



Cooperative Bulk Handling Limited

Submission to the Australian Competition &
Consumer Commission

Port Terminal Services Undertaking

Dated 14 April 2009

Submission to the Australian Competition & Consumer Commission

Port Terminal Services Undertaking

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Submission to the Australian Competition & Consumer Commission

Port Terminal Services Undertaking

Contents

1 Introduction and summary of submission

1.1 Purpose of submission

This submission is made by Cooperative Bulk Handling Limited (**CBH**) in support of its Port Terminal Services Undertaking (**Undertaking**) submitted to the Australian Competition and Consumer Commission (**ACCC**) under section 44ZZA of the *Trade Practices Act 1974* (Cth) (**TPA**).

1.2 Structure of submission

This submission is divided into 6 parts:

- (a) **Part 1** contains introductory information and a summary of the main conclusions in the submission;
- (b) **Part 2** contains detailed information on the structure and operation of the export wheat industry;
- (c) **Part 3** summarises the legislative and regulatory context in which the undertaking is offered;
- (d) **Part 4** reviews the competitive dynamics in the export wheat industry;
- (e) **Part 5** sets out the major features of the Undertaking and provides detailed reasons and supporting evidence for the adoption of particular approaches to issues such as:
 - (i) the definition of the Port Terminal Service;
 - (ii) the term of the Undertaking;
 - (iii) use of a publish/negotiate/arbitrate model rather than specified pricing methodologies;
 - (iv) non-discrimination principles and indicative port rules; and
 - (v) ring fencing arrangements; and
- (f) **Part 6** states the reasons why the Undertaking satisfies the relevant requirements of the TPA and should be accepted by the ACCC.

1.3 Common elements with undertakings and submissions of other port operators

The Undertaking and this submission contain elements common to submissions and undertakings submitted on behalf of ABB Grain Limited (**ABB**) and GrainCorp Operations Limited (**GrainCorp**).

CBH has engaged in discussions with the ACCC, ABB and GrainCorp for the purpose of efficiently determining whether and to what extent, a common structure and approach may be appropriately adopted by all of the operators. These discussions were for the purpose of efficiency – to reduce unnecessary

duplication. Importantly, the parties to these discussions have taken care to ensure that no competitively sensitive information was disclosed and no arrangements were made that would raise concerns under Part IV of the TPA.

Common elements of the Port Operators undertakings include:

- drafting style and structure;
- a publish/negotiate/arbitrate mechanism for terms and conditions of access (which terms have been arrived at separately by each Port Operator);
- robust principles of non-discriminatory access;
- the inclusion of indicative, published Port Terminal Rules to address capacity management and scheduling issues (which rules have been drafted separately by each Port Operator).

Significant differences also exist between the structure and content of the undertakings and submissions submitted by each of the Port Operators. These are the result primarily of factual differences between the businesses of the Port Operators and differences in physical conditions and market structure.

1.4 Legislative and regulatory context – WEMA, the *Bulk Handling Act (WA)* (BHA) marketing deregulation and vertical integration

CBH submits that the legislative and regulatory context in which the Undertaking is offered favours a relatively light-handed approach to regulation of Port Terminal Services.

The *Wheat Export Marketing Act* 2008 (Cth) (**WEMA**) effectively requires that, in order to be accredited as a wheat exporter, and therefore continue to have a right to market bulk wheat to export customers, CBH must submit an access undertaking under Part IIIA of the TPA, to be approved by the ACCC and in operation by 1 October 2009¹. The precise operation of the relevant provisions and their application to CBH is dealt with in more detail in Part 3 below.

The WEMA was introduced as part of a package of reforms relating to the removal of the single desk for bulk wheat exports which operated in Australia from the late 1930s until July 2008.

The Undertaking relates to the provision of access to “Port Terminal Services” (as defined in the WEMA) provided by CBH for purposes relating to the export of bulk wheat. The Undertaking is not required to, and does not, relate to any part of the export grain supply chain other than “Port Terminal Services”. Parliament considered this issue and resolved not to include upcountry receival points in the WEMA².

Importantly, the rationale for the Access Test in the WEMA is concern that owners of port terminals who wish to market bulk wheat for export do not attempt to use their ownership of port terminals to derive an unfair advantage in their marketing operations. In short, the access test requirement and this

¹ Section 24 WEMA

² *Wheat Export Marketing Bill* 2008 Explanatory Memorandum, 16.

Undertaking are primarily responses to issues arising from vertical integration between Port Operators and grain marketers. This is relevant to the appropriate structure and content of the Undertaking.

The Undertaking provides a reasonable and appropriate level of regulation given:

- (a) CBH is subject to substantial regulation under the BHA;
- (b) it is possible that the Access Undertakings will only be a transitional measure while the industry adapts to deregulation;
- (c) there is a history of open access in the industry;
- (d) there will be substantial oversight of the export arrangements by Wheat Exports Australia under the WEMA, the ACCC under the Undertaking and, in 2010, a Productivity Commission review; and
- (e) deregulation of coarse grain exports in Western Australia.

The industry is in transition - the relatively short term of the Undertaking means that the ACCC retains the option of imposing more intrusive regulation in the future in the unlikely event that it should be necessary.

1.5 CBH is constrained

CBH is subject to substantial constraints in relation to its provision of Port Terminal Services, including:

- (a) CBH's primary incentive is to maximise throughput and ensure that Australian wheat exports remain competitive in the global market;
- (b) the likely access seekers are sophisticated purchasers who are well resourced and have countervailing power;
- (c) the levels of competition in the various markets for the storage, handling and marketing of bulk wheat;
- (d) CBH is owned by growers who are collectively and individually active in ensuring the supply chain is efficient and beneficial for their respective farming businesses;
- (e) a number of other constraining factors on the behaviour of CBH which, while not individually significant, in aggregate give further confidence that Port Terminal Services will be provided on a non-discriminatory basis.

1.6 Key features of the Undertaking

The Undertaking has the following key features:

- (a) **Publication of price and non-price terms for standard services:** CBH must publish prices and non-price terms for standard Port Terminal Services.
- (b) **Non-discrimination:** CBH must provide access in accordance with price and non-price terms that include efficiency, fairness and

transparency as central elements. CBH must not discriminate³ between access seekers, or in favour of its own operations. This principle applies not only in the context of access negotiations but in the context of operational decision-making in the performance of an access agreement.

- (c) **Good faith negotiations:** CBH is obliged to negotiate with access seekers in good faith in accordance with a detailed negotiation process to ensure that such negotiations are progressed according to benchmark timeframes.
- (d) **Ring fencing:** CBH has amended and supplemented its existing ring fencing arrangements from its Grain Express project. The new arrangements include provisions providing for legally distinct entities to conduct trading activities, physical segregation of those entities, accounting separation of those entities, information flow restrictions, reference to dispute resolution and external independent audits.
- (e) **Arbitration of access disputes:** There is a detailed dispute resolution mechanism which provides that, where a dispute arises between access seekers and Applicants as to the application of the Undertaking, including the terms and conditions of access (both price and non-price) for review by an independent arbitrator and oversight by the ACCC.
- (f) **Published Port Terminal Rules:** The current draft Port Terminal Rules are annexed to this submission as **Attachment 1**, but not incorporated in the Undertaking. CBH is in the process of re-drafting its Port Terminal Rules and is consulting with industry for that purpose. CBH expects to complete its consultation process in May and will publish and provide to the ACCC a copy of the Port Terminal Rules for 2009/2010 as soon as they are available. The Port Terminal Rules, together with the non-price terms and conditions and Cargo Accumulation Guidelines, will govern the operational provision of the Port Terminal Services. The Port Terminal Rules do not form part of the Undertaking because they must retain the flexibility to change and evolve with operational requirements and other factors that may become evident as the full consequences of deregulation become apparent. However, the Port Terminal Rules (and any amendments to them) are required to comply with the principles of non-discrimination and be implemented and interpreted in a non-discriminatory manner. The Standard Terms require CBH to comply with the Port terminal Rules.

1.7 The Undertaking meets the requirements of the TPA

In the circumstances, the Undertaking represents a reasonable, measured and balanced approach to access regulation in relation to Port Terminal Services.

³ Operationally, the Undertaking recognises that decisions must be taken that will necessarily advantage one user over another in the context of that decision alone. However, the Undertaking provides a mechanism for preventing preferential self-dealing and ensuring decisions are made on objectively verifiable commercial factors.

The Undertaking:

- provides for a detailed negotiate/arbitrate model with publication of prices and non-price terms before the start of each season - there is no need for ex ante approved pricing given the lack of incentive to monopoly price, the countervailing power of access seekers to negotiate and the resort of binding arbitration under the oversight of the Commission if an access seeker is not satisfied;
- contains specific provisions relating to the provision of access on non-discriminatory terms and, in terms of removing the potential favouring of related marketing operations, backed up by ring fencing measures tailored to the structures of each of the Applicants - given that there is in fact little ability to use information obtained through operation of facilities in the supply chain in an anti-competitive manner, it would not be appropriate to require CBH to undertake major changes to its operational structures and processes for a theoretical risk; and
- when considered together with the WEMA, contains provisions providing for the operation of the shipping nomination and queuing processes and the availability of shipping stem information to enable monitoring of compliance.

The incentive to provide open access (as demonstrated by past behaviour) and constraints on anti-competitive conduct means that intrusive and prescriptive regulation is not necessary. Such an approach will add unnecessary costs which will be ultimately passed on to exporters and growers and make CBH less competitive relative to the other handling companies around Australia and the world.

On this basis, the Undertaking satisfies the criteria for acceptance by the ACCC under Division 6 of Part IIIA of the TPA. In particular:

- (a) the access arrangements (as already exist and now expanded and more fully documented in the Undertaking) promote the economically efficient use of, and investment in, bulk wheat export terminals, and also promote competition in upstream and downstream markets by giving industry confidence that the transition to deregulation will not be hindered by port access issues arising from anti-competitive behaviour;
- (b) the proposed process for publishing pricing and a binding third party arbitration process is, and provides for outcomes, consistent with the Pricing Principles set out in section 44ZZCA of the TPA;
- (c) the access arrangements will promote CBH's legitimate business interest in providing access on price and non-price terms and conditions that ensure that it receives at least a return on investment that is commensurate with risk; and
- (d) the public interest and the interests of access seekers is served by CBH continuing to provide access to Port Terminal Services to accredited wheat exporters but under more fully documented arrangements which ensure certainty, transparency and non-discrimination such that the

public and access seekers can be confident of a successful transition from a single desk to competition in the export of bulk wheat.

Accordingly, CBH submits that the Undertaking should be accepted by the ACCC.

2 Structure of the industry

In order to provide the context against which the proposed Undertaking will operate, the following section provides background information in relation to bulk wheat export supply chains in Australia. As the ACCC is aware, CBH provided a detailed submission with its notification of exclusive dealing conduct in 2008 (**Grain Express Submission**). This part of the submission draws upon that earlier submission but to avoid excessive duplication, has not reproduced the supply chain description set out in the Grain Express Submission.

2.1 A competitive global wheat market

Since the removal of the single desk, Australian wheat exporters now compete for sales directly in the global wheat market.

Australia's wheat and barley production each account for around 2-3% of annual world production. Domestic demand is limited due to Australia's relatively small population, so that approximately 80% of wheat and barley produced in Australia is exported. Australian produced wheat and barley accounts for between 8% and 15% of world trade in each of these grains.⁴ For example, in 2007/2008, approximately 91.3 million tonnes of wheat were traded in the export market, of which Australian exports accounted for 7.4Mt.⁵

Although one of the five largest national wheat exporters with the United States, Canada, the European Union and Argentina, Australia's domestic based wheat exporters compete in the international export wheat market with a number of multi-national corporations including Cargill, Elders, Toepfer and Glencore. Many of these exporters are vertically integrated, owning export marketing and flour milling businesses. This integration means they are both competitors and customers of CBH's trading business GPPL. As is outlined in Part 5 of this submission, this constrains CBH's conduct in the provision of access to Port Terminal Services.

Table 1 below sets out Australia's wheat production compared to global production:

Table 1 - Australian wheat production

| | 2007-08 | 2006-07 |
|----------------------------|---------|---------|
| Australian production (mt) | 13 | 10.8 |
| Australian exports (mt) | 7.4 | 8.6 |
| World production (mt) | 609 | 598 |
| World Consumption (mt) | 615 | 611 |

Source: ABARE

Table 2 below sets out the export volumes of the five top exporting countries.

⁴ <http://www.awb.com.au/aboutawb/communityeducation/grainproduction>

⁵ www.agc.org.uk/downloads/grainsupdate/trade_graphs.pdf

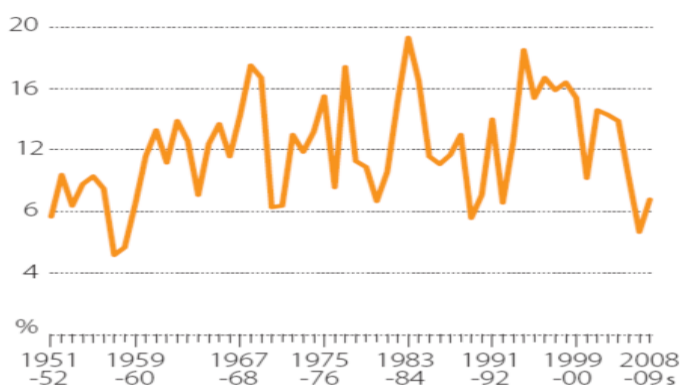
Table 2 - Export volumes of major global producers

| Country | 2007-08 (Mt) | 2006-07 (Mt) |
|----------------|--------------|--------------|
| US | 35 | 25 |
| Canada | 15 | 19 |
| European Union | 11 | 13 |
| Argentina | 10 | 12 |
| Australia | 7 | 11 |

Source: EWC Annual Report 2007-08, citing from ABARE

To provide further context, Figure 1 below sets out Australia's wheat exports as a percentage of world wheat exports between 1951 and 2008.

Figure 1 - Australian wheat exports



Source: ABARE Outlook 2009 issues insights, Factors affecting Australian agricultural exports, March 2009

2.2 The export wheat supply chain in Western Australia

The Australian export grain supply chain typically involves the following key steps:

(a) Production and transport from point of production to silo

There are approximately 4,800 growers in Western Australia. Those growers transport their grain (generally by road) from the point of production to country storage and handling facilities ("**Receival Sites**").

Receival Sites are usually located at upcountry locations in or adjacent to growers' wheat producing areas, but most Ports have Receival Site facilities located on or near the Port Terminal.

Grain yields in Australia are particularly subject to variations in rainfall and seasonal conditions. This was demonstrated in 1982, 1994, and 2002, when major droughts led to production levels of less than 10.0 million tonnes of wheat. In particular, the drought affected low yield

1982 season was followed by the 1983/84 season which produced a significant crop of 22.0 million tonnes.⁶

More recently, in 2006-07, production fell by 57% to 10.8 million tonnes from the previous season.⁷

The Western Australian wheat crop for 2008/09 was estimated at approximately 8.9 million tonnes, an increase of 2.8 million tonnes from the previous year⁸. This illustrates the seasonal volatility affecting CBH's operations.

Approximately 81% of the Western Australian grain crop is exported. Japan is the largest buyer of Western Australian grain, closely followed by Indonesia and South Korea.⁹

The Port Terminals in Western Australia also handle a substantial volume of barley and coarse grains, which increases the complexity of the task. The following table summarises the comparative volumes of grains in the supply chain over the recent 5 year period.

Table 1. WA crop production, 2003/04-2007/08 (million tonnes)

| | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 5 year average |
|--------------|---------------|---------------|---------------|--------------|--------------|----------------|
| Wheat | 10.437 | 7.705 | 9.478 | 4.396 | 4.933 | 7.390 |
| Barley | 2.941 | 2.080 | 2.598 | 1.650 | 2.414 | 2.337 |
| Canola | 0.606 | 0.490 | 0.630 | 0.379 | 0.650 | 0.551 |
| Lupins | 0.969 | 0.688 | 0.926 | 0.223 | 0.144 | 0.590 |
| Total | 14.953 | 10.963 | 13.632 | 6.648 | 8.141 | 10.867 |

Source: Department of Agriculture and Food, 2008.

(b) Country storage and handling

Wheat is unloaded at Receival Sites, sampled, analysed, weighed, graded and sorted. Wheat may be "warehoused" for varying periods of time at a site by growers before being sold (where title to the grain is transferred to another person). If grain requires fumigation, this is carried out prior to being loaded for transport from a Receival Site.

The Western Australian grain belt can be divided into four distinct zones, each served by a port:¹⁰

- the Geraldton zone comprises the area surrounding the Geraldton port and includes the regional centres of Mingenew, Mullewa and Morawa;

⁶ <http://www.awb.com.au/aboutawb/communityeducation/grainproduction>

⁷ ABS, Agricultural Commodities, Australia, 28 May 2008

⁸ *Australian Crop Report No.149*, ABARE, 17 February 2009.

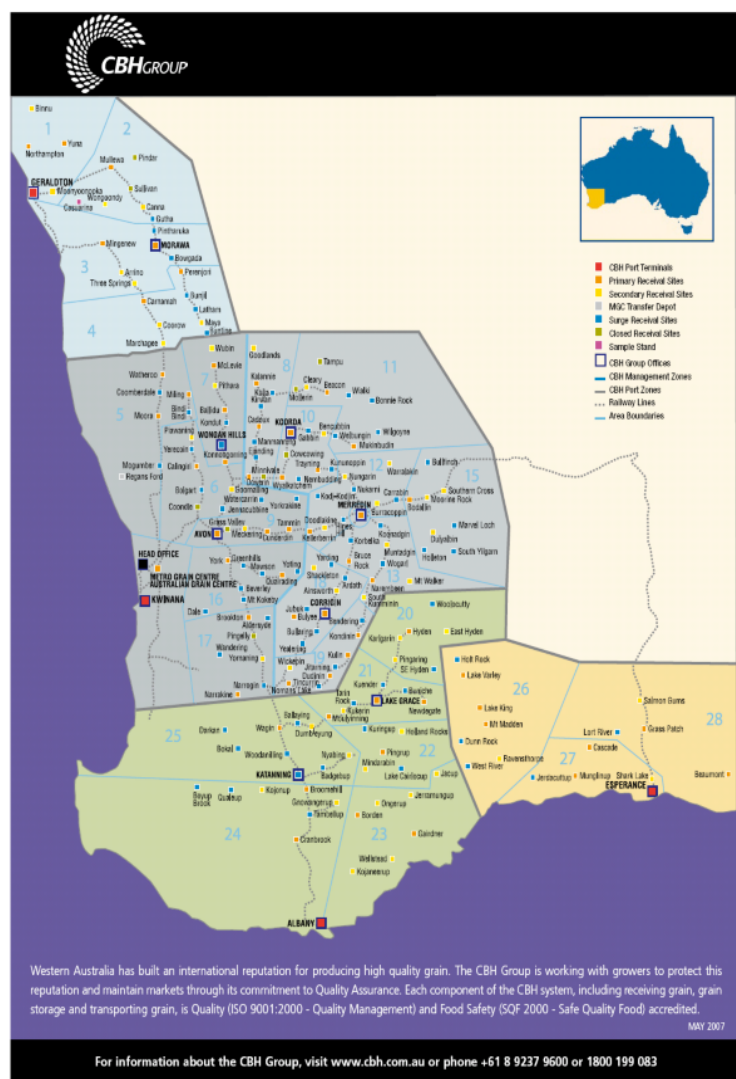
⁹ Department of Agriculture and Food (WA), WA Grain Industry, 2007, page 7

¹⁰ CBH Notification N93439 supporting submission, page 13

- the Kwinana zone comprises the largest area of the Western Australian grain belt, stretching from Kwinana in the west to Southern Cross in the east, and from Narrogin in the south to Wubin in the north. It is served by the Kwinana port to the south of Perth;
- the Albany zone covers the south-west corner of Western Australia from Hyden and Newdegate in the north-east to Albany in the south and Bunbury in the west. This zone includes the regional centres of Katanning, Lake Grace and Albany; and
- the Esperance zone comprises the south-east grain belt, the area north of Esperance and surrounding Salmon Gums.

Figure 5 shows the location of the storage network and ports in Western Australia.

Figure 2 - Western Australian storage network and ports



Source: www.cbh.com.au

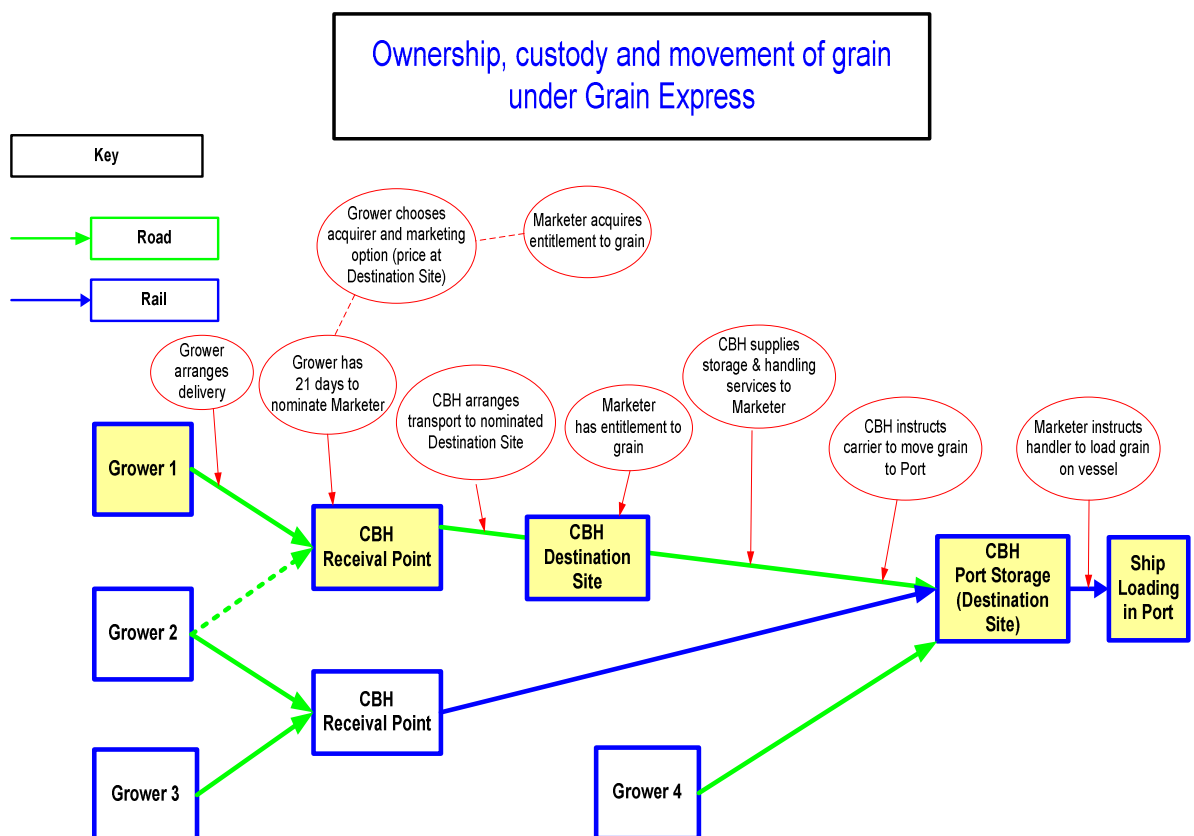
Since late 2008, CBH has provided co-ordinated wheat export supply chain logistic services under an exclusive dealing notification provided to the ACCC. The arrangements are known as “Grain Express”.

Under Grain Express, CBH supplies a bundle of grain storage and handling services, grain supply co-ordination services, and grain transport services to growers while the growers’ grain remains in CBH’s custody.

The resultant central co-ordination of grain storage, handling and transportation in Western Australia provides significant efficiency benefits for the supply chain.

Figure 6 below demonstrates the operation of the grain supply chain in Western Australia under Grain Express.

Figure 3 - Grain Express



Source: CBH submission to the ACCC, Notification N93439, 11 June 2008

The bulk handling of grain by CBH is regulated by the *Bulk Handling Act 1967 (WA)* (**BHA**). Section 19 of the BHA requires that CBH allow any party to use the bulk handling facilities and equipment controlled by it at

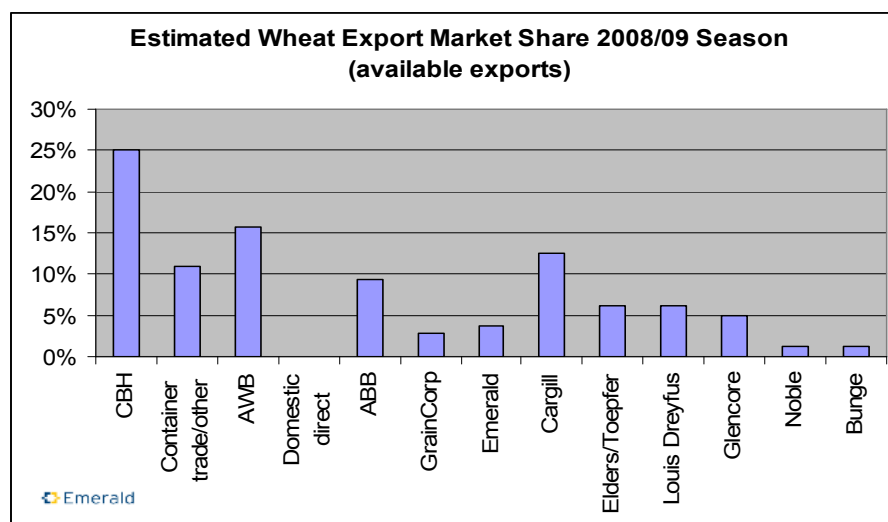
its ports. CBH also has a number of obligations under the BHA and regulations in relation to the receipt and delivery of grain and the publication of information

(c) Sale to grain marketer/trading and accumulation

Growers sell their grain to a wide range of grain traders or marketers at any point along the export supply chain. Grain may be traded several times while it remains in the supply chain before being sold to its end customer.

For the purposes of the marketing of bulk wheat for export, there are currently 23 Accredited Wheat Exporters¹¹ (a complete list of these Accredited Wheat Exporters is in **Attachment 2**). In addition to CBH, ABB and GrainCorp, accredited wheat exporters include the former statutory monopoly AWB as well as major multi-national corporations such as Elders, Toepfer, Cargill and Glencore.

below sets out an estimate of wheat export shares for 2008/09.



Source: Emerald Group Australia, *Coping in the deregulated market*, ABARE Outlook 2009 Conference, March 2009

(d) Bulk freight/transportation

Grain is transported from upcountry receipt and storage sites to port by rail or road. Under CBH's Grain Express service, CBH arranges transport to port, using the rail service of ARG and the road services of a range of competitive operators.

¹¹ Wheat Exports Australia, <http://www.wea.gov.au/WheatExports/RegisterOfAccreditedWheatExporters.htm>, accessed 8 April 2009.

(f) **Port storage and handling**

Once bulk wheat is transported to the port, it is stored for cargo accumulation and export.

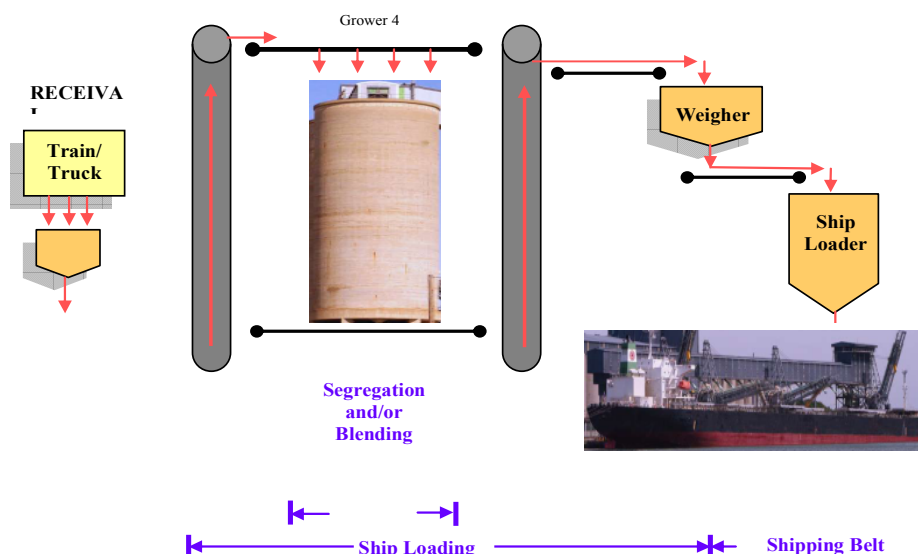
The services typically provided at port terminals include the following:

- **Receival (by rail or truck);** Grain received at a port terminal from a Receival Site is typically weighed, quality tested, checked for insect infestation and conveyed or elevated into storage facilities;
- **Storage:** Grain is stored in silos or bins and either segregated or potentially mixed with other grain to meet the requirements of the exporter (title holder);
- **Ship weigher:** A conveyor belt is used to transport grain from the storage facilities to the ship weigher which measures the weight of grain to be loaded onto the ship;
- **Shipping belt:** Grain is transported from the ship weigher to the ship loader by the shipping belt; and
- **Ship loader:** Located either on a jetty or a land-based berth, discharges grain into the hatches of bulk grain vessels.

The precise services supplied under the Undertaking are set out and defined in the Undertaking, Standard Terms and Conditions and Port Terminal Rules.

Figure 4 below shows the grain handling process at port.

Figure 4 - The grain handling process



CBH owns and operates each of the four export grain terminals, located at Kwinana, Geraldton, Albany and Esperance. At present, there are no other export grain terminal facilities in Western Australia

2.3 Operation of export terminals and provision of Port Terminal Services

CBH currently provides access to services provided by means of its Port Terminals as follows:

- CBH publishes details of the terms and conditions on which its Grain Express grain handling and storage services (including Port Terminal Services) are provided each year. The Standard Terms and Conditions for Port Terminal Services that are annexed to the Undertaking are derived from and are substantially similar to these terms and conditions;
- CBH enter into a grain storage and handling agreement with parties seeking those services for the relevant season. These terms contain Export Accumulation Guidelines;
- in relation to Port Terminal Services, there is generally sufficient storage and handling capacity to accommodate all users except for some periods of peak demand for services soon after harvest times;
- capacity to load ships is considered sufficient for current and foreseeable harvests. However, at peak times this capacity may be affected by transportation limitations (eg. road or rail capacity), loading, storage and outloading capacity, scheduling of loading and accumulation of specific grain cargoes to ships, variations to ship arrival times, quarantine or customs requirements, load contamination, ship survey failures or delays and physical storage / accumulation capacity at the port terminal, rather than shortfalls in ship loading capacity;
- demand for Port Terminal Services can vary dramatically both within a harvest season period and between annual harvest seasons depending on factors such as the harvest yield, timing of harvest completion (eg. due to weather conditions) and global demand;
- port loading allocation has primarily been determined by ship nomination subject to changes necessary to maximise throughput or deal with contingencies (eg. late ship arrivals). In accordance with the continuous disclosure rules in the WEMA, the policies and procedures for managing demand for the Port Terminal Services, including the process for managing nomination and acceptance of ships to be loaded, bookings, cancellation and cargo accumulation are required to be set out in published port terminal protocols. They may also be subject to broader port rules issued by the port authorities as well as additional regulatory compliance requirements such as those imposed by quarantine, customs and health & safety agencies;

- to handle capacity constraints in the current harvest, CBH is trialling a system in which marketers may make an expression of interest to book an export window. This opportunity is offered to all eligible marketers;and
- under the continuous disclosure rules in the WEMA, the Port Operators must publish “shipping stems” on a daily basis which set out the name of each ship scheduled to load grain (including bulk wheat), the timing of each ships’ nomination to load, acceptance as a ship scheduled to load, the quantity of grain to be loaded and the estimated date on which grain is to be loaded. This publication provides transparency to users to ensure that the relevant Port Operator is complying with the priority rules applying for the Port Terminal Services.

3 Legislative and regulatory context

This section describes the legislative and regulatory background to the Undertaking. This is important to the ACCC's assessment, because the effectiveness of an undertaking can only properly be judged in context, and with an eye to the nature, origin and seriousness of the competition concern that Parliament seeks to address.

As a preface to this issue, CBH observes that there is no history of unreasonable CBH refusal of access to Port Terminal Facilities to any marketer, nor have there been any proven instances of discriminatory or obstructive practices. This is an important factual distinction that justifies a less prescriptive approach than may be appropriate in other industries.

3.1 WEMA

The bulk wheat export industry is in the early stages of transition following removal of the single desk on 1 July 2008.

On 1 July 2008, the Wheat Export Accreditation Scheme 2008 (**Scheme**) was established under the WEMA to create a system of accreditation for exporters of bulk wheat from Australia. CBH has been granted accreditation under the Scheme until 30 September 2009, and intends to apply for renewal of its accreditation from 1 October 2009.

In order to obtain and maintain accreditation under the Scheme from 1 October 2009, an exporter of wheat, which is also a provider of Port Terminal Services (**Port Operator**) is required to satisfy the Access Test set out in section 24 of the WEMA. The Access Test requires that on or after 1 October 2009:

- (a) the Port Operator complies with the continuous disclosure rules in relation to the Port Terminal Service (see below); and
- (b) either:
 - (i) there is in operation, under Division 6 of Part IIIA of the TPA, an access undertaking relating to the provision to accredited wheat exporters of access to the Port Terminal Service for purposes relating to the export of wheat; or
 - (ii) there is a decision in force under Division 2A of Part IIIA of the TPA that a regime established by a State or Territory for access to the Port Terminal Service is an "effective" access regime, and under that regime accredited wheat exporters have access to the Port Terminal Service for purposes relating to the export of wheat.

The continuous disclosure rules require transparency in relation to policies and procedures for managing demand for the Port Terminal Services and the shipping stem for an accredited wheat marketer who owns or operates an export terminal. Specifically, these disclosure rules require:

- (c) publication on the Port Operator's website of a statement of the policies and procedures for managing demand for the Port Terminal Service (including for the nomination and acceptance of ships to be loaded using the Port Terminal Service); and
- (d) daily publication of up-to-date shipping stem information that sets out the schedule of vessels due to load grain, including vessel details, nomination booking and acceptance dates, estimated dates of loading and quantities of grain to be loaded.

An example of this information, as published on CBH's website is set out in **Attachment 3**.

As a direct and immediate effect of the WEMA scheme, there are already 23 Accredited Wheat Exporters who have been granted access to export markets for bulk wheat. Media reports indicate that there is evidence of growers directly obtaining the benefits of increased competition for their crops as a result.¹² CBH has negotiated service agreements with all accredited exporters who have requested services.

The Access Test in the WEMA was established as part of the deregulation of the wheat export market. As the ACCC is aware, prior to July 2008, AWB Limited held an exclusive right to export Australia's wheat in bulk.¹³ The WEMA, which came into effect on 1 July 2008, removed AWB's single desk monopoly and introduced a regulatory regime under which parties can seek accreditation from Wheat Exports Australia (**WEA**). The purpose of the Access Test has been stated to be:

*"to avoid regional monopolies unfairly controlling infrastructure necessary to export wheat in quantities, to the detriment of other accredited exporters. All accredited exporters should have access to these facilities while allowing the operator of the facility to function in a commercial environment"*¹⁴.

The need for the Access Test was not the subject of a detailed investigation of relevant markets. While concerns of monopoly behaviour or vertical leveraging may have been raised by industry participants at various times, little direct evidence has been presented in support. However, in recognition of the rationale behind the access test and the requirements of the TPA, CBH's Undertaking includes robust non-discrimination principles, a disciplined dispute resolution process and detailed ring fencing arrangements. In summary, the WEMA is concerned with export markets. The access test in section 24 of the WEMA is required as a condition of marketing accreditation for companies that own port terminals. This structure differs substantially from the source of other forms of economic regulation. CBH submits that this justifies an approach to undertakings that relies more on appropriate principles and an effective dispute resolution process rather than up-front prescriptive regulatory intervention.

¹² 'Farmers get pick of the crop on exports', *Australian Financial Review*, 23 March 2009.

¹³ Containerised and bagged wheat could be exported by persons other than AWB Limited.

¹⁴ Wheat Export Marketing Bill 2008 Explanatory Memorandum.

It is also possible that the Productivity Commission's review of the wheat export accreditation system (which is to be commenced by 1 January 2010) may conclude that the Access Test is not necessary. This is relevant both to the term of the Undertaking and to the extent to which expensive and onerous regulatory measures are required of Port Operators.

3.2 Regulatory context

The introduction of the Access Test should also be considered in the broader context of access regulation generally in Australia and ports in particular.

- (a) The Council of Australian Governments Competition and Infrastructure Reform Agreement¹⁵ provides that ports should be subject to economic regulation only in circumstances where there is a clear and demonstrable need for such regulation in order to promote competition in upstream or downstream markets or to prevent the misuse of market power
- (b) The recent draft findings of the 2009 review by the Essential Services Commission ("**ESC**") of the Victorian Grain Handling and Storage Access Regime¹⁶ in which the ESC concluded that, in the Victorian context, regulation of export terminals is unnecessary to permit effective competition in the grain market, as export terminals are not uneconomical to duplicate and there is a significant degree of substitutability between alternative options. This was consistent with its earlier review in 2007.
- (c) The recent findings of the 2007 Ports Pricing and Access Review, conducted by the Essential Services Commission of South Australia (**ESCOSA**), which concluded that price monitoring provided the benefit of transparency to access seekers and that there was no justification for introducing more heavy-handed price regulation.
- (d) The existence of legislative provisions in Western Australia, including section 19 of the Bulk Handling Act, Victoria and South Australia which provide for third party access to port facilities.¹⁷ Notably, these regimes are very light handed and the Victorian and South Australian regulators have rejected the need to undertake detailed price regulation on the basis that price monitoring is sufficient.
- (e) The existing level of specific regulation of the activities of CBH and other Port Operators by Commonwealth and State regulators including AQIS, Port Authorities, Worksafe, Main Roads, Office of the Rail Regulator, ERA, Australian Customs and Border Protection Service.

The provision of Port Terminal Services is subject to a substantial level of regulatory oversight by Wheat Exports Australia and the ACCC. The provision of Port Terminal Services by accredited wheat exporters will also be the subject of a detailed review by the Productivity Commission.

¹⁵ Council of Australian Governments, Competition & Infrastructure Reform Agreement, 10 February 2006.

¹⁶ On 27 February 2009, the ESC released its 2009 Review of the Victorian Grain Handling and Storage Access Regime draft report. A final report is expected to be completed by early April 2009.

¹⁷ These regimes have not been certified under Division 2A of Part IIIA of the TPA.

This very significant level of regulatory oversight -- together with the ready availability of transparent information in relation to the provision of those services and the clear ability of large and sophisticated customers to interpret that information and draw any concerns to the attention of regulators -- operates as a significant constraint on the conduct of the Port Operators.

4 Competitive dynamics in the export wheat industry

The wheat export supply chain in Western Australia is characterised by:

- a large number of growers, who determine what crops and crop varieties they will grow and the persons to whom they will sell those crops;
- an incumbent storage and handling supplier (CBH) that is owned in a co-operative formed by those growers;
- a number of competing logistics services providers; and
- a large number of grain marketers, many of whom are substantial vertically integrated multi-national corporations which compete for sales of wheat at a global level and own flour milling businesses.

This section describes these industry characteristics and the competitive constraints in the wheat export supply chain in the context of this Undertaking. Specifically, this section identifies a number of constraints upon CBH's incentive and opportunity to discriminate in favour of its trading business.

4.1 The competitive export wheat market

In relation to the position of Australia's grain exporters, the ACCC has previously recognised that:

"Internationally, grain trading is very competitive and encompasses a large number of participants. Export grain prices are set in international markets in which Australia is a price taker".¹⁸

The export wheat market is characterised by bulk sales in spot markets, and such sales are therefore directly subject to the global dynamics of supply and demand.¹⁹ While ports can be considered a "bottleneck" within the export supply chain infrastructure, the pricing power of the port owners is constrained when the customers in the downstream markets are able to choose between supply chains. In effect, the ports are one element of a supply chain which must be efficient to compete on a global market.

This was recognised by the 2005 Exports Infrastructure Taskforce which formed the view that regulation should be applied sparingly to infrastructure used by export industries, concluding that *"Australia's export chains are strongly exposed to world market disciplines, and hence have strong incentives to be, and remain, efficient."*²⁰

Lack of efficiency in the supply chain is likely to have substantial adverse impact on all participants in the Australian wheat industry, including CBH and its grower members. Recent media reports have highlighted this as a pressing concern, reporting that:

¹⁸ Authorisation nos A30233, A30234 and A30235 ACCC determination 15 April 2005

¹⁹ Allen Consulting Group (March 2008) "Competition in the export grain supply chain"

²⁰ Australia's Export Infrastructure, Report to the Prime Minister by the Exports and Infrastructure Taskforce, May 2005

*“The \$4.5 billion wheat export trade may go in the hands of rival markets as there are growing complaints from leading Asian customers that rail and port bottlenecks are causing big delays to grain shipments. Australia exports wheat on a large scale to Indonesia, South Korea and Japan. Western Australia is the biggest wheat producing State. Some Asian flour mills have turned to the United States and Canada to secure wheat at higher prices. Analysts warn that Australia will be unable to supply big wheat customers until June, which would be a heavy monetary loss. ...”*²¹

4.2 Opportunities and incentives to discriminate

CBH owns the majority of Western Australia’s grain storage and handling infrastructure, with a total capacity in excess of 19 million tonnes. CBH also owns and operates the four port terminals which are used to export grain from Western Australia.

CBH is vertically integrated in the Western Australian grain supply chain through its wholly-owned subsidiary, Grain Pool Pty Ltd (**GPPL**). GPPL is a specialist marketing organisation which supplies grain to international export markets. CBH acquired GPPL in November 2002.

CBH operates in a unique set of circumstances which constrain its conduct:

- CBH is a grower-owned co-operative, governed by its Memorandum of Association and Articles of Association, which prescribe the manner in which CBH may operate and how it must apply its income;
- CBH is bound by the terms of the *Bulk Handling Act 1967* (WA), section 19 of which provides that CBH must allow others to use its port facilities;
- the grain export market is an aggressively competitive international market;
- the significant fixed and sunk cost of Port Facilities means that throughput is vital to reducing the cost of storage and handling services to CBH’s customers, and grower returns (which are net of supply chain costs);
- the volatility of harvest and finite storage capacity at ports; and
- the increasing availability of on-farm storage as an alternative to CBH storage, and the real threat of new port facilities being established in Western Australia.

4.3 CBH co-operative structure constrains its conduct

CBH is a grower-owned co-operative, with approximately 4,800 shareholders who are grain growers in Western Australia. CBH was incorporated on 4 April 1933 and is governed by the *Companies (Co-operative) Act 1943* (WA) (**Co-operative Act**).

²¹ ‘Logjam forces wheat customers into the arms of rivals’, *Australian Financial Review*, 24 March 2009, 6.

CBH is also governed by its Memorandum of Association (**Memorandum**) and Articles of Association (**Articles**). Among other things, the Memorandum and Articles direct the manner in which CBH may operate and how it must apply its income. For example:

- each shareholder of CBH can only hold a maximum of 5 CBH shares (article 5);
- CBH is prevented from distributing any of its income or profit to its shareholders (article 110);
- all income and property of CBH must be applied towards CBH's objects, as set out in its Memorandum (article 111); and
- any surplus assets of CBH after the payment of its debts and liabilities and the costs of winding up are not to be distributed to shareholders (article 114).

CBH's objectives are contained in article 2(a) – (ee) of its Memorandum. Its main objectives are contained in articles 2(a), (b) and (f) which are:

- “(a) To establish maintain and conduct any schemes or systems for handling of wheat and/or other grain in bulk or otherwise.*
- (b) To receive, handle, transport, grade, classify and store wheat and/or other grain...*
- (f) To carry on either in conjunction with or separately from the businesses authorised to be carried on by the preceding paragraphs or any of them all or any businesses or business which in the opinion of the Directors may be conveniently carried on by the Company or promote assist be incidental or conducive to the attainment of its objects or any of them.”*

Because CBH is a grower co-operative, its primary motivation is to act in the interests of grain producers, by ensuring a reliable and cost-effective grain storage and handling service. CBH's Memorandum and Articles mandate this, through the requirement that CBH use its income to achieve its objectives of establishing and conducting systems for handling grain in bulk, and not to pay dividends to shareholders.

CBH is prohibited by its Articles from paying dividends to shareholders, and must apply its income in the pursuit of its objectives as set out above.

CBH was established to provide grain storage and handling services to its shareholders – grain growers. The extracts from CBH's Memorandum and Articles above illustrate several fundamental differences between CBH, as a grower-owned co-operative, and a profit-maximizing corporation. CBH's culture, operations and decision-making are driven by the requirement that CBH provide grain storage and handling services to grain growers, rather than to maximise profits and distribute returns to shareholders.

CBH's charges to marketers are typically deducted from the returns paid to growers. This means that CBH's grower members, many of whom supply to marketers other than GPPL, are directly affected by supra-competitive pricing

or discrimination against GPPL's competitors. In this way, CBH's cooperative structure inherently and powerfully constrains its conduct and reduces its incentive to discriminate.

4.4 Bulk Handling Act constraints

In addition to its obligations under the Memorandum, the Articles and the Co-operative Act, CBH has a number of obligations under the *Bulk Handling Act 1967 (WA)* (**Bulk Handling Act**) and Bulk Handling Act Regulations 1967 (WA) (**Bulk Handling Regulations**). These obligations are summarised below:

- CBH must receive all grain tendered to it that meets the requisite standards: Bulk Handling Act, section 42, and Bulk Handling Regulations, regulation 13;
- CBH must determine the grade of the grain tendered to it and inform the person tendering the grain of CBH's determination: Bulk Handling Act, sections 6A and 43(2);
- on receipt of the grain tendered to it, CBH must cause the grain to be weighed and issue a weighbridge ticket for the grain to the person tendering the grain: Bulk Handling Act, section 36(1);
- CBH must issue a warrant for the grain tendered to it: Bulk Handling Act, section 37(1);
- CBH must deliver the grain to the receival point or port in the State as required by the person who is entitled to the grain under the warrant: Bulk Handling Regulations, regulation 20;
- The holder of the warrant issued under Bulk Handling Act section 37(1) must take delivery of the grain by 30 September next following the receipt of the grain by CBH: Bulk Handling Act, section 45(1);
- If the holder of the warrant issued under Bulk Handling Act section 37(1) does not take delivery of the grain by 30 September next, CBH can sell the grain, deduct its costs from the funds realised from the sale and pay the net proceeds from the sale to the warrant holder: Bulk Handling Act, section 45(2), and Bulk Handling Regulations, regulation 26;
- CBH must insure all grain in its custody or under its control: Bulk Handling Act, section 11.

Sections 35A(b), (c) and (d) of the Bulk Handling Act also place restrictions on the manner in which CBH can use its income or property. These sections provide that:

- *“(b) all income and property of the Company [that is, CBH] shall be applied, subject to this Act, towards the objects of the Company as set out in clause 2 of its memorandum of association and not otherwise.*
- *(c) the directors of the Company may set aside out of the profits of the Company such sums as they think fit as reserves for application, in the discretion of those directors, in meeting contingencies or in achieving any other purpose that is, under the memorandum or articles of association of*

the Company but subject to this Act, a proper purpose for the application of profits of the Company;

- *(d) where any reserves set aside pursuant to paragraph (c) are not immediately required for application in accordance with that paragraph, they may, in the discretion of the directors of the Company, be applied in the business of the Company or in furthering, subject to this Act, the objects of the Company as set out in clause 2 of its memorandum of association, paying off or reducing some or all of its debentures for the time being outstanding, or liquidating any other indebtedness of the Company or they may be invested in such investments as those directors think fit”.*

Section 19 of the Bulk Handling Act is especially relevant in relation to port access. Section 19 provides that:

“Subject to this Act and the regulations, the Company shall allow a person, on payment of the prescribed charges, the use of any bulk handling facilities and equipment controlled by it at ports in the State.”

This means that, by virtue of the Bulk Handling Act, CBH is already legislatively bound to allow other parties access to its ports.

4.5 Port terminals are throughput businesses

The sunk costs of port facilities, and the nature of CBH's business, is such that maintaining volume of throughput is essential to ensure the ports are economically viable. That is why, as is stated above, CBH has never unreasonably refused any accredited exporter of grain access to CBH Port Terminal Facilities. Port Terminal Services are to be charged on a per tonne basis based on average throughput over a number years.

Because the majority of costs associated with CBH's port terminals are fixed and sunk there is a strong economic incentive for CBH to facilitate increased throughput at its ports. By maximising throughput, CBH can optimise the efficiency of its port operations, particularly where a port terminal is operating below capacity.

In circumstances where a port terminal is operating at peak capacity, or if demand exceeds capacity, delays and operational issues are inevitable. However, this does not raise intrinsic concerns in relation to the terms on which access is provided.

A key challenge for CBH as a Port Operator is to ensure maximum utilisation of installed storage and handling capacity at port in order to minimise the holding costs of capacity which is only used occasionally. The fundamental incentive is to grant access to a variety of users to ensure that throughput is maximised.

The following comments reported recently in the rural media in Western Australia illustrate this point:

“...CBH, which knows that being a volume business, any grain it loses from the system will hurt its bottom line... Retiring CBH chief executive Imre Mencshelyi acknowledged that in being a volume-

*based operation any loss of volume through an alternative supply chain would have an impact.*²²

4.6 Possibility of new entry

The ability of Port Operators to raise prices above efficient levels is also constrained by the potential entry of new competing port facilities and also competition from container exports (see below).

Over the past 10 years, two new port terminals have been built in Victoria and South Australia, with the capacity to handle in excess of 50% of Victorian grain production, namely:

- the construction of the 40,000 tonne Melbourne Port Terminal (**MPT**) at Port Melbourne at a cost of \$42 million; and
- the construction of a new 60,000 tonne port terminal at Outer Harbour at Port Adelaide by ABB Grain at a cost of \$135 million.

Both the MPT and Port Adelaide terminals have been constructed in a manner to facilitate future expansion, for example:

- MPT has spare land for the construction of additional bins that would feed into the existing conveyor/ship loading system; and
- the Port of Melbourne and the MPT is also in the process of expanding its rail intake lines to handle more trains and is planning to deepen the port which would give the MPT access to the larger Panamax ships.

The construction of these terminals suggests that port terminals are not uneconomic to construct and it would be possible for any major participant in the grain industry (or consortium of participants) to develop port terminal facilities if dissatisfied with their existing access to export markets.

In Western Australia, while actual new entry has not yet occurred, recent press coverage points to the following preliminary steps toward new entry taking place:

- a group of Geraldton growers is investigating a proposal to invest in Port Terminal Facilities;
- a group of growers in the Albany zone is in talks with a third party supplier in relation to Port Terminal Services²³.

In addition to new entry in Port Terminal Services, CBH's services may be in part substituted by alternative forms of on-farm storage²⁴. In its consideration of

²² L Ladyman, 'CBH monopoly under threat', *Countryman*, 12 March 2009, 5.

²³ K Wilson, 'CBH ship listing unless it changes', *Farm Weekly*, 5 March 2009, 3; L Ladyman, 'CBH monopoly under threat', *Countryman*, 12 March 2009, 5; 'Growers look at moving own grain to port', *Farm Weekly*, 19 March 2009, 6; S Quinton, 'WA port monopoly under seige', *Countryman*, 19 March 2009, 5.

the Grain Express arrangements, the ACCC previously considered that the use of on-farm storage by farmers in Western Australia would provide a competitive constraint on the potential for CBH to exercise market power.

Because of the high proportion of fixed and sunk costs involved in supplying Port Terminal Services, even small scale entry is capable of effectively constraining CBH. This is because even small losses of tonnage may have a substantial effect on CBH's ability to cover its high fixed costs. Such an effect would be likely to trigger increases in charges. In short, CBH is strongly constrained by the threat of new entry, however small the entrant.

4.7 Competition from export container grain

A small but not insignificant portion of Australia's wheat is exported by containers. While containerisation is not necessarily considered a realistic substitute for the purposes of exporting all wheat, it does provide an alternative mechanism and therefore poses a realistic pricing constraint to the Port Terminal Services.

There is some evidence of limited substitution between containerised wheat and bulk wheat. In 2006-07, following the deregulation of containerised wheat exports, volumes of containerised wheat dramatically increased, with approximately 877,000 tonnes of non-bulk wheat being exported from Australia, representing 8.7 per cent of total wheat exports.²⁵

In 2007-8, this volume continued to increase. From a 5 million tonne wheat harvest in Western Australia, 904,000 tonnes, or nearly 20% was exported in containers. While it is accepted that containerised wheat is not a perfect substitute for bulk, the constraint it represents is significant because of the potential for volume loss to high fixed cost bulk export facilities to render the services provided by the owners of those facilities uneconomic.

4.8 Power of vertically integrated customers

A significant number of grain exporters that seek access to Port Terminal Services are vertically integrated multi-national companies with substantial experience in grain exports, supply chain logistics, global grain marketing and flour milling. These include Cargill, Glencore, Elders Toepfer, Louis Dreyfus and AWB.

These exporters have a substantial degree of bargaining power and the ability to retaliate in response to unfavourable treatment. If dissatisfied with the services they receive in the Australian export wheat chain, these exporters have the ability to shift their supply sources (and crop investments) to wheat produced in other countries or to retaliate by refusing to trade with GPPL.

²⁴ 'On farm storage is in big demand', *Efficient Farming News*, 29 October 2008; C Bettles, 'Super sized storage in WA Wheatbelt', *Farm Weekly*, 26 March 2009.

²⁵ Allen Consulting Group, *Competition in the export grain supply chain (Report to AWB Ltd)*, March 2008, 21.

This is demonstrated by the following recent comments reported in the Australian Financial Review:

“The chairman of Indonesia’s Wheat Flour Association, Franciscus Welirang, said his mills were being forced to secure supplies from Canada due to the long delays in Australia. ...

Mr Welirang, who is a director of Indonesia’s biggest flour mill, Bogasari, estimated that Australia had lost up to 150,000 tonnes in wheat sales to Indonesia, worth about \$50 million at current prices.”²⁶

These customers are also well positioned to obtain and interpret the large amount of transparent information available, and to draw any concerns about the provision of the Port Terminal Services to the attention of government, Wheat Exports Australia, the Productivity Commission (in the forthcoming review), and the ACCC (either under Access Undertakings or competition provisions of the TPA).

The use of Port Terminal Services is therefore subject to a high level of external scrutiny by these regulatory bodies. The threat of heavier-handed regulation if CBH is found to have acted inappropriately operates as a substantial competitive constraint on CBH.

Additionally, the Australian grain industry is a highly political and emotionally sensitive issue, particularly in rural communities. There are several large influential rural lobby and grower groups which represent grain growers (amongst others) in Western Australia, including Grain Trade Australia, the Pastoralists and Graziers Association, and the Western Australian Farmers Federation. These organisations also provide a constraint on any ability CBH may have to discriminate against third parties seeking access to its ports. These organisations are also well placed to draw any concerns about CBH’s provision of Port Terminal Services to the regulatory authorities should CBH act inappropriately.

CBH is also constrained by the real threat of heavier-handed regulation if it is found to have acted inappropriately. The threat is heightened by the following factors:

- the transparency of information CBH is required to publish through the continuous disclosure requirements of the WEMA and the monitoring by Wheat Exports Australia;
- the presence of sophisticated and well-resourced competitors who operate on a global level and therefore have the ability to critique CBH’s behaviour and pricing against global benchmarks;
- the forthcoming Productivity Commission review.

²⁶ ‘Logjam forces wheat customers into the arms of rivals’, *Australian Financial Review*, 24 March 2009, 7.

4.9 Information publicly available

The publication of the shipping stem on CBH's website as required under the WEMA effectively provides a level of transparency in relation to shipping at its port terminals. With such information available publicly, and considering the mammoth logistic planning required to ensure the appropriate grain is in shipping position at the right time, there is no incentive and little ability for CBH to discriminate in relation to the shipping stem.

In addition to the shipping stem, much of the information on grain held by CBH at its ports can be obtained from government agencies, such as the Australian Bureau of Agricultural and Resource Economics (**ABARE**), the Australian Bureau of Statistics (**ABS**), commercial marketing publications (eg Profarmer), from field observations or from marketing activities. Public information includes grain production, grade/quality information, surplus export tonnages, rail movements, port prices and shipping stem information. For example:

- ABARE publishes monthly reports²⁷ which provide information on:
 - opening stocks held by bulk grain handlers, milling operators and feed and other wheat users;
 - the current year's production, supplies and wheat available;
 - the volume of wheat used for export and domestically;
 - the volume of wheat committed for export and domestically; and
 - the wheat balance as at the end of each month;
- ABS publishes information in relation to the stocks of grain held by bulk handling companies and grain traders²⁸. This includes the volume of wheat held for milling and for other purposes;
- Wheat Exports Australia publishes the wheat export charge on its website²⁹; and
- in accordance with the continuous disclosure requirements of the WEMA, shipping stem information for each of CBH's ports is publicly available on its website³⁰.

Potential concerns about pricing conduct, the availability of non-discriminatory access and leveraging of information is addressed by the binding arbitration procedure and ring fencing provisions in the proposed Undertaking. The ring fencing provisions ensure the separation of CBH's port operations and GPPL's

²⁷ Available at <http://www.abare.gov.au/interactive/AusWheat/> accessed 6 April 2009.

²⁸ Available at [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/FFAEB67B7DF5D4DACA25757100105216/\\$File/73070_jan%202009.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/FFAEB67B7DF5D4DACA25757100105216/$File/73070_jan%202009.pdf) accessed 6 April 2009.

²⁹ Available at <http://www.wea.gov.au/WheatExports/WheatExportCharge.htm> accessed 6 April 2009.

³⁰ Available at <http://www.cbhoperations.com.au/grainopsindex.html> accessed 6 April 2009.

marketing operations, restrict information flows and provide mechanisms to monitor compliance.

The ACCC has previously considered issues relating to the potential access of grain storage and handling providers to their customers' competitively sensitive information in its consideration of:

- GrainCorp's and Cargill's acquisition of Milling Australia; and
- GrainCorp's proposed acquisition of Ridley Corporation.

In each case, the ACCC concluded that the provision of storage, handling or logistics services would not result in the service provider obtaining access to customers' competitively sensitive information such as would distort competition or provide any competitive advantage.

Port Terminal Services are essentially a logistics function which takes place after the relevant customer contract has been won (i.e. after competition has taken place for the relevant supply and after the customer has placed its order).

The provision of Port Terminal Services provides the relevant Port Operator with very limited (and only a very partial picture of) the sales arrangements of the relevant customer. For example, while the provision of Port Terminal Services will provide each Port Operator with certain information about the amount and quality of the wheat being shipped, the destination of the wheat and the timing of export, the Port Operator will not have any information about:

- (i) the identity of the ultimate customer (unless there is a monopoly buyer at the relevant destination port). This is particularly the case as grains are often traded several times while they remain in the logistics or delivery chain;
- (ii) the price at which, or other terms on which, the wheat was sold;
- (iii) the date on which the exporter won the tender, or entered into the contract, to supply the wheat;
- (iv) whether the exporter is fulfilling the entire customer order from wheat exported from that port (or whether the exporter is supplementing the order from wheat exported from any other port around the world);
- (v) whether the grains exported will be blended with any other grains at another location after export;
- (vi) each of the other arrangements that the exporter may have to acquire wheat, trade wheat or supply wheat, either in Australia or overseas; or
- (vii) any of the customers future tenders, contracts, marketing proposals or trading positions.

Put simply, a snapshot of information about the volume of grain to be exported on one or more vessels provides the Port Operator with absolutely no visibility of the exporter's wider trading operations. That position is determined by the

owner's stocks, purchases and sales of wheat at a *global level* and over a *period of time*:

$$\text{Trading Position} = \text{Contracted Purchases} + \text{Stock on hand} - \text{Contracted Sales}$$

Port Operators are not aware of or privy to a wheat owner's sale and purchase contractual arrangements, the prices at which those sales take place, the wheat owner's trading position or any information in relation to competition for future sales.

4.10 Threat of regulation is effective

CBH is constrained by the very real threat of heavier-handed regulation if it is found to have acted inappropriately. This threat is heightened by the level of scrutiny to which the Port Operators are subject:

- through the transparency of information through the continuous disclosure requirements of the WEMA and the monitoring by WEA;
- the presence of sophisticated and well resourced competitors who operate on a global level and therefore have the ability to critique the Port Operator's behaviour and pricing against global benchmarks; and
- the forthcoming detailed Productivity Commission review.

5 Key features of undertaking

The purpose of this part of the submission is to outline the approach taken to particular issues, explain the reasoning behind the approach adopted and provide evidence for the positions adopted where they may be the subject of scepticism or further enquiry. The approaches discussed in this part of the submission are:

5.1 Structure and scope

The Undertaking will cover multiple ports.

The “General Terms” section of the Undertaking applies generally to all the ports.

The “Port Schedules” deal with port specific matters and have priority over the General Terms.

The Undertaking only covers Port Terminal Services in relation to bulk wheat as required under the WEMA. It does not cover all services provided in the grain supply chain or to other grains because the WEMA mandates an access undertaking for Port Terminal Services only.

5.2 Term and variations

The term of the Undertaking is 3 years. This term is appropriate because of the rapidly changing structure and operation of the export wheat supply chain. At this early point in the deregulation process, it is difficult to predict the future dynamics of the industry. In addition, the 2010 Productivity Commission review may conclude that there is no compelling case for the continued inclusion of the access test in the WEMA. The Undertaking should be for a sufficiently brief term to enable these developments to be taken into account.

As set out above, the Undertaking is provided in order to satisfy the access test in the WEMA. As a result, it allows the Applicant to seek the ACCC’s consent to a withdrawal of the Undertaking:

- if the WEMA no longer requires it or an Applicant or a related body corporate ceases to be accredited; or
- in respect of a particular port, if a port is sold or a port becomes subject to a certified State-based access regime which meets the Access Test requirements.

5.3 Service definition

The definition of the Port Terminal Service is in Clause 5.1(b) of the Undertaking which in turn refers to the Port Schedules. The Port Terminal Service has two particular features that require specific explanation:

- the Port Terminal Service is for the purpose of cargo accumulation for export only; and

- the Port Terminal Service is a segregated service. The Undertaking does not allow or require CBH to co-mingle the wheat of an access seeker with the wheat of other users.

The limitation of the storage service to cargo accumulation purposes is a response to the export focus of the WEMA and the limited storage capacity of the Port Facilities. Storage for purposes other than cargo accumulation may occur in other locations, including on-farm storage facilities.

CBH will offer a segregated service and not a co-mingled service for a number of reasons. A service that involves the co-mingling of grain with grain of other users (including CBH's Grain Express customers) is a service provided by facilities other than the Port Terminal Facilities. The Grain Express service generates substantial efficiencies from enabling grain entitlements for equivalent grain parcels held in different locations to be set off against one another. To illustrate, a marketer may be entitled to a particular quantity of grain as a result of having acquired grain from a grower in Merredin. To accommodate an outturn request from that marketer, CBH may load a vessel with grain to an equivalent specification that is already at Port (ie, not precisely the same grain that was acquired). This may enable CBH to more efficiently move grain by adopting a "*whole of supply chain*" approach to efficiency. The regulated Port Terminal Service is not required to include services provided by facilities other than the Port Terminal Facilities.

In addition, CBH may not have been in a position to verify the condition of grain brought to the terminal by an access seeker. For Grain Express grain, CBH knows the identity of the grower, has detailed quality and fumigation status of the grain and has coordinated the movement of the grain to port. For grain brought to port by an access seeker, CBH has no such knowledge or assurance. Segregation of the grain reduces CBH's risk of contaminating its facilities or other customers' grain, if delivered grain is contaminated or of reduced quality. Contaminated grain in CBH's conveyor system has the potential to close a port terminal while facilities are cleaned. This imposes costs on CBH and other users of the facilities, some of which costs (such as damage to reputation) may not be calculable or readily compensable.

However, the segregated service offers substantial marketing discretion for access seekers wishing to offer their customers grain of particular origin or narrow specification.

5.4 Price and non-price terms

Consistent with current arrangements, CBH must publish on an annual basis the prices and standard terms for standard Port Terminal Services. The Undertaking does not require prior regulatory approval to the price and non-price terms. The reasons why this is appropriate are explained below.

Publication of pricing is appropriate

Annual publication of pricing for standard Port Terminal Services is appropriate because:

- it provides transparency in the provision of Port Terminal Services which facilitates *ex post* monitoring to ensure CBH does not engage in discriminatory pricing and promotes efficient negotiation and timely agreement on the terms of access to the port terminal by competitors operating in the market for services provided by CBH;
- access seekers are well resourced and have the knowledge, experience and resources to assess and negotiate terms and conditions of access;
- given there may be up to 20 ports nationally involved, and a range of divergent business and operating models used by CBH and other bulk handlers in providing Port Terminal Services, it is not practicable to undertake a uniform price determination exercise for each port in an attempt to determine an efficient price in advance of such negotiations; and
- to the extent disputes may arise, access seekers will have clear and ready recourse to binding arbitration.

In the context of the way that CBH has and continues to provide access to Port Terminal Services for the export of bulk wheat, the regulatory costs of undertaking *ex ante* regulation of prices outweighs the benefits. This is particularly the case given that:

- the legislative framework of the WEMA itself leans towards light-handed regulation as evidenced by the continuous disclosure rules which are cast as an obligation to publish only;
- there is a history of open access on reasonable terms and conditions;
- CBH businesses are volume-driven and there is no incentive to turn away customers with volume, but rather an incentive to encourage increased throughput volumes;
- Port Operators have historically faced wheat exporters with considerable countervailing power and will continue to do so;
- the commitment in the Undertaking not to discriminate between wheat exporters ensures that a Port Operator cannot charge other wheat exporters monopoly prices to subsidise its own wheat export business. Furthermore, as Australian wheat exporters (including the Port Operators' wheat export businesses) face a competitive global market for bulk wheat, this imposes a constraint on the maximum price that a Port Operator can charge its own bulk wheat exporting business. Any attempt to charge a monopoly price for Port Terminal Services will lead to a reduction in wheat exports, and or reduced revenue for growers;
- the threat of arbitration and/or heavier-handed regulation is a powerful disincentive against monopoly pricing (to the extent that is possible in the first place); and
- growers are constantly questioning supply chain costs.

Finally, given the proposed short duration of the Undertaking, the history of available port access on reasonable terms and conditions, the availability of binding arbitration and the Productivity Commission review of the Access Test requirement in the near future, it is appropriate that any price requirements should be light-handed, timely and cost effective.

In relation to determining a pricing dispute, the General Terms give the arbitrator the same guidance that would be available in an arbitration for declared services under Part IIIA.

Publication of Standard Terms is appropriate

CBH is in the process of drafting Standard Terms for the provision of the Port Terminal Services. The current version of the Standard Terms is annexed as **Attachment 4**. Those terms incorporate the Port Terminal Rules. The Undertaking requires CBH to offer the Port Terminal Services on those terms and at the Reference Prices in response to a request from an accredited marketer. This mechanism provides certainty and transparency.

Flexibility is achieved through the ability of access seekers to negotiate terms through the process specified in the Undertaking, and any changes from the Standard Terms are subject to non-discrimination principles. The Port Schedules specify the service definition by reference to the infrastructure present at each port.

The Undertaking does not preclude an access seeker requesting non-standard services or amendments to the Standard Terms. If there is a request for non-standard services, the Applicant is required to negotiate in good faith with the availability of binding arbitration should negotiations fail.

The current draft Standard Terms are attached but do not form part of the Undertaking itself. This is necessary in order to preserve flexibility. The industry generally works on an annual contracting basis and incorporating the terms and conditions would remove the flexibility to deal with developments and emerging market efficiency incentives (such as capacity booking mechanisms) without obtaining consent to variation. This is not practical. It would also create regulatory difficulty if any breach of contract were enforceable as a breach of the Undertaking. CBH assumes that the ACCC does not wish to be burdened with contract disputes that raise no apparent competition concerns.

The concerns raised by AWB and others through the WEMA consultations have focussed on the potential for, rather than any actual discrimination and leveraging. The appropriate response to concerns of this nature is a regime that includes a requirement to publish terms, embedded non-discrimination principles, reasonable ring fencing measures and disciplined dispute resolution and oversight processes. The Undertaking contains all of these elements.

5.5 Non-discriminatory access

Under the Undertaking, CBH must provide access in accordance with price and non-price terms that include efficiency, fairness and transparency as central elements.

CBH must not discriminate³¹ between access seekers, or in favour of its own operations. This principle applies not only in the context of access negotiations (clause 6.4) but in the context of operational decision-making in the performance of an access agreement (clause 9.2, 9.3 and 9.4).

In relation to the negotiation of price and non-price terms and conditions, the starting point is the published standard terms and conditions for Port Terminal Services. To the extent that additional costs have to be incurred, or efficiency savings made when providing services to users, the Undertaking provides that these cost variations are to be reflected in the published prices available to Applicants and users. This approach is consistent with the pricing principles set out in section 44ZZCA of the TPA.

The Undertaking also recognises that it can be appropriate for Port Terminal Services to be provided to different users on differentiated terms, reflecting the particular requirements of each user. Again, this approach is consistent with the pricing principles set out in section 44ZZCA of the TPA and promotes efficiency in the use of Port Terminal Services.

The non-discriminatory nature of existing access to the Port Terminal Services is evidenced by the large number of wheat exporters which have sought accreditation from Wheat Exports Australia and most of which are active participants in the wheat market.

5.6 Negotiation and dispute resolution proposal

CBH is obliged to negotiate with access seekers in good faith in accordance with a detailed negotiation process, to ensure that such negotiations are progressed according to benchmark timeframes.

The negotiation arrangements are similar to those found in the ARTC access undertaking, except the removal of the step involving the Indicative Access Proposal. (This step is considered unnecessary given that the agreements are likely to only run for no more than a year, although there is sufficient flexibility to accommodate other requests.)

The Undertaking contains a detailed dispute resolution mechanism to provide access seekers with an opportunity for review by an independent arbitrator should they be dissatisfied with the terms and conditions on which they are granted access. Again, this is based on the ARTC arrangements although it provides for independent arbitration rather than arbitration by the ACCC. However, the ACCC is given an oversight role in that it can veto the chosen arbitrator, choose the arbitrator if the parties are unable to agree and participate in the arbitration process.

5.7 Capacity management

As noted previously, there is generally excess capacity at each export grain terminal operated by CBH, except for short periods of peak demand. The ports

³¹ Operationally, the Undertaking recognises that decisions must be taken that will necessarily advantage one user over another in the context of that decision alone. However, the Undertaking provides a mechanism for preventing preferential self-dealing and ensuring decisions are made on objectively verifiable commercial factors.

operate through port allocations being given in accordance with published non-discriminatory protocols.

There are two key mechanisms for capacity management on which the Access Undertaking relies:

- (a) the Port Terminal Rules; and
- (b) the shipping stem,

both of which are in the public domain.

These mechanisms need to be read in conjunction with the ring fencing provisions detailed in the individual submissions of each Applicant. These commitments should substantially address any concerns about the way port terminal capacity or information obtained through port usage is managed.

The Undertaking obliges CBH to publish these documents and therefore CBH is subject to oversight by both the WEA under the WEMA and the ACCC under the Undertaking.

The continuous disclosure rules under the WEMA require a current statement setting out the Port Operator's policies and procedures for managing demand for the Port Terminal Service (including policies and procedures relating to the nomination and acceptance of ships to be loaded using the Port Terminal Service).

As discussed above, CBH is obliged to publish the shipping stem which includes information concerning the nomination and scheduling of vessels for each port and which is updated on a daily basis.

In both cases, this provides transparency about the operation of the port and the port allocation and enables wheat exporters to ensure that the Applicant is complying with its obligations under the Port Terminal Rules and management of the shipping stem.

The approach to capacity management and scheduling that is adopted in the Undertaking is designed to strike an appropriate balance between:

- the need to ensure non-discrimination in relation to operational matters such as the priority of trucks and trains into unloading facilities, the mobilisation of staff to attend to grain movements within port facilities and the movement and loading of vessels in the shipping stem; and
- the need for the Port Operator to maintain some degree of appropriate flexibility in relation to port rules so that operational decision making does not become mired in administrative complexity or victim to gaming by access seekers.

The starting point for this analysis is the principles of non discrimination that are prominent in the Undertaking (see clauses 6.4, 9.2, 9.3 and 9.4). While the Port Operator considers that incentives and opportunities to engage in discriminatory conduct on an operational level are limited for the reasons outlined in part 5, it also recognises the importance of non-discriminatory

principles and outcomes to multiple stakeholders involved in bulk wheat export including the ACCC, the Federal Government, prospective access seekers, grain growers and the public at large.

For this reason, the Undertaking contains clearly expressed and mandatory non discrimination requirements, which may be applied directly to the conduct of the Port Operator. Importantly, these non discrimination principles apply both to the negotiation of terms and conditions of access and also at the day to day operational level of decision making in relation to capacity management and scheduling. The mechanism adopting this Undertaking does not involve incorporating the detailed Port Terminal Rules into the body of the Undertaking itself. Instead, the Capacity Management aspects of the Undertaking, such as the port rules are explicitly subject to non discrimination principles.

A number of inherent safeguards exist to ensure these obligations will be complied with. The Port Terminal Rules themselves are required to be published by the Port Operator. This provides access seekers and potential access seekers with the opportunity to object to any current provisions of the Port Terminal Rules or to any changes to the Port Terminal Rules once made. Operational decisions are subject to a dispute resolution process under the Standard Terms.

Many of the operational decision makings which will be subject to the rules take place in full public view, both as a consequence of the disclosure requirements introduced under the WEMA, and as a result of the fact that scheduling and queuing, particularly of trucks, takes place in view of other users of the port facilities. Were the Port Operator to operationally favour the trading business in relation to the shipping stem, that conduct would be detectable and likely to give rise to public complaint. Since the requirement to publish shipping stem information, CBH has been asked to explain a high proportion of changes to the stem. It has also been audited for compliance. Intense scrutiny is already applied to shipping stem decisions by an informed market and an effective regulator in the WEA.

CBH submits that it would be both unworkable and inappropriate to require the port rules to form part of the Undertaking itself. As the ACCC will have observed in the course of site tours of port facilities, the efficient deployment of the facilities in providing Port Terminal Services is an enormously complex and difficult task, particularly during the harvest period. The movement of millions of tonnes of export wheat through port facilities in the space of a few months creates some inevitable scheduling conflicts and no facility could be constructed efficiently that would be free of such inherent conflicts.

As with many logistic chains a delay or inefficiency in one part of the supply chain may give rise to a cascading series of problems and require changes in other parts of the logistics chain. Decisions are often made in changing circumstances, under considerable pressure. For this reason, the Port Terminal Rules that provide the framework for operational decision making must remain flexible enough so that changes may be efficiently implemented to take account of unforeseen circumstances.

The Port Terminal Rules will be drafted for the purpose of the Undertaking in an environment in which sweeping and substantial changes are occurring at multiple levels of the export wheat industry. Against this background, it is unrealistic to expect a Port Operator to have comprehensively and finally determined the precise form of its Port Terminal Rules such that they would require no amendment for the duration of the Undertaking. Accordingly, it is essential for the efficient operation of facilities that Port Operators have a mechanism to amend Port Terminal Rules where appropriate, and without having to provide a new or amended Undertaking.

However, it is appropriate for any changes to the Port Terminal Rules to be made in accordance with the non-discrimination principles embodied in the Undertaking, to be made publicly and for decisions in relation to Port Terminal Rules to be subject to an appropriate dispute resolution process. All of these measures are embodied in the Undertaking.

5.8 Capacity expansion

Given the proposed short term of the Undertaking, it does not address capacity expansion as any expansion would need to be addressed over a longer period than the proposed term of the Undertaking.

Any imbalance between demand and capacity will be adequately addressed by CBH's policies and procedures for capacity management. It would not be commercially viable to build capacity equivalent to meet peak demand as this would mean even more idle capacity for most of the year, and particularly in poor seasons.

For these reasons, CBH considers it unnecessary to address capacity expansion in the Undertaking.

5.9 Ring fencing arrangements

CBH's ring fencing measures are substantially more detailed than those regarded as acceptable by the ACCC in its consideration of the Grain Express Notification. CBH has adopted a more detailed approach in recognition of the WEMA's focus on vertical integration issues.

The ring fencing measures contain measures including:

- legally distinct trading entities with separate legal personality;
- physical separation of staff;
- staff training;
- restrictions on staff transfer between trading and operations businesses;
- information flow measures;
- accounting separation for trading entities;
- dispute resolution; and
- independent audit.

6 TPA requirements

For the reasons set out above, CBH considers that it is appropriate for the ACCC to accept the proposed Undertaking having regard to the requirements of the TPA.

6.1 The objects of TPA Part IIIA

To the extent that Port Terminal Facilities cannot be economically duplicated, an undertaking to provide access to services from those facilities on transparent and non-discriminatory terms would promote the economically efficient use of those facilities and promote competition in vertically related markets, thereby promoting the objects of Part IIIA.

However, the assumption that Port Terminal Facilities cannot be economically duplicated has not been fully established although an assumption to that effect appears to underlie the inclusion of the access test in the WEMA.

CBH considers that there is scope for new entry, and there is some potential for inter-port competition. Given that CBH has historically provided access to its services in the absence of a formal access undertaking, the Commission should accept an undertaking that requires CBH to publish reference prices for a set of standard services without those forming part of the undertaking. This approach would protect investment incentives and promote economically efficient investments in Port Terminal Facilities.

CBH submits that the Undertaking will promote the economically efficient operation of, use of and investment in bulk wheat export terminals and thereby promote effective competition in upstream and downstream markets.

6.2 The pricing principles specified in TPA section 44ZZCA

The Access Undertaking requires that access to Port Terminal Services be provided on non-discriminatory terms. It has provisions specifically prohibiting CBH from discriminating in favour of its own business. This, together with a binding dispute resolution process, ensures that CBH provides access at prices which generate expected revenue for Port Terminal Services that is at least sufficient to meet the efficient costs of providing access to the Port Terminal Services, including a return on investment commensurate with risk.

The dispute resolution process provides a mechanism for pricing to be tested and, if appropriate, amended in order to ensure cost-reflective and non-discriminatory pricing.

Accordingly, the published pricing proposed under the Undertaking is consistent with the Pricing Principles set out in TPA section 44ZZCA.

6.3 The legitimate business interests of the provider

CBH has the following legitimate business interests:

- CBH should be subject to regulatory compliance measures and costs that appropriately reflect the nature and size of its business and the seriousness of competition concerns giving rise to its regulation;

- CBH should not be required to subsidise the Port Terminal Service with efficiencies generated by its other business activities;
- CBH should be entitled to impose appropriate measures to address risks and costs flowing from the provision of the regulated service; and
- CBH should be able to maintain operational flexibility in order to respond to changing circumstances for the purpose of efficiency.

CBH has never unreasonably refused access to its Port Terminal Facilities. In relation to its services generally, CBH is required to give access and to receive grain by the Bulk Handling Act. As a co-operative, CBH's goal is to deliver benefits to its members and this is directly relevant to assertions that it has incentive to engage in inefficient practices such as discrimination. For it to do so would be in direct conflict with its obligation to its members. CBH grower members pay the real price of supply chain inefficiency in the form of reduced returns from grain that becomes less competitive in a global market. The significance of CBH's co-operative structure should not be understated.

6.4 The public interest

The public interest is served by a prudent approach to regulation that:

- appropriately considers the practicalities of prescriptive regulation, the burden of compliance on export industries and the risk of regulatory error;
- promotes the economically efficient investment in Port Terminal Services;
- incorporates measures that are reasonably proportionate to the competition concerns giving rise to regulation.

In this case, regulation arises not from a declaration process, a contravention of Part IV of the TPA or a Productivity Commission (**PC**) review. Regulation arises prior to a PC review in an environment of sweeping industry change and in an export industry that is important to the national interest. In these circumstances, the risk of detriment from regulatory error or disproportionate compliance costs is clear and present.

In the circumstances, and given that more extensive regulation may be adopted at the option of the Commonwealth, CBH submits that the Undertaking represents a prudent approach. In substance, competition concerns may be tested in the Undertaking's dispute resolution processes, which will respond to the real concerns of the market, which is well resourced and informed.

6.5 The interests of persons who might want access to the service

Under the Undertaking, CBH will continue to provide access to Port Terminal Services to any accredited wheat exporter that meets reasonable prudential requirements. Such users are adequately protected by the requirement to publish pricing for standard services, the obligations not to discriminate and the detailed negotiate/arbitrate mechanisms.

Access seekers want certainty – certainty of terms, certainty of price fairness, certainty of non-discrimination and the certainty of disciplined processes for negotiation and dispute resolution. The Undertaking provides all of these elements.

Co-operative Bulk Handling Limited