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RE: CBH Port Access Undertaking 2011

Dear Mr. Wing

Thank you for the opportunity to comment on CBH's proposed 2011 Port Access Undertaking. We believe the ACCC oversight of port access arrangements within remnant monopoly-control situations is vital for the development of an increasingly competitive grains industry in Australia.

Specifically as it relates to CBH and Western Australia,

1. the ACCC's review of port access arrangements, including port pricing which is inordinately high and therefore discourages up-country competitive investment in storage and handling facilities, is necessary;

2. we regard CBH's proposal for baseload capacity allocation of port shipping slots outside of the auction system as self-evidently self interested; and

3. CBH's previous behaviour demonstrates that effective ringfencing rules are required.

INTRODUCTION

The Pastoralists' and Graziers' Association of WA (Inc) (PGA) is a non-profit industry organisation, established in 1907, which represents primary producers throughout Western Australia. The Western Graingrowers Committee specifically represents the interests of PGA grain growing members, who produce a significant percentage of Western Australian grain every year.

All of our members are grower-shareholders of the Western Australian bulk handling cooperative, Cooperative Bulk Handling (CBH).

To varying degrees from year to year, our members sell grain through CBH Grain (the trading arm of CBH), through one of the competitors of CBH Grain, and/or in their own right (domestically and internationally) in direct competition with CBH Grain.

The majority of the specific issues raised in the Issues Paper are most appropriately commented upon by marketers. But we would like to emphasise that, in the absence of competition or the lack of open and fair access to monopoly-controlled ports, grain growers

ultimately pay for inefficiency and higher costs which result. As representatives of grain producers in Western Australia, we make the following general comments.

BACKGROUND

Deregulation of wheat export marketing in 2008 was another step forward in a long process of change for the Australian wheat industry. Western Australian wheat growers have benefited from movement from a regulated to an open and contested marketing environment.

As a result of the liberalisation of grain marketing in 2008, Western Australian grain growers immediately benefited from a substantial improvement in basis. The introduction of more than 20 competing buyers into what was previously a closed market was beneficial to growers, especially at a time of great volatility in international and domestic financial markets.

While much progress has been made, there remain challenges. Deregulation of wheat export marketing has exposed underlying problems, primarily in the bulk handling of export wheat, that were naturally hidden within the regulated system.

Western Australia is Australia's largest wheat exporting state, and across all commodities, approximately 90% of the average 10 million tonne crop is exported. Bulk exports of grain go through four (4) ports (Kwinana, Geraldton, Albany, Esperance), which are controlled by one bulk handler, CBH.

In 1987-88 the McColl Royal Commission identified the appalling culture of bulk handlers.

> *Perhaps the most read section of the 1988 McColl Royal Commission report...was that which detailed the costs of moving grain from the paddock to the port. The Commission found the system of grain distribution did "not meet the criteria of economic efficiency, cost effectiveness and integration" principally because "most grain is channelled along a restricted number of predetermined paths with minimal scope for using lower cost paths." The commission found fault with the BHA's practice of pooling transport costs and charging growers an average price. "Hence, inefficient facilities are over-utilised, efficient facilities are under-utilised, and the cost of undertaking the grain distribution task is again higher than it would otherwise be." Because the grain distribution system operated in "an environment largely devoid of competition," inefficiencies have proliferated.*

–A Shared Harvest by Whitwell & Sydenham; 1991; McMillan Education Australia; pgs. 148-150

Grains Industry Review, a report by Accenture in August 2002 commissioned by GrainCorp, stated:

> *"High costs to growers are being caused by barriers to competition and efficiency in the supply chain, grower services, and the operation of the single desk"*

And

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"Opportunities for others to provide value for growers are being constrained." The conclusion of Recommendation 1 was "What is needed is a more open, contestable supply chain..."

In short, the report advocated the benefits of competition in driving cost reduction.

The monopolistic control of the supply chain by bulk handlers exists because of historical protection within the regulated marketplace.

In Western Australia, bulk handler CBH emerged as the monopoly provider of port terminal services and upcountry storage and handling services.

Since 2008, CBH has supplied grain storage and handling services on the condition that growers and marketers use CBH's supply chain coordination services, and that they acquire transport services from CBH nominated carriers. Because this forced tying of services contravenes the Trade Practices Act, CBH has operated "Grain Express" under an ACCC Exclusive Dealing Notification (EDN). ACCC began the process of re-assessing the EDN last year and issued a draft ruling in December in which revocation of the exclusive dealing notification was recommended. A final ruling is expected by mid-June.

In a submission to the Productivity Commission's Review of Wheat Export Marketing Arrangements in April 2010 the PGA stated:

> *...it has become clear with the second full harvest since the wheat market was deregulated that there is a significant impediment that exists in Western Australia to true market conditions. That is the monopoly power of Cooperative Bulk Handling (CBH). CBH controls the entire wheat logistics structure (both port terminal services and upstream services in Western Australia. CBH controls 197 receival sites; and the export supply chain through Grain Express). They are able to extend their port monopoly up-country, and discourage investment in alternative pathways to the ports through Grain Express and business rules. It is quite possible that all the benefits of deregulation (of which PGA is in favour) will not come to fruition if the monopoly is allowed to function in its current state.*

<u>In the case of CBH, the single most critical point of control by the remnant monopoly is the port.</u>

For this reason, during this time of further adjustment to competition, ACCC oversight port access within CBH's monopoly control is vitally important to the Western Australian grain farmer.

PRICING

There are two fundamental issues at stake: 1) CBH controls the port facilities and can make trading grain out of WA very difficult through the imposition of a host of business rules, the port access ones purportedly addressed in the undertaking. But even if all the access issues were ironed out and all grain marketers truly had equal and fair port access, CBH's ability to discourage up-country investment in competing storage and handling facilities exists due to 2) CBH's ability to set the price at port.

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After deregulation of wheat export marketing, CBH restructured their fees, more than doubling port fobbing fees from $8.50 to $17.10. At the same time, upcountry time-based storage fees were eliminated, and replaced with an $8.50 outturn fee. This fee is avoided if the grain stays in the CBH system. It was effectively transferred to being charged at port rather than up-country, consistent with CBH's pricing policy conceded in their letter of 11 April 2011 to ACCC regarding the Grain Express exclusive dealing notification:

> *1.1 Gross revenue derived from all fees. Because CBH charges a range of fees, its primary factor in setting the level of particular fees is whether the aggregate revenue from all fees will meet all costs. This may be surprising, since the ACCC may be used to reviewing entirely cost reflective pricing methodology. However, it is not unusual for cooperatives to set prices in this manner because they are not obliged to derive profits for shareholders.*

CBH's charges are not market-based prices, but arbitrary abstractions.

The $17.10 fobbing fee at port is excessive and is designed to discourage competition in up-country storage and handling services. One cannot invest in and charge for (or amortise) storage facilities and compete with CBH when faced with a $17.10 fobbing fee at port. Even if the Grain Express exclusive dealing notification is revoked, the fact that CBH has rearranged the fees to favour their own up-country storage (knowing that they will recover that amount at port) stifles competition.

The fees were restructured in 2008 with the apparent intent of thwarting competition. If CBH did not have monopoly control of the port (even though subject to an access test), they would not have been able to do so.

In 4.7 of their supplementary letter to ACCC, CBH states, *"There have not been any submissions from interested parties that lack of pricing certainty is an issue, nor have there been any complaints from users about CBH□s port terminal services pricing under the Undertaking."*

Reasonable people have known that it would do no good to complain to CBH about the pricing. There have been negotiations on elimination of the additional fees charged at port so as to improve certainty of pricing. So while what CBH has written is technically true, it ignores underlying actualities that evidence problems in this vein.

In 4.9 of their letter, CBH *"estimates that the costs of port terminal access regulation over the last eighteen months has exceeded $1.5 million. CBH was already providing access to all wheat exporters prior to the access undertaking. Prior to the passage of the WEMA, there was no evidence that CBH had refused access or engaged in any market leverage strategy for the purpose of lessening competition."*

Were CBH genuine in drafting an access agreement that reflected a sincere interest in accommodating the trade rather than attempting to ensure continued exclusivity for themselves, their costs would be substantially less.

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CBH goes on in 4.10 to say that the negotiate/arbitrate process is adequate for pricing issues. When there is no competitive alternative to CBH, and there is no regulatory ruling on pricing within the monopoly, marketers are cynical about expending any resources in attempting to change the pricing structure of CBH. There is no negotiation strength on the part of the users of CBH's monopoly port system. The ACCC's review of port pricing is essential.

In 4.12, CBH boasts of its low supply chain pricing compared to other BHCs in Australia. The comparison is entirely inappropriate. Western Australia has always been the largest wheat exporting state, and the entire supply chain developed with taxpayer subsidies and, under the old AWB, focussed expenditure in the WA export supply chain. In addition, there are natural advantages in Western Australia versus other states in large distances combined with low populations, leading to lower regulation (for example, of road trains), which significantly lowers the entire cost of transport to port in this state. CBH is claiming credit for efficiencies that exist despite them.

The core issue for the purposes of this undertaking is the pricing at port, which does not *"provide incentives to reduce costs or otherwise improve productivity."*

Port pricing for grain export in Western Australia compares unfavourably to that at other grain exporting ports in the world. CBH attempts to justify this on the basis of the capital invested. The capacity of our ports, though, is much greater than has ever been used. In the provision of port services, grain producers should not be made to pay more for services they do not require simply in order to offset the monopoly operator's luxury capital expenditure.

In addition, growers in effect are being asked to pay again for something that has already been paid for. The original capital used for port development was, over a number of years, forcibly deducted from growers prior to issuing the proceeds of their grain sales.

Finally, the portion of the ports that is used is not being utilised efficiently. Marketers have complained that, especially considering the capacity of the ports, the loading of ships is slower than it should be. Both capital and operating costs are higher than what they would be within a competitive system. Given that the capital is sunk, it's time to make sure the port infrastructure is used efficiently.

In 4.13, CBH states, *"pricing has not been strictly and directly cost-reflective on an item by item basis, primarily because, as a cooperative, CBH has not needed to derive commercial rates of return on particular functions but has instead approached revenue, cost and capital expenditure on a consolidated basis."*

This is further evidence of monopoly control and lack of competition which drives efficiency and lower cost structures. In any competitive business, every cost must be identified, measured and lowered in order to be lean and efficient. For CBH to state that it will cost them too much to understand costs is the most compelling admission to date that Western Australian grain producers are being disadvantaged in world markets due to inefficient supply chain management.

BASE LOAD CAPACITY

Section 5 of CBH's supporting letter deals with the new baseload capacity proposal. We regard this proposal for baseload capacity allocation of port shipping slots outside of the auction system as self-evidently self interested. It will further stifle competition in this state, as it favours the incumbent monopoly operator, CBH.

CBH states in Section 5.5: *"The PC report suggests that capacity should be determined without reference to the capacity of the existing land-based supply chain. Such an approach would inevitably lead to users paying for capacity that the existing land-based supply chain may be incapable of delivering. This would be unrealistic and inefficient."*

While CBH's concern for users of the port is touching, it is not for them to protect marketers from bad decisions. We endorse the Productivity Commission's view that port capacity should be offered without regard to what CBH believes the existing land-based supply chain may be (in)capable of delivering.

5.12 CBH is concerned that difficulties associated with a pure auction system may be causing marketers to prefer to do business in other States over Western Australia.

While marketers might prefer to do business in states other than Western Australia, never has the pure auction system been blamed. In most cases, speaking anecdotally, marketers are frustrated by CBH's use of business rules and pricing to discourage competition in this state.

From our contact with grain marketers, we understand that the auction system is workable, with the immediate past year being an improvement upon the prior year.

The eligibility rules set out in sections 5.14 and beyond consolidate power to CBH rather than making the system more open and transparent. Within the existing monopoly situation, no port capacity should be set aside before auctions, regardless of what new program or name is invented for such a set-aside.

RING FENCING

CBH quoted the Productivity Commission in section 7.2:

> *"Although the Commission sees merit in ring fencing in certain circumstances, it does not see convincing arguments to enforce ring fencing provisions in what is very much a market in transition. In seeking to achieve competitive outcomes, ring fencing measures should be considered as more of a „last resort□ than a first option for a developing market. Further, the Commission considers that there are benefits to be gained from vertical integration in the export of bulk wheat – indeed, the fact that all of the major handlers have acquired a trading arm would attest to this fact. Most of Australia□s overseas competitors are also vertically integrated and to deny such benefits in the Australian context could place domestic traders at a disadvantage relative to other global players."*

The critical difference is that the vertically integrated companies that operate in competitive markets like the United States do not have full control over the port facilities. There is competition between vertically integrated operators at the ports.

CBH happen to be incumbents with a 70-year advantage within a totally protected, government-mandated marketing system. They have not become vertically integrated through a free market system. All their actions to date indicate they are still operating as though grain logistics and marketing should be a sheltered workshop.

We support continued requirements for and diligent oversight of ringfencing.

CONCLUSION

The 2008 deregulation of wheat marketing further exposed the significant problems that are inherent within a monopoly that has developed due to state protection and forced single desk marketing.

CBH is the incumbent monopoly operator of the entire grain storage and handling system in Western Australia. They have total control of all grain exporting ports along with 70 years of built-up infrastructure and operations assets at their disposal.

They have restructured fees to preference their own – and to discourage competitive investment in – up-country storage and handling facilities.

CBH appears to have the power to make the rules to their own benefit and to oversee any negotiations or arbitrations that might arise. The state of Western Australia has the capacity to solve the problems arising from CBH's monopoly control of grain storage and handling in this state under the Bulk Handling Act. An independent arbiter of port access arrangements and pricing would allow for competition to develop at port, which would then allow for more competition in up-country service provision.

In the absence of such a solution, we support ACCC's continuing oversight of port access arrangements. Specifically, we submit that

1. the ACCC's review of port pricing is necessary;
2. CBH's proposal for baseload capacity allocation of port shipping slots outside of the auction system inordinately favours CBH; and
3. effective ringfencing rules are required.

Once again, we appreciate the opportunity to comment on this undertaking, and make ourselves available to you for any additional information you might require.

Sincerely,

John Snooke
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