the Proposed Arrangements, while there would be individual negotiations, collective bargaining would be authorised. The costs and time involved with growers entering into a collectively negotiated contract would likely to be less than what would be incurred without the Proposed Arrangements.
86. For the purposes of the Draft Determination, we consider that at this stage it is not practicable or appropriate to fully quantify the estimates of the likely benefits and detriments from the Proposed Arrangements. In making this preliminary assessment, we have had regard to the information provided during our discussions with industry participants. To date, all of the parties we have spoken to consider that, in the Waikato BoP chicken growing market, there would likely be some benefits from allowing the Association to collectively bargain with Inghams and these benefits are likely to outweigh any likely detriments.
87. Accordingly, on the evidence before us, our evaluative judgement is that the Proposed Arrangements would likely result in a benefit to the public outweighing the lessening in competition arising from Proposed Arrangements.

Draft Determination

88. The Commission's draft determination is that the Proposed Arrangements will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition. Therefore, the Commission proposes to grant an authorisation for the Proposed Arrangements under section 58 of the Act for the period set below.
89. Under section 61(2) of the Act, the authorisation (if granted) would expire on the tenth anniversary of the date of the granting of the authorisation.

Attachment A: Inghams' production process⁴⁷



⁴⁷ Includes information primarily sourced from Inghams but with modifications made by the Commission. See Figure 26: Inghams' production process in Inghams Prospectus: Initial Public Offering of Ordinary Shares (21 October 2016) at page 38. Retrieved from <http://inghams.co.nz/> on 7 September 2017.