

**MANDATORY HORTICULTURE CODE OF CONDUCT**  
**A REGULATION IMPACT STATEMENT**

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## 1. Introduction

The Australian Government ('the Government') committed in the 2004 election to implement a mandatory horticulture code of conduct ('the code') to increase the clarity and transparency of trading relationships in the fresh fruit and vegetable markets. The code will include a practical and cost effective dispute resolution mechanism. This Regulation Impact Statement (RIS) assesses the regulatory proposal.

The Government's election commitment for a mandatory code followed the break down in Government brokered negotiations between growers and wholesalers on minimum terms of trade under the voluntary Produce and Grocery Industry Code of Conduct.

An independent consultant, the Centre for International Economics (CIE), was appointed by the Government to develop options for the code and conduct widespread industry consultation.

It is intended that the proposed Code be prescribed under Section 51AE of the *Trade Practices Act 1974* (TPA). The only existing mandatory Code of Conduct under the TPA, is the Franchising Code of Conduct.

The TPA regulates corporations, trade across state borders and trade within a territory (Australian Capital Territory and Northern Territory). The TPA does not cover wholesale trade in fresh fruit and vegetables by unincorporated bodies or trade within a particular state. Based on information provided by the Australian Chamber of Fruit and Vegetable Industries it is estimated that a high proportion of wholesale horticulture trade occurs across state borders and around 50 per cent of wholesaling businesses are incorporated. This means that around 80 per cent of wholesale trade will be covered under the code.

The Australian Competition and Consumer Commission (ACCC) is expected to play a major role in the enforcement of the proposed code. Complaints about non-compliance that cannot be resolved through the dispute resolution mechanisms in the code can be directed to the ACCC. The code would complement other avenues parties have to pursue legal action, including under common law.

## **2. The fruit and vegetable wholesale sector**

### ***2.1 Production***

In 2002, fresh fruit and vegetable production in Australia was valued at \$5.8 billion by the Australian Bureau of Statistics (ABS) and \$8.2 billion by Horticulture Australia Limited. In 2003-04, there were approximately 4,298 establishments engaged in growing vegetables and 13,658 establishments engaged in fruit production, or a total of 17,956 establishments.

The vegetable growing industry is characterised by small family farms (IBISWorld 2004a). Similarly, fruit growing is comprised of many small sized participants (IBISWorld 2005a). Nearly half (about 47 per cent) of producers are classified by the ABS as having a gross value of operations of less than \$100,000.

### ***2.2 Wholesalers***

In 2003–04, the fruit and vegetable wholesaling sector recorded estimated sales revenue of nearly \$8.5 billion (accounting for an estimated three per cent of total wholesale revenue in Australia) and contributed \$861.4 million to the Gross Domestic Product. In that year, the industry was composed of 960 establishments, employing 14,374 people, who earned a total of \$517.5 million (IBISWorld 2005b).

According to IBISWorld (2005b), there are three broad types of wholesalers that operate within the central wholesaler markets located in Melbourne, Sydney, Newcastle, Brisbane, Adelaide and Perth:

- merchant wholesalers — who buy the produce from the grower at an agreed price and then on-sell the produce. The wholesaler owns the produce;
- grower wholesalers — who sell produce they have grown themselves in the ‘growers shed’; and
- agent/broker wholesalers — who sell produce on consignment from the grower for a commission. The grower retains ownership of the produce until the sale is completed with a third party.

In practice, the distinction between merchant wholesalers and agent/broker wholesalers is blurred. Many non-grower wholesalers act as both merchants and agents/brokers depending on the quality of produce they receive from a particular grower, as well as other factors. Indeed, it is alleged that many so-called ‘hybrid’ wholesalers do not declare their intended role to the grower until they have already secured a transaction with a buyer.

Wholesalers report that they seek out ‘good’ growers and seek to maintain a business relationship over time. A range of approaches to the conduct of business is apparent from inspection of a number of wholesalers’ business premises. Some transactions are recorded in writing (for example, via fax) or with a consignment notice or invoice; others are conducted on the strength of a verbal agreement.

Wholesalers have a range of customers. They include other wholesalers, retailers, providers, restaurateurs, processors, and the supermarket chains. They deal with large, as well as small, quantities to meet the needs of their customer. Inspection of market behaviour indicates that a mix of transaction types are used, including the operation of credit accounts, cheque payments and cash transactions. Verbal arrangements are not uncommon.

There is evidence to indicate that the wholesale market is subject to intense competition. Key factors follow.

- There are large numbers of traders in each marketplace. Sydney, the largest, has about 100 wholesalers. Perth has a smaller market with approximately two dozen wholesalers, although it is reported that there are a similar number (or more) of wholesalers operating in the area surrounding the market.
- There is a reasonable number of wholesalers who deal with all of the major horticulture products in most markets (see table 2.1).
- One wholesaler is a close substitute for another. This is evidenced by the fact that most wholesalers handle a wide range of horticulture produce types (with the exception of banana wholesalers). In the Sydney central market, for example, 73 per cent of wholesalers stock between six and 20 varieties of fruit and vegetables. Chart 2.2 gives an indication of the number of products sold by each wholesaler at the Sydney Markets.
- There are very few barriers to entry to becoming a wholesaler. The key factor appears to be experience, which is often learnt within families. The capital requirements are modest compared to many smaller scale businesses and the requirements for entry to trade within a central market do not appear to be onerous or pose significant constraints. Wholesalers in central markets, particularly in the Melbourne markets are subject to space constraints, but there is very little that prevents wholesalers from operating independently of the central market, in fact many do. The capital requirements to set up a wholesaling business are small relative to turnover.
- The wholesale market is not concentrated. According to IBISWorld (2005b), the four major players account for an estimated 17.7 per cent of industry sales revenue.

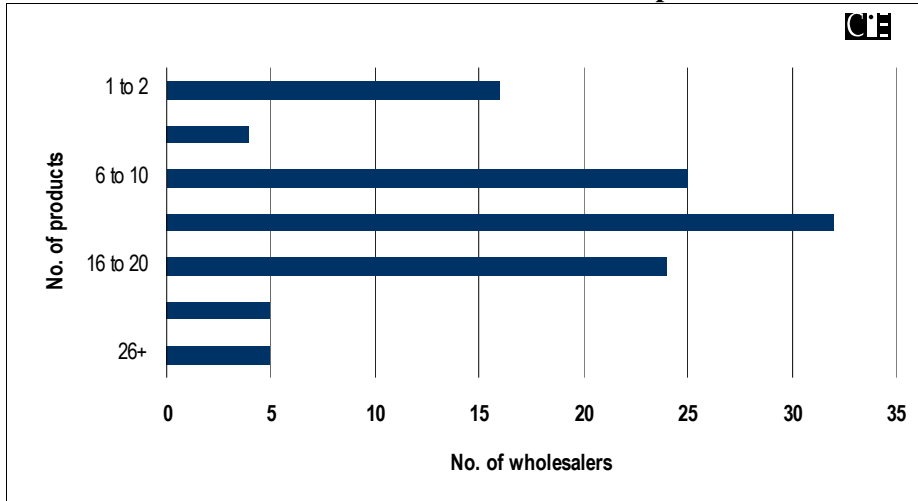
### 2.1 Number of central market wholesalers for selected fruit and vegetables

<i>Fruit/Vegetable</i>	<i>Sydney</i>	<i>Melbourne</i>	<i>Brisbane</i>	<i>Adelaide</i>
Potatoes	5	12	8	6
Carrots	5	6	2	5
Onions	4	15	9	7
Bananas	11	17	5	4
Apples	28	9	7	7
Oranges	32	10	8	7

<sup>a</sup> Wholesalers and their products are not available for the Perth and Newcastle markets.

Source: CIE estimates based on data from the Australian Chamber of Fruit and Vegetable Industries (2005).

## 2.2 New South Wales wholesaler's distribution of products

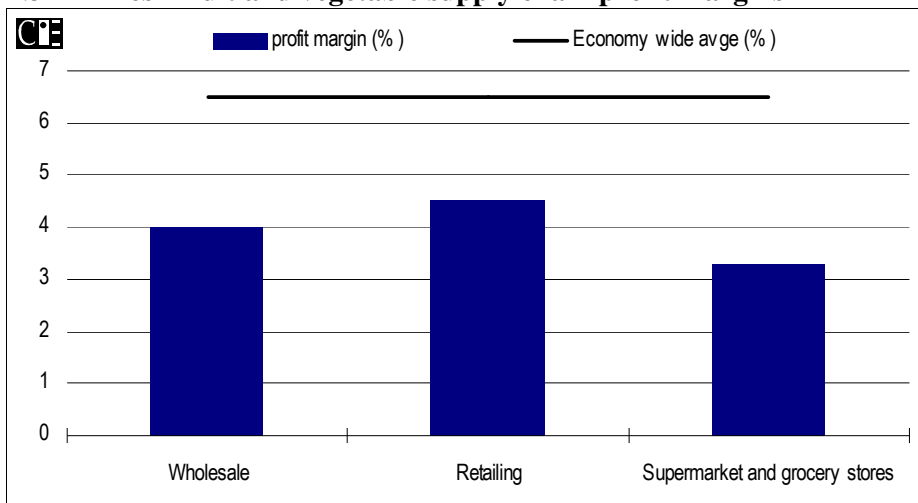


Data source: CIE estimates based on data from the Australian Chamber of Fruit and Vegetable Industries (2005).

The evidence of competition at the wholesale level is reflected in key market outcomes — particularly relatively low profit margins.

ABS data reveals that the profit margins obtained by the fruit and vegetable wholesale sector at large are lower than the average prevailing in the economy at large. Wholesalers' profit margins are also lower on average than that obtained by the retail sector (see chart 2.3).

## 2.3 Fresh fruit and vegetable supply chain profit margins



Data source: ABS (2005b). Data for 2002-03 the latest available year.

Public audited accounts provided by the publicly listed wholesaler Chiquita Pacific show that of gross revenue of \$503 million in the past two years, it made a profit before interest and tax of \$17.5 million, a 3.5 per cent profit margin. Chiquita Pacific was previously a solely owned subsidiary of the global fruit giant Chiquita Brands International. That it is only able to sustain an average rate of return given its size and expertise is symptomatic of a highly competitive industry.

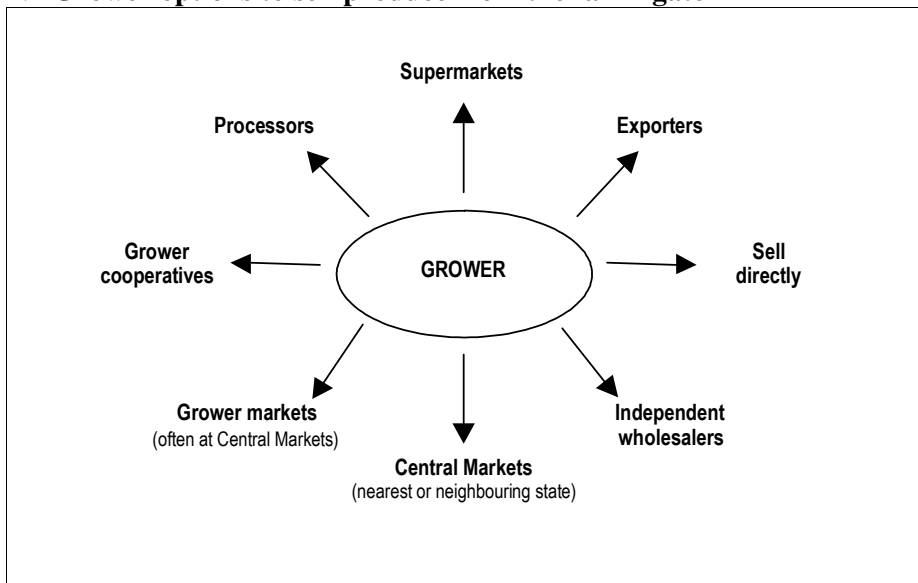
There are many other wholesalers and agents of fresh fruit and vegetables who do not operate through central wholesale markets. Often, they are regionally based.

Most major horticultural produce areas have access to wholesale facilities in a central market or one in close proximity. However, it is likely that there are regions where the wholesale options are limited, and the wholesale market is less competitive.

### **2.3 Competition**

Wholesalers compete for access to fresh fruit and vegetables with other wholesalers, supermarket chains, processors and exporters. For some products, they also compete with packers and grower cooperatives who sometimes play a market intermediary role. Growers have many options when searching for a channel into the market for their produce.

### **2.4 Grower options to sell produce from the farm-gate**



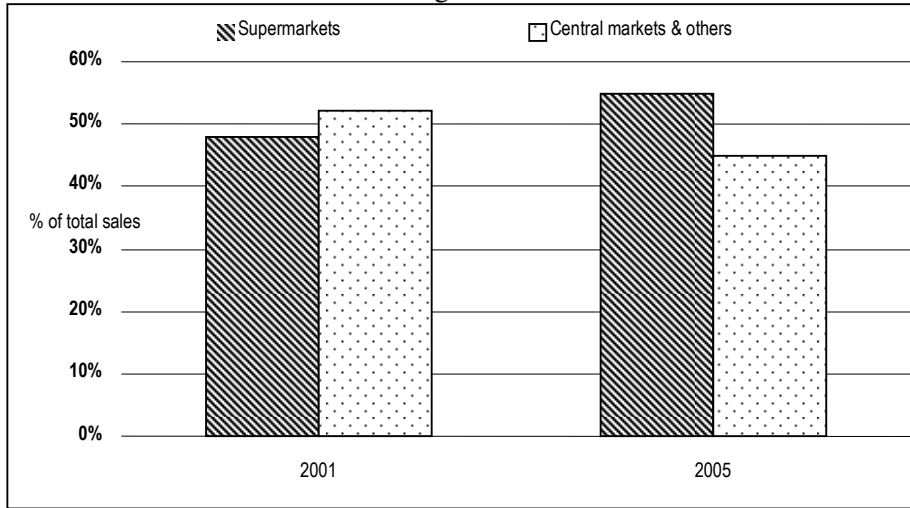
Major retail supermarkets are increasingly assuming direct responsibility for managing and developing the distribution processes and reducing the market share of wholesalers, including the central markets.

According to Wright and Lund (2002), food retailers are extending contractual arrangements downstream and developing exclusive supply arrangements directly with farmers to facilitate greater control over stocks as well as the quality and price of produce.

Spencer (2004) found that the major supermarket chains currently source 50 to 70 per cent of their fresh fruit and vegetable offerings directly from growers, and top up the rest by purchasing from wholesalers. They maintain significant facilities in wholesale markets to support procurement and distribution of many major lines of fresh fruit and vegetables. They specify and adhere to very strict quality standards and use their purchasing power to drive hard bargains with growers, but compensate by offering them prompt payment as well as certain and more stable revenue streams.

Chart 2.5 draws upon data provided by Sydney Markets Limited. It reveals an estimate of wholesalers' loss of market share over the last five years.

2.5 Share of fruit and vegetable sales



Data source: Sydney Markets Limited (2005).

### 3. The problems

The key problems in the horticulture wholesale sector are information asymmetry and adverse selection of low cost, but also low clarity transactions. Due to intense competition to keep transaction costs low, it becomes difficult for traders who wish to provide clear and transparent trading terms to compete against those who have the cost advantage of not providing such information.

In some parts of the horticulture wholesale sector there is:

- an under-supply of important information, particularly in regard to prices obtained and prices paid by traders in the central markets.
- failure to invest in development of clear, written terms of trade arrangements;
- inconsistencies in the treatment of high quality produce and volatility in the returns for quality; and
- an increasing number of growers preferring to bypass wholesalers and deal direct with retailers, particularly major supermarkets, which might result in loss of competition at the wholesale level.

The problems of lack of clarity and transparency impact mainly on smaller scale growers (55 per cent of fruit and vegetable producers supply around 18 per cent of produce in Australia), growers who are a long way from the markets, growers who supply infrequently to the markets, or who are new entrants and growers who have found it difficult to overcome information problems in the market. They are 'outsiders'. These growers are currently disadvantaged as they have less access to market information, are likely to receive less attention by wholesalers, pay more for their services, face delays in payments and discover difficulties in finding a better wholesaler. The CIE estimates that potential problem transactions make up less than five per cent of total sales of domestically produced fruit and vegetables.

Large growers, those with a long history in the industry and well-organised groups of small growers experience few problems as they are likely to have privileged access to information through well established business relationships with wholesalers. They are 'insiders'. Given the large proportion of produce supplied by these growers, problematic transactions are few.

The insider-outsider problem was reflected in the diverse views held by growers about problems in the markets. Some, particularly smaller growers distant from the market, tended to argue that the problems in the market were very serious and large, and that they lacked market power. Others, particularly larger growers or those organised into groups and those closer to markets, tended to say there were no problems and that the market was working very efficiently.

Among those arguing that serious problems existed, most complaints were about the six central wholesale markets, operating in Sydney, Melbourne, Perth, Adelaide and Newcastle, where written terms of trade are typically not provided, the provision of

transaction information is low and the rights and responsibilities of growers and wholesalers is often unclear.

Comparatively, retailers and processors (who also trade directly with growers) provide clear contractual terms and provide a high degree of transparency.

## **4. Objectives**

Three primary objectives underlie the code:

- to address the problem identified;
- to avoid unintended side effects such as penalising those already undertaking business best practices; and
- to ensure it is effective.

### ***4.1 Addressing the problem***

Overcoming the identified problem requires:

- (a) raising the clarity of transactions so:
  - (i) both growers and wholesalers understand the terms and conditions under which business will be conducted;
  - (ii) growers can compare what terms, conditions and opportunities are on offer from various wholesalers and marketers so that competition is transparent and effective.
- (b) raising transparency about how prices, margins and charges are determined and returned to the grower; and
- (c) empowering wholesalers to deal efficiently with costly, unsolicited and unwanted produce.

### ***4.2 Avoiding unintended side effects***

Minimising the economic costs of imposing the Code requires:

- (a) minimising interference in areas where problems do not exist;
- (b) ensuring flexible trading options remain so that:
  - (i) there are no prescriptive, ‘one-size-fits-all’ terms and conditions that limit choice of terms of trade and impose severe rigidities on the activities of any market participant; and
  - (ii) not imposing anti-competitive structures that might greatly favour one party over another and force some players out of the market.

### ***4.3 Ensuring effectiveness***

Ensuring the Code is workable and effective requires:

- (a) establishing a non-litigious, low cost and fair dispute resolution mechanism;

(b) minimising compliance costs by:

- (i) minimising extra activities required to comply;
- (ii) allowing flexibility and choice in ways of meeting the important objectives of the Code; and
- (iii) establishing a code that minimises disputes and provides low-cost, but quick and effective dispute resolution.

## 5. Options

Six options are examined in the RIS. These three options developed by the CIE for industry consultations, two further options developed by the CIE following the consultation period and a preferred option developed following additional consultation on the CIE options with key grower and wholesaler industry organisations.

A 'no code' option was not considered because of the Government's election commitment.

### 5.1 Consultation RIS options

The consultation RIS developed by the CIE, included three code options:

- Option 1: drawing upon a preliminary submission received from the Horticulture Australia Council (HAC) and the National Farmers' Federation (NFF). This option sought to raise clarity and transparency by requiring all traders at the first point of sale from the farm-gate to act as agents or merchants (although wholesalers could trade using both roles for different transactions if they wished). For merchant transactions, price would be set at the farm-gate. Where a price had not been set the transaction would be deemed to be an agent arrangement. Wholesalers would provide detailed transaction information under agent arrangements. Payment would be made to growers within 14 days of the point of sale.
- Option 2: drawing upon the consultants' amalgamation of submissions received from Brismark and the Australian Chamber of Fruit and Vegetable Industries (ACFVI). This option is similar to Option 1 but proposes greater flexibility in the merchant framework for price to be set according to the market (see 'hybrid arrangements' in Option 3 below). Payment would be made to growers within 28 days of the point of sale. Wholesalers would provide limited transaction information and would not disclose the buyers of produce or the price produce was sold for.
- Option 3: drawing upon the consultants' blending of Options 1 and 2. This option proposed a compromise, taking the best features suggested by growers and wholesalers. It is based on three trading models: agent, merchant and hybrid. The hybrid was a variation seeking to clarify existing arrangements where wholesalers act as agents up until the point of sale to a third party, where they then take ownership of the produce and return a price to the grower based on what the market paid (also called market set pricing). No Goods and Services Tax is payable on hybrid transactions. Payment terms are flexible and would be negotiated between trading parties. Wholesalers are required to keep records and provide details to the grower about the price received for each sale.

## ***5.2 Options 4 and 5 (Centre for International Economics)***

Following the consultation process, the CIE developed two additional options to account for problems with Options 1 to 3 which became apparent during the consultation process and to provide greater flexibility in trading arrangements to account for the diversity of trade conducted in the horticulture industry.

The CIE's Option 4 and 5 are the same except for which sectors of the industry they propose to cover.

Option 4 proposes to cover all initial transactions between growers and buyers of horticulture produce in Australia, which includes sales to wholesalers, retailers, packing sheds, exporters and processors. This option was developed to avoid any market distortions by imposing the same regulatory conditions on all competitors for produce at the first point of sale.

Option 5 proposes to ring fence the coverage to the six central wholesale markets operating in Sydney, Melbourne, Brisbane, Perth, Adelaide and Newcastle, where the problems of transparency and clarity have been identified.

Options 4 and 5 have the following features:

- requires wholesalers dealing with single transactions to clearly disclose whether they are acting as a merchant or an agent;
- requires written terms of trade to be provided for transactions prior to the transaction setting out how and when the parties are paid and other matters such as how rejections or returns of produce are handled;
- establishes minimum written documentation for all transactions setting out what produce has been sent, what has been received and prices obtained;
- provides flexibility within the definition of merchant and agent so that parties can engage in a variety of business arrangements, including hybrid arrangements under merchant trade;
- allows parties wishing to conduct multiple and multi-period transactions to enter into mutually advantageous marketing agreements (provided that these meet minimum requirements and provide protection for growers), which allow existing pooling, period contracts and pre-existing agreements to be conducted unhindered;
- applies a dispute resolution process involving four stages, including initial resolution between the parties, verification by an independent assessor, compulsory mediation by an independent mediator, and at any stage of this process application to the Australian Competition and Consumer Commission for redress of a mischief or wrongdoing;

- applies to all initial transactions between growers and buyers of horticulture produce in Australia, unless sold to farmers' markets or directly to consumers.

### **5.3 Option 6**

Option 6 provides clarity in trading arrangements, applies the code across the wholesaling industry in a way that would have minimal market distortions and provides flexibility for growers and wholesalers to agree on terms of trade.

This option was developed following additional consultation on the CIE options with key representative groups, the NFF, HAC, ACFVI and the Central Markets Association of Australia.

Option 6:

- applies the code to all wholesalers, including the central wholesale markets, off market wholesalers and other intermediaries (transactions directly between growers and retailers, processors and exporters would be excluded);
- improves the clarity of trading arrangements by stipulating that wholesalers trade as either agents or as merchants. Under merchant arrangements the price can be set prior to or on receipt of produce as agreed between trading parties;
- wholesalers are required to prepare and publish written terms of trade containing minimum conditions on how they will trade with growers. Growers can choose to accept the conditions in the wholesaler's terms of trade or may negotiate with the wholesaler for alternative arrangements, which will be agreed in writing provided they meet the minimum conditions;
- minimum conditions in the terms of trade are simplified to key elements such as payment timeframes, pricing and fees, transaction information to be provided, and some other conditions. Flexibility is provided for growers and wholesalers to agree on the quantum of these elements;
- allows all existing written contracts to be grandfathered under the code unless renewed, extended, amended or transferred after the announcement date;
- provides a framework for growers and wholesalers to enter long-term agreements for the supply of produce;
- ensures that wholesalers do not have to disclose the identity of their buyers, except for debt recovery purposes in agent transactions. This meets a key concern of wholesalers who consider the identity of buyers to be their intellectual property and fear that growers will bypass them and approach buyers directly. Growers can request an independent assessment to confirm that produce was sold to a bona fide third party but will not have access to the identity of the buyer except for the purposes of debt recovery.
- applies a dispute resolution process as described in Chapter 6 below.

## **6. Dispute resolution**

The dispute resolution process outlined here is recommended for Options 3,4,5 and 6 and is acceptable to many stakeholders.

All of the parties to the code may seek to use the dispute resolution process set out in this code which would complement other avenues parties have to pursue legal action, including under common law. There are four levels to the proposed arrangements.

### ***Level 1***

Wholesalers are required to specify in their minimum terms of trade people who should be contacted in the first instance to discuss issues and flag problems or the existence of a dispute. This must be an employee or a director of the business and they must be able to be contacted at a time when queries would arise. Ideally, they would be at a senior level within the organisation.

### ***Level 2***

Where the initial process is not successful, and recognising the perishable nature of horticulture products, the code allows for a process of independent third party fact identification. Rapid discovery of the facts by independent parties is expected to resolve many issues and concerns.

Either party may engage the services of an independent horticulture inspector to report on the condition of their produce in the market or, in the case of agency arrangements, to confirm the price produce was sold for and that it was sold to a bona fide third party.

All of the parties are required to provide necessary access to these assessors to perform their assessment.

The assessors will be identified, accredited and placed on a register via the Office of Mediation Advisor. Technical skills as well as independence will be a central part of this process. There are horticulture surveyors available in places where produce is sold and in major produce growing areas. It would appear that produce assessment can be provided at modest cost (around \$150 plus GST) for a routine assessment in most places where produce is sold. Independent financial assessors, such as qualified accountants are also readily available.

### ***Level 3***

If the initial dispute resolution processes fail, or at any stage before that, either party has the option of elevating the dispute to a mediation service. This involves the complainant in contacting the appropriate disputes contact listed in the Terms of Trade (or the representative of a grower) in writing.

The parties are expected to agree on a mediator from the list of registered mediators. If the parties can not agree on who should be the mediator within seven days, either party may apply to the mediation adviser to appoint a mediator.

The mediator may seek to confirm the dispute with the parties and in so doing see if the dispute can be easily resolved without needed to take further and formal mediation.

The mediator decides the time and place for mediation, and all relevant parties must attend and try to resolve the dispute at this stage. They are required to attend mediation and act in good faith in the process.

Where a solution to the dispute is achieved, elements of the agreement should be prepared in writing, specifying the obligations of the parties.

#### ***Level 4***

At any time a party to a transaction in the wholesale sector of the horticulture market may approach the ACCC to seek redress for a mischief or wrong-doing.

## **7. Impact Analysis**

### ***7.1 Impact groups***

The benefits of the code will accrue mainly to smaller scale growers, growers who are a long way from the markets, growers who supply infrequently to the markets, new entrants to the market and growers who have found it difficult to overcome information problems in the market. These growers are currently disadvantaged as they have less access to market information, are likely to receive less attention by wholesalers, pay more for their services, face delays in payments and discover difficulties in finding a better wholesaler.

Large growers and those with a long history in the industry will obtain minimal benefits from the code because they are likely to already have privileged access to information through well established business relationships with wholesalers.

The costs of the code will affect all wholesalers and growers (an estimated 1,140 wholesalers inside and outside the central wholesale markets and approximately 11,100 fruit and vegetable growers throughout Australia).

The introduction of a mandatory code will have the effect of making parties do things that they would not otherwise do, including some paper work and recording and reporting requirements. The code may also prohibit some transactions/marketing activities that currently provide benefits to growers and wholesalers.

Additional requirements and costs brought about by the code will primarily impact on wholesalers. It is possible that wholesalers will pass most of the additional costs back to growers and some costs are also likely to be passed along the supply chain to consumers given inelasticities in the demand for fruit and vegetables.

Increased transparency and clarity are expected to improve market efficiency, reduce the incidence and costs of disputes, reduce information search costs and increase demand through better information guiding the grower to produce more precisely what the market wants. Wholesalers may become a more attractive option for growers, who are increasingly preferring to sell directly to major retailers. This could also increase competitiveness in the fresh fruit and vegetable markets.

### ***7.2 Analysis of Options***

#### ***Consultation RIS options***

Analysis of option 1 indicates that it would be beneficial in raising clarity and transparency. It would, however, impose significant costs through the elimination of a wide range of trading arrangements currently undertaken in the market. There would be high costs to growers and wholesalers to comply with additional requirements of this code, including detailed recording and reporting requirements and 14-day payment timeframes. It is viewed as likely that this code would split grower communities. Some in the community, particularly those able to produce consistently high quality produce in large volumes would trade using prices established at the farm

gate and would obtain some certainty and most of the expected increment in producer prices. Others, especially smaller growers, that produce less consistent quality or smaller quantities, are expected to be subject to greater market volatility.

Analysis of Option 2 indicates that it would provide additional clarity to agent and merchant trading arrangements although it would not improve the transparency of the price setting process. Broadly, Option 2 reflects an attempt to meet grower concerns with minimal disruption to wholesalers. This option does not provide sufficient improvements in clarity or transparency to warrant the costs of establishing the code. Option 2 may also constrain some current trading arrangements.

Analysis of Option 3 indicates that it may restrain competition by eliminating many current legitimate approaches to business. There would also be significant compliance costs involved in meeting new requirements to record and report all transactions in writing.

### ***Options 4 and 5***

Options 4 and 5 would reduce some of the costs associated with Options 1 to 3 by providing greater flexibility to account for the wide variety of business arrangements in the horticulture industry. Options 4 and 5 would also allow growers and wholesalers to make longer term arrangements that apply to a period of time, a crop or harvest, or arrangements to apply for some years.

The CIE argues that it is essential to maintain flexibility for parties to enter into contracts. Contract arrangements between growers and wholesalers inside central markets and outside of them are important to the way that groups of smaller growers are able to compete on a level footing with large and international competitors.

Options 4 and 5 contain some prescriptive conditions including written notification of delivery, order and acceptance of produce. These options also prescribe specific requirements such as payment timeframes and procedures for the rejection of produce. The prescriptive procedures and conditions in these options could impose high costs by forcing parties to do things they would not otherwise do and reducing the flexibility needed for a wide variety of trade.

Applying the Office of Small Business's Costing Tool, Option 5 is estimated to cost industry (including 450 central market wholesalers and approximately 9,000 fruit and vegetable growers) a total \$51.4 million over four years (\$12.8 million per annum). This equates to an estimated average annual cost of \$18,848 for wholesalers and \$486 for growers.

These costs would be much higher for Option 4 because it applies to all first point of sale transactions from the farm-gate. Option 4 would impose a regulatory burden on many transactions which already meet the objectives of the code, including those transactions conducted by retailers, processors and exporters.

Option 5 confines the costs of the code by ring-fencing it to the central wholesale markets, where the main problems of lack of transparency and clarity have been identified. The risk of a ring fenced code is that it could introduce a regulatory distortion in the market by imposing additional costs associated with code compliance on only some market participants.

It is difficult to anticipate what the net effect of the application of a ring fenced code to the central markets would be. Experience with the application of a similar approach applied to the Perth Markets suggests that the measure would provide an incentive for some wholesalers to leave the central market and operate outside of the regulation, splitting the market and reducing economies of scale. It is possible that the main beneficiaries will be those that use shortened supply chains dealing direct with growers (ie, supermarkets and their suppliers).

### ***Option 6***

Option 6 improves the clarity of trading arrangements by stipulating that wholesalers trade as either agents or as merchants. This meets the key concerns of many growers who strongly rejected the inclusion of “hybrid” trading arrangements, which they claim would perpetuate existing trading arrangements where growers are disadvantaged and bear all the risks.

The proposed trading arrangements under Option 6 are expected to improve confidence in the market and remove uncertainty associated with the roles and responsibilities of growers and wholesalers.

However, there is a risk that the trading arrangements proposed under Option 6 may cause some smaller growers and those that supply the market infrequently to be disadvantaged. Wholesalers have said they will offer low prices to these growers, or refuse to deal with them, to defray the additional risks involved in trying to off-load lower quality produce or smaller consignments.

On balance, Option 6 is expected to impose a lower net cost than other options because of the additional flexibility for growers and wholesalers to agree on terms of trade.

Under Option 6, the terms of trade are simplified to key components, such as payment timeframes, pricing and fees, the transaction information to be provided, the default terms of trade and other conditions, but does not specify their quantum. This will increase transparency and protect growers’ interests, while providing the flexibility to accommodate a diversity of trading relationships and minimise compliance costs.

Applying the Office of Small Business’s Costing Tool, Option 6 is estimated to cost industry a total \$7.6 million over four years (\$1.9 million per annum). This equates to an estimated average annual cost of \$2,306 for wholesalers and \$171 for growers. The average annual operating profit before tax of fruit and vegetable wholesalers is \$165,000 and \$17,000 for fruit and vegetable growers.

The proposed coverage for Option 6, which includes all wholesalers, provides a compromise between applying the code to where the problems have been identified and ensuring that the code does not impose market distortions and encourage migration of businesses outside the central wholesale markets.

### 7.3 Summary of benefits and costs of options

Table 7.1 summarises the benefits and costs of each option relative to the current situation. All options are expected to deliver improvements in clarity and transparency. Option 5 is expected to have the lowest enforcement costs because the code is ring fenced to the central wholesale markets. Options 1 to 4 will have high enforcement costs because the code would cover all first point of sale transactions.

Option 6 is expected to have the lowest overall costs but there is a risk of unintended side effects and costs for small growers through requirements that wholesalers trade as either agents or as merchants.

#### 7.1 Benefits and costs relative to existing situation

<i>Criteria</i>	<i>Option 1 HAC/NFF</i>	<i>Option 2 Wholesalers</i>	<i>Option 3 Blended</i>	<i>Option 4 Broad scope</i>	<i>Option 5 Narrow scope</i>	<i>Option 6 Preferred option</i>
<b>Addressing the problem</b>						
Written terms of trade	Benefit	Benefit	Benefit	Benefit	Benefit	Benefit
Clarity of trading options	Benefit	Benefit	Benefit	Benefit	Benefit	Benefit
Price transparency	Benefit	No change	Benefit	Benefit	Benefit	Benefit
<b>Avoiding unintended side effects</b>						
Flexible trading options	Potential cost	Potential cost	Potential cost	No change	No change	Potential cost
Flexible terms of trade requirements	Significant cost	Significant cost	Significant cost	Significant cost	Significant cost	Small cost
<b>Ensuring effectiveness</b>						
Cost of enforcement	Significant cost	Significant cost	Significant cost	Significant cost	Small cost	Cost
Frequency of disputes	Cost	Cost	Benefit	Benefit	Benefit	Benefit
Compliance / paper work	Cost	Cost	Cost	Cost	Cost	Lowest cost
Risk / uncertainty	Significant cost	Significant cost	Significant cost	Potential cost	Potential cost	Potential cost
<b>Benefits to small growers</b>	Cost	Cost	Cost	Small benefit	Small benefit	Small benefit
<b>Net economic benefits</b>	<b>Significant cost</b>	<b>Significant cost</b>	<b>Significant cost</b>	<b>Small cost</b>	<b>Small cost</b>	<b>Lowest cost</b>

## **8. Stakeholder consultations**

An extensive stakeholder consultation process was conducted as a central part of the RIS process. In total 215 written and oral submissions were received.

The formal consultation period from 22 July to 24 August (5 weeks) including public forums in five capital cities (Sydney, Melbourne, Brisbane, Hobart and Adelaide) and in three regional centres (Atherton, Humpty Doo near Darwin and Mildura), in addition to an extensive number of meetings with individual growers and grower representative groups, wholesalers at central wholesale markets in Sydney, Melbourne, Brisbane, Adelaide and Perth, independent and major retailers, processors, packing sheds, state government representatives in every state and the Northern Territory and Australian Government agencies such as the ACCC.

The stakeholder consultation process provided vital insight into the complex nature of the wholesale sector of the fresh fruit and vegetable industries and the range of views of people in the industry.

One key point observed was that problems in the market do not prevail everywhere and they probably only impact upon a small share of the market value of produce, but nonetheless impact on a reasonably large number of small growers.

The response from the stakeholder consultation process suggests that there is not unanimity in the industry about the regulatory approach to take, or even about the need for a mandatory code.

In summary, the outcomes of the consultation process were:

- Some growers strongly support the code option put forward by the HAC/NFF. Some said that they do not support it and proposed alternatives of their own, or said that they did not want a mandatory code.
- The HAC/NFF case is essentially that only simple and well-defined arrangements can provide the clarity and transparency necessary. Their view is that the flexibility found in current industry arrangements is a cause of many of the problems and that these arrangements are basically illegal.
- Wholesalers generally do not support application of a mandatory code, but if one is to be implemented, in addition to improved clarity and transparency, they note that it is essential that it provide the flexibility necessary to add value to produce and to compete.
- The compromise offered by the consultants in the draft RIS was strongly rejected by the HAC/NFF and some other growers who viewed it as offering too much flexibility. Wholesalers were concerned that the arrangements to conduct business in writing and provide additional transparency would still add significant costs as well as constrain necessary flexibility.

- The one area where growers and wholesalers agreed was that the code should apply broadly and provide a level playing field across all those in the industry who trade with growers.
- Supermarkets, independent retailers and others such as processors and packing shed/wholesalers said that they were not part of the problem. Many of these parties already meet the requirements of the code under their existing commercial arrangements, do not have the record of disputes apparent in other areas, and have dispute resolution arrangements provided under a voluntary code and paid for by the Government. They indicated that they were strongly opposed to being included in a mandatory code.
- Many of the submissions and comments provided to the consulting team highlighted the importance businesses placed upon existing contracts, the opportunity to contract in the future, and arrangements that supported pooling of produce and prices. The effect of many of these arrangements is to allow even small growers to participate in the market on much the same terms as large national or global businesses.

## 9. Conclusions

All options are likely to provide some improvement in transparency and clarity in trading relationships. Written terms of trade in particular provide greater clarity and certainty about transactions.

All options are likely to impose a net economic cost. Costs are expected to outweigh benefits because costs are imposed on all participants, whereas benefits will mainly accrue to a limited number of growers.

Options 1, 2 and 3 are likely to impose the highest costs because of prescriptive terms of trade requirements and trading options. Options 4 and 5 provide more flexible trading options, but include costly procedures and terms of trade requirements. Option 4 would impose higher costs than Option 5 because it applies the code to all first point of sale transactions from the farm-gate. Option 5 confines costs by ring-fencing the code to the central wholesale markets.

Option 6 is the recommended option. It is also likely to impose a net economic cost. However, it is expected to provide clarity and transparency at a lower net cost than the other options. Option 6 applies the code across the wholesaling industry in a way that would cause minimal market distortions and provides flexibility for growers and wholesalers to agree on terms of trade which will keep compliance costs low.

Maintaining the status quo by not introducing a code will also have costs because the market currently disadvantages wholesalers who wish to improve trading standards by providing clear and transparent terms as well as increasing the information search costs for many growers and reducing overall market efficiency.

The recommended option is expected to increase transparency and clarity, which could lead to improved market efficiency, a reduction in the incidence and costs of disputes, reduced information search costs and increased demand through better information guiding the grower to produce more precisely what the market wants. The key beneficiaries will be smaller scale growers, those who supply the market infrequently and growers who have found it difficult to overcome information problems in the market.

## **10. Implementation and Review**

To oversee the management of the code, a Horticulture Code Policy Committee would be appointed by the Minister for Agriculture, Fisheries and Forestry ('the Minister'). The Committee would monitor the performance of the code and provide policy advice to the Minister on the working and performance of the code. The Department of Agriculture, Fisheries and Forestry ('DAFF') would provide secretariat support. Officials from relevant agencies such as the Australian Competition and Consumer Commission may be invited to observe and provide assistance about implementation matters.

The first task of the Committee would be to develop its terms of reference and establish performance indicators to measure the code's performance in improving the quality of transactions, improving market efficiency and reducing the incidence of disputes.

The introduction of the code would be accompanied by awareness-raising and education activities conducted by DAFF, ACCC and industry.

A Horticulture Code Mediation Adviser, appointed by the Minister would establish the register of independent assessors and mediators that may be engaged by the parties affected by the code.

The costs to the Government would be around \$10.9 million to fund the operation of the code over four years. This would include:

- \$1.8 million for the Horticulture Code Committee, secretariat and public awareness campaign; and
- \$9.1 million for enforcement of the code by the ACCC.

The code would have a sunset clause and independent review provision. The review would be carried out after three to four full years of operation. The continuation of the code beyond four years would be subject to Cabinet review.

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