26 Feb 2024

Ms C Wundersitz
General Manager, Rural Affairs
National Farmers' Federation

Dear Charlotte,

RE: RESPONSE TO INTERIM REPORT: EXPLORING THE POTENTIAL FOR A CODE OF CONDUCT TO INCREASE MARKET TRANSPARENCY AND COMPETITION IN AUSTRALIAN POULTRY MEAT SUPPLY CHAINS.

in light of the Alan Fels report, and the responses by APIA and Mr Chris Turner on behalf of the processors to the Interim report, we wish to provide additional comments on issues raised by these.

1. **Professor Alan Fels report**
   Commissioned by the ACTU, Alan Fels (former Commissioner of ACCC) specifically examined supermarket pricing in the context of other pricing in the economy and reported on Feb 7, 2024. The report in full can be examined HERE.

   Of note are the following:

   1.1 Professor Fels recommends making the current Food and Grocery Code mandatory. This Code is currently voluntary and is characterised by the number of small players that have not signed to the Code, as well as alleged pressure tactics by the two major supermarkets onto suppliers.

   ACGC recognises that the chicken meat processing companies are sometimes under considerable pressure from the two major supermarkets to keep wholesale prices low at any cost while delivering elegant returns to shareholders (Inghams). However, with only two major chicken meat processors in the supermarket sector representing around 75% of fresh chicken meat production and controlling more than 90% of the meat poultry genetics, it is fair to say that there is suitable countervailing power between the major supermarkets and major chicken meat processors (ratio of 2:2).

   With chicken meat already the least-cost meat protein available to consumers (by some margin!), and with growers only representing less than 3% of retail cost, it is unlikely that even a significant rise in growing fees would result in any substantial increase in retail/consumer cost if pricing was based on other than a "cost plus" model (see example at 2.7).

   Notwithstanding this, there is potential that conversion of the Food and Grocery Code to a mandatory and enforced format would result in less pressure on chicken meat processors, and thus the potential for a better deal for growers. To that end ACGC strongly supports Professor Fel's recommendation.

TABLE 1. PRICE INCREASES: BETWEEN MARCH 2021 AND SEPTEMBER 2023

Automotive Fuel	45.4%
International Travel and Accom	36.3%
Gas and Other Household Fuel	35.7%
Electricity	22.3%
Oils and fats	34.2%
Insurance	22.6%
New Dwellings Purchases by Owner-Occupiers	31.1%
Groceries:	
• Cheese	27.3%
• Bread	24.1%
• Milk	22.7%
• Ice cream and dairy products	22.5%
• Eggs	19.7%
• Breakfast cereals	19.2%

1.2 Professor Fels notes the rate of rising costs as per Table 1 (previous page). It is notable that the major costs in chicken meat processing include automotive fuel, gas and other household fuel, electricity, and insurance – 3 of the top 6 price rise areas for growers.

Even recognising this, processors are not only continuing to supply birds to growers without a new contract, but currently offering growers LESS in the new draft contracts than the ones dated as early as 2018.

1.3 The Fels report identifies corporate operating surpluses, profitability and labour costs between 2015 and 2023 (Figs 1 & 2). It is worth noting that between 2019 and 2022 Australia had a *La Nina* event, resulting in huge grain harvests and therefore low prices for the key feed inputs. This means that Fig 1 applies to poultry processors, but during this period growers' costs were rising rapidly and they were not paid more for their service fee.

1.4 The contracts, particularly those including the operation of pools schemes, are very close to confusion pricing because the grower cannot work out the parameters by which they earn their place in the pool.

1.5 Given the level of vertical integration of the processors the sheer market power offered by the "big 2" processors Ingham and Baiada, and their complete control over the genetics of the remaining processors, and the opaque pricing that results, government could well include these processors in any proposed new divestiture law as proposed in the report. Inghams in particular has been able to provide dividends to shareholders well above normal profit, and Baiada is almost certainly operating at similar margins even though (and perhaps because) they are privately owned.

1.6 Report Recommendations: ACGC supports Recommendations 1.1-1.6, 2.2-2.4, 3.1-3.5 and 4.12-4.14 of the Fels report.

FIGURE 1. CORPORATE OPERATING SURPLUSES, 2015-2023

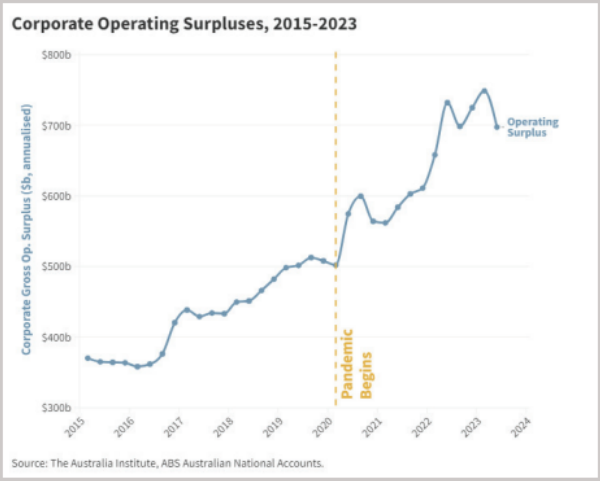
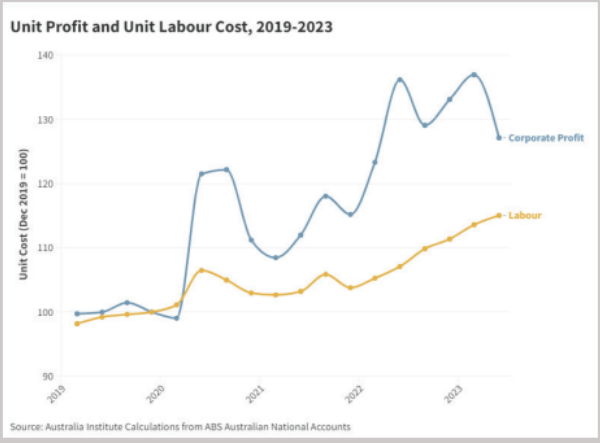


FIGURE 2. UNIT PROFIT AND UNIT LABOUR COST, 2019-2023



2.0 APIA response to the Interim Report

2.1 Conflict of Interest

The APIA response alleges a conflict of interest by the NFF conducting the study. Why has this been raised only now, when government approved the project, APIA was represented on the Advisory Committee for the entire period and $500,000 has been spent? ACGC has evidence that the project was creditably run, and was visibly and continuously oversighted by the ACCC and DAFF. We are aware that APIA made direct allegations to DAFF, and NFF was able to demonstrate to DAFF that the terms of reference of the project were fully met with good governance and due diligence, so it is unclear why this is raised again.

2.2 Price Transparency

In spite of APIA's protestations, it is *obvious* that a Code would increase price transparency. Publishing standard form contracts on the websites as suggested by the report and included in the Dairy and other Codes makes this obvious.

2.3 PAG Inquiry

References to the PAG inquiry are interesting, but peripheral to, the current project and this is a deflection. ACGC recommends that references to the PAG Inquiry remain in the document without change, as an expression of history.

2.4 *Proprietorial Interest.* This is not necessary for a key sector of a supply chain (like grain, or growers, or pick-up crews) to have proprietorial interest. The issue in the report is not an analysis of proprietorial interest, but of thuggish behaviours, poor price transparency, and confusing and conflicting contracts that most solicitors recommend growers do not sign.

2.5 Price Transparency.

APIA alleges that there is currently competition between growers. There is not. The pool system is corrupted by different placement dates, feed, pick-up patterns, even hatcheries in some cases. There is NO competition by processors to contract the best growers, and growers have no opportunity to competitively tender their services to multiple processors.

2.6 Statistical Significance.

The project is demonstrably statistically significant, with the possible exception of processor consultation, which was hampered by their deliberate self-exclusion from the process.

The methodology is so widely practiced and so widely published it would appear to be inviolable, but one example is HERE. In any event, even if the project had not been statistically significant, the responses were so consistent for a *qualitative* study that the sample is more than adequate. The results are valid.

2.7 Retail Price.

The processors allege that a mandatory Code of Conduct would "drive up the cost" to consumers. The processors allege that a mandatory Code of Conduct would be inefficient – but how much more economically inefficient can it be to have growers subsidising supermarkets through their processors, growers not building new farms even with an approved DA, banks threatening, and lawyers recommending that contracts not be signed as they are unconscionable in whole and in part?

A "real life" example of grower "take home" for chickens is shown in the box. If a grower received an additional 5c/bird, to $1.05, then the retail cost or our indicator roast chicken theoretically rises to $12.05, which is a rise of **0.4%. BUT** a problem arises due to "cost plus" pricing by both processors and supermarkets, which increases their net cash "take" at the expense of consumers.

It is also worth noting that in nobody's economic model/theory does it state that the bottom of the supply chain should *subsidise* another part of the supply chain for the believed benefit of consumers. In a true supply/demand system as price rises, consumer purchases should decrease in accordance with the elasticity of the demand curve.

Predictably however, and in an identical strategy used by the multinational Fronterra during the Dairy Industry Code development, the meat chicken processors seem to be suggesting that "*we'll all be rooned*[11]" if a chicken grower receives any fee rise, arguing that the proposed Code will increase retail prices. Therefore, they are essentially stating that growers fees will rise under a Code, which is an admission that they believe growing fees are inadequate at the present time.

However, this is almost completely avoidable. All they have to do is develop their pricing based on *costs*, not on "cost plus".

EXAMPLE: Growers receive around an average $1 growing fee for a bird of around 2.8kg, or around 35c per kg. A whole roast chicken from the supermarket, which is one of the lowest-cost poultry presentations, is around $12/bird. So AT BEST, growers receive, on average, less than 4% of retail chicken cost. (Note that dressing % is not included as virtually all parts of the bird are saleable (feet, feathers, giblets etc) and high value cuts (below) offset low by-product prices).

That $12 bird is around 1.65kg, or around $7.27/kg. *Note that prime chicken cuts (breasts around 30% of total weight, thighs around 25%), which represent the majority of bird weight, retail for around $16/kg (Coles) or up to $35/kg for free range.*

Secondary processed product, which uses small volumes of lesser chicken cuts bulked out with other ingredients (eg nuggets, tenders etc) can retail for $14/kg or more but have only 39% chicken meat in them.

So the average actual "take home" for the grower is around 2.7% of retail cost.

Example: How "COST PLUS" pricing drives up consumer cost unnecessarily.

Say a farmer grows a chicken for $1.

Say the processor sells that chicken for $5 (500% lift), so he makes $4.

Then the retailer sells it for $10. (100% lift). So he makes $5.

If the grower receives a 10% price rise because his costs have risen, that's $1.10. That's **10c** to the grower.

With 500% lift at processor level, that's $5.50 Now the processor is making $4.40, that's **40c** better off. For no extra work and no extra cost.

Now the retailer takes that $5.50 chook and sells it for $11.00. Now he's **50c** better off. For no extra work and no extra cost

So, for the 10c rise to the grower, the processor pockets 40c extra and the retailer 50c extra.

SO any price rises to consumers will be **90%** the result of the processor and retailer, and only **10%** the result of the grower.

WHERE'S THE PRICE CAPTURE??

[1] *"Said Hanrahan", poem by John O'Brien 1879-1952.*

2.8. "Solving" complex contractual negotiations developed over decades with a mandatory Code of Conduct.

Firstly, ACGC is delighted that APIA believes that contractual negotiations have been complex for decades – decades that have included forced state-level legislation to control negotiation due to market vilification by processors, changes to ACCC laws, the PAG review - all without success– because of the significant countervailing power issues between processors and growers. Those decades have included a litany of growers who have been forced to sell after they represented groups of growers in negotiations, failed reinvestment in older farms because their depreciation has been "stolen" by processors and forced shut-down of viable farms because processors have done deals to divide Australia geographically for their own needs.

Nobody, not least ACGC and presumably the NFF, believes that a mandatory Code of Practice will "solve" all the countervailing power issues. That government is even considering a mandatory Code of Practice is testimony to power imbalance and entrapment of growers in a way not seen in the red meat industry where there are many processors, buyers and sellers and few unconscionable contracts as a result. It is the extremely high concentration of market power in the hands of processors and supermarkets that have turned processors into proxies for supermarkets and caused the overt market failure.

However, what a Mandatory Code of Conduct will do is provide a set of enforceable rules, disputes mechanism and oversight that will at least give growers just the beginning of an opportunity to more fairly collectively negotiate with processors and by extension, supermarkets.

It's worth remembering that growers and government would not be in the current situation if they had been treated fairly within the current system. Red meat farmers are not crying out for a mandatory Code of Conduct.

If APIA is truly convinced that this will provide no solution to the issues raised in the report then no harm is done and we look forward to APIA supporting a mandatory Code of Conduct on that basis.

3.0 Chris Turner response to the Interim Report

3.1. "Statement of known facts".
If these statements were *actual* "facts" (they are not) then the industry:

- would have processors competing for highly efficient growers to meet demand (they do not),

- would have farms selling in a week or two, and not in the months to years they are currently taking to sell,

- would have farm values higher with shedding on them and not farm values higher with the shedding removed as is the case in a number of growing areas, and

- would not have farms on biosecurity-dangerous 3 day “turnarounds” or even in one state *negative* turnarounds due to the current shortage of shedding.

To simply state that there is no evidence of banks being unhappy is not a “fact”. There is no evidence that they have been asked about their degree of “happiness”.

Calling something an “undisputable fact” does not make it so.

3.2 PAG review.
Mr Turner’s response refers extensively to the ACCC PAG review and responds to many of the elements in the PAG review.

The PAG review completed some 3.5 years ago, and things have moved on since that time. During that period ACCC has been forced to modify elements in contracts which were then presented to growers as “approved by ACCC” in a completely misleading manner. New contracts have been developed that move risk to growers in other ways, reduce returns to growers and force costly upgrades without consideration. Growers returns have continued to decline in the face of significant mortality events, short placement issues, termination of contracts as a vilification event, pool manipulation and withholding weighbridge dockets (among other unconscionable practices), out of reach of ACCC examination of some contract clauses.

The government instituted the project that was conducted by the NFF. With respect, it’s time to move on from the PAG report.

3.3 “..without examining other options” (P1).
Again, this is simply not true. Over the last 30 years, the industry has examined many options including and beyond the Government project operated by NFF and including but not limited to

- countervailing power legislation (which operated reasonably well, but was dismantled due to the economic philosophy of the time),
- multiple changes to Australian Consumer Law,
- collective bargaining authorisations;
- the USA tournament system,
- EU multi-layer bargaining system
- voluntary Code, and
- mandatory Code.

The Project lists these in Section 4 (in case the writer hasn’t seen them). All the Australian options (ACL changes, authorisation etc) have failed, and re-instituting legislation (as is happening with the Packers’ legislation in the USA) may be over-reach IF a Mandatory Code of Conduct can be made to work.

3.4 “…true consultation with growers” (P1).
The report specifically identifies that there was statistically relevant qualitative consultation with growers. Mr Turner is referred to Part 3 of the report. To claim otherwise is a furphy.

Of course the processors want the *status quo* to continue, that should be their economically rational response to even the tiniest dent into their overwhelming market power. That supermarkets have indicated they will support a mandatory Code is telling, noting that the Food and Grocery Code by which they are bound may also convert to a mandatory Code.

Mr Turner concludes, *without evidence*, that growers did not attend workshops because they prefer the *status quo*. There are many alternative reasons why growers may not have attended, including the potential for their processor to engage in vilification and/or contract termination if they had found out the names of the growers that attended. Therefore, Mr Turner's conclusion must be treated as a furphy unless and until *actual* evidence is provided.

3.5 "..other options.."
If Mr Turner genuinely believed that there were "other options", why were these not put to the government or project operator to be included in the final report?

It has been nearly 2 years since this project was mooted, why is this being suggested only now? Why is there no detail provided on these "other options" to which Mr Turner refers, not even a list of what these "other options" might be? If "other options" were available why weren't these presented to growers prior to the PAG report *3.5 years ago* as a way to assuage the issues that Mr Turner agrees on page 2 are present?

In the absence of any answers to these questions, the most logical explanation is that any "other options" have not yet been invented by the processors and that this is a stalling tactic.

3.6 *"I would strongly suggest that is not in our interest that is the growers and processes to move forward with a code." (highlighting mine)*

Mr Turner represents processors on the Advisory Committee, therefore "our" interest is the processors'. ACGC would also agree that it may not be in the *processors' interest* to move forward with a Code.

A mandatory Code would finally provide a degree of transparency in negotiations against which regulators could assess business thuggery. A mandatory Code would identify where in the supply chain that price capture was occurring, particularly if the Food and Grocery Code also becomes mandatory. A mandatory Code would provide a dispute mechanism oversighted by ACCC *in toto* and not by individual clauses. A mandatory Code as suggested would provide key information for potential entrants into the industry before they become trapped between the processors and the banks. Code reviews could shed light on the actual costs of farming through benchmarking.

There is no expectation that a mandatory Code would "solve" everything, but it would be an excellent base for industry improvement as has been seen in other industries where mandatory Codes have come into force. That would appear to be why the project was instigated in the first place.

Conclusion
A well known former PR head of NSWFarmers quoted his "first rule of PR" being:

"If you have the ascendent argument, play the argument, if not, play the person or the process.

In the responses to the Interim report funded by government, APIA and Mr Turner have criticised the process, the statistics, the consultation, the options assessment, and so on. This is in spite of having had a seat on the Advisory committee that could have addressed these issues at the time; in spite of having been able to have direct input into the project; and in spite of having the ability to have directly negotiated "other options" directly with growers both prior to and during the project process.

Instead, we have just seen game-playing by deliberate refusal to engage, complaints to government, complaints about not receiving meeting requests, and complaints about the process.

No *elemental* criticisms of the report have been offered.
No *constructive* criticisms of the report have been offered.
No actual alternatives have been offered.

While the project process has been ongoing, negotiations for new contracts have been peppered by threats "not to talk to supermarkets", of grower negotiation representatives suddenly an inexplicably dropping to the bottom of their pool, and new contract clauses demanding the purchase of costly water licenses well in excess of needs.

The time for intervention in the abuse of market power in this industry is well overdue. If not a mandatory Code of Conduct, then perhaps legislation will be the only way to achieve respectful relationships between the duopolistic processors and the suppliers who keep their businesses profitable.

Yours Faithfully,

(by email)

Dr Joanne Sillince BVSc(Hons) MBA FAICD
Chief Executive Officer