GrainCorp

For Public Register

Mr Anthony Wing
General Manager
Transport and General Prices Oversight
Australian Competition & Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

7 April 2011

Dear Mr Wing

GrainCorp Operations Limited – Port Terminal Services Access Undertaking
Consultation on the draft decision dated 24 March 2011
Transfer and Trading of Booked Elevation Capacity

Thank you for the opportunity to provide comments to the Australian Competition & Consumer Commission **(ACCC)** on its draft decision dated 24 March 2011 in relation to GrainCorp's Port Terminal Services Undertaking, particularly in relation to issues relevant to arrangements for the transfer of shipping slots.

We enclose GrainCorp's submission responding to the ACCC's request for comments. GrainCorp also proposes to make a further submission on other aspects of the Draft Decision.

If the Commission requires any further information, or has any questions in relation to the information provided in the enclosed submission, GrainCorp would be pleased to assist.

Yours sincerely

Nigel Hart
Group General Manager Storage and Logistics

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For Public Register

GrainCorp Submission on Transfer and Trading

of Port Elevator Capacity

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Table of contents

GrainCorp

1. Purpose of this submission

GrainCorp Operations Limited ("**GrainCorp**") is providing this submission following the issue of the draft decision on 24 March 2011 ("**Draft Decision**") and related request for comment by the ACCC on possible arrangements for transfer of booked elevation capacity at GrainCorp port elevators.

GrainCorp proposes to lodge a separate submission addressing other issues raised in the ACCC's Draft Decision.

2. The issues raised by the ACCC for discussion

The ACCC indicated in its Draft Decision that, in its preliminary view, the continuation of the first come, first served allocation arrangements in GrainCorp's Proposed 2011 Undertaking is likely to be an appropriate system for providing access to GrainCorp infrastructure.

However, having regard to s44ZZA(3) of the *Competition and Consumer Act 2010* ("**CCA**"), the ACCC indicated that the 2011 Undertaking may be more likely to be deemed appropriate if changes were made to management of capacity to enable shippers to trade or transfer elevation capacity on the GrainCorp shipping stem, with any traded capacity to retain all confirmed arrangements as they appear on the shipping stem.

The ACCC has indicated that a secondary market for elevation capacity could be created by appropriate revision of provisions in the GrainCorp Terminal Port Protocols ("**Protocols**"). The ACCC stated that:

> *"... it is also the ACCC's preliminary view that these arrangements may not result in economically efficient outcomes at peak times. In particular, when port terminal services are fully utilised the flexibility allowed in GrainCorp's protocols for operators to change shipping arrangements for a booked slot is not viable in practice."*

3. Context of access Undertaking submission

GrainCorp is seeking approval of the Proposed 2011 Undertaking, not because of the inability of third parties to access its port terminal infrastructure, but in order to comply with the Access Test so as to be eligible to export wheat under the *Wheat Export Marketing Act* 2008 ("**WEMA**").

If directed to do so by the ACCC, GrainCorp will introduce a trading or capacity transfer system for elevation capacity in order to have its undertaking accepted.

However, GrainCorp wishes to point to the practical and industry issues arising from the ACCC's proposal to require the introduction of elevation capacity transfer and trading, and that the company opposes the introduction of such a system.

As the ACCC has noted, there is no identifiable harm to be redressed by the imposition of a capacity based trading system on GrainCorp's port terminals, as there are actually very limited circumstances where GrainCorp's elevation services are fully utilised.

Furthermore, GrainCorp has strong concerns with this approach for the following reasons:

a) The introduction of elevation capacity transfer and trading will have the following effects:

- Reduce export supply chain efficiency, resulting in congestion at GrainCorp's terminals and reduced total grain exports to the detriment of the Australian economy.
- Significant increase in the cost of execution of export sales, particularly at peak times.
- Reduced grower net returns, as increased costs arising from the secondary trading and related execution costs are passed back to growers by exporters.

b) A secondary trading mechanism for port capacity, to be practical in its operation, will apply to all grains, not just wheat, representing a breadth of regulation by the ACCC that was not intended by the WEMA.

c) The flexibility in the current Protocols is sufficient to ensure that booked shipping capacity is used in a productive and efficient manner.

Under the current GrainCorp system, exporters are able to book elevator capacity up to 12 months ahead, and the system provides;

- Flexibility - Allows exporters to move elevation capacity between ports and across elevation periods in response to seasonal or grain market changes, and swap stock at port with other exporters to facilitate efficient cargo accumulation and vessel loading,
- Equity - Favours neither large exporters nor disadvantages small exporters who are seeking to establish or expand their export operations,
- Transparent pricing – All exporters pay the same base elevation tariff,
- Fairness – Eliminates speculation that can drive up export execution costs in peak times, and eliminates capacity hoarding by any one exporter.

d) Requiring secondary market trading of elevation capacity will be of limited, or no benefit, to any exporting party, and will:

- Create a significant risk of jeopardising the efficient operation of GrainCorp's port terminal elevators;
- Introduce the capacity for gaming of elevation capacity;
- Encourage elevation capacity booking speculation by traders; and
- Potentially lead to a reduction in grain exports as customers seek to source grain from other markets.

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4. Problems Related to Transfer and Trading of Port Elevation Capacity

Based on available evidence and experience in managing port protocols in the past 2 years, including experience from the CBH system of auction and secondary market, a move to introduce a 'market' for trading elevation capacity at GrainCorp port elevators would not be efficient or beneficial to the grain industry for the following reasons.

Elevation capacity booking system cannot be seen in isolation from the grain supply chain

The 'efficient use' or maximisation of export elevator capacity cannot be seen in isolation from the supply chain that provides the link between grain storage, and the port elevator.

Where a supply chain is under stress, due to either natural disasters or a shortage of transport capacity for the task at hand (which is the case this year), the manner in which elevation capacity is allocated at a port is largely irrelevant.

For example, an exporter may purchase elevation capacity in an auction, secure title to booked capacity as a result of a transfer of that capacity from another exporter, or purchase capacity via a secondary market, but should that exporter fail to secure enough grain, fail to procure sufficient rail or road transport to accumulate their cargo in a timely manner (meet their assigned load date), suffer delivery delays due to excessive rain, or natural disasters, find that grain is infested or unsuitable for export, the manner in which an exporter secures elevator capacity is irrelevant.

In such instances, and they are common this year, but not present in an 'average' year, the exporter will suffer shipping delays *because the supply chain has failed.* The presence of a secondary market for elevation capacity will not make any difference to such a situation.

No data to support the ACCC argument of a 'need' for trading of elevation capacity

In the draft decision, the ACCC state:

> "*The ACCC acknowledges the economic benefits of market arrangements to allocate scarce port terminal services.*"[1]

The port elevators operated by GrainCorp have an annual capacity of approximately 14.8 mmt. In an average year, GrainCorp handles ~4 mmt of grain through these elevators, a capacity utilisation rate of between 25 and 30%.

- Even in a year where grain production is at a record peak, as it was from the 2010/11 harvest, GrainCorp anticipates that bulk exports handled through its elevators will be between 6.5 and 7 million tonnes, at a capacity utilisation rate of between 44 and 47% for the year.
- Constraints on exporting grain from eastern Australia are due to a shortage of transport capacity, and are not related to the allocation of elevation capacity.

[1] ACCC Draft Decision, p 50.

To date, public submissions made by interested parties in relation to GrainCorp's Proposed 2011 Undertaking *have not proven the need for the introduction of a capacity trading system*.

No data has been published supporting the contention that the current elevation capacity booking system is either inefficient, or hindering the export of grain through GrainCorp elevators.

On the contrary, actual port elevator delays *not* related to supply chain problems delaying delivery of grain to GrainCorp elevators (a matter not related in any way to the system of booking elevation capacity, but related to the serious lack of road transport capacity, the unwillingness of some exporters to commit to take-or-pay rail capacity, or their inability to source sufficient grain in a timely manner to meet their shipping expectations), have been minimal.

Year to date;

- There has only been one port elevator block-out (October at Fisherman Islands),
- The average time from vessel ETA[2] (not Assigned Load Date) to loading is 6 days,
- The average time from vessel notice of readiness (not Assigned Load Date) to loading is 4 days
- Where vessels have been delayed and loaded outside a requested elevation period by pre-port supply chain delays, the average delay is 2 ½ days.

The transfer and trade market concept is "experimental"

In the international market context, it is *grain* that is traded or sold at an elevator, not the *elevator capacity*. GrainCorp is not aware of any international jurisdiction where grain elevation capacity is traded in the manner proposed by the ACCC.

The only experience with elevation capacity 'trading' available to the Australian grains industry is that gained from Western Australia. This system can be considered to have failed as it;

- Has been criticised by participants, and
- As the flaws and inefficiencies have been exposed (and highlighted by CBH in their submission to the ACCC), CBH are now seeking to by-pass their own auction and secondary market, with their proposition to introduce a Base Load Allocation system of capacity allotment to a select few exporters.

[2]A vessel Estimated Time of Arrival is not the date upon which a vessel is assigned a load date. Assigned load dates are determined by elevator activity and will be one or more days after the actual arrival of a vessel.

Overview of CBH experience

In their 1 April 2011 submission to the ACCC, CBH cast doubt on the appropriateness and viability of not only the system of auctioning port elevation capacity, but on the distortionary effect both the auction and the secondary market for elevation capacity has on the grain market in Western Australia.

CBH concede that;

- The auction system is both complex and costly,
- There are significant supply chain inefficiencies caused by the uncertainty in the market, which has driven CBH to develop their 'Base Load Capacity' proposal,

  > "*Certainty of BLC will allow CBH to ensure that costs and shipping are spread out over the year to retain the lowest cost supply chain for participants in the Western Australian Grain Supply Chain.*"[1]

- The planning of grain transport logistics is compromised as a result of the uncertainty created by both the auction and the secondary market,

  > "*...larger users can generate efficiencies from being able to negotiate for capacity much earlier than the standard auction system allows*".[1]

- Customers prefer to source grain in other Australian states as a result of the difficulties associated with their auction system.

  > "*...difficulties associated with a pure auction system may be causing marketers to prefer to do business in other States over Western Australia*[1]"

The creation of an elevation capacity market is thus 'experimental' and therefore inherently risky and dangerous.

Should the 'experiment' not work (and based on the problems identified in of the CBH system there is a high degree of likelihood that it will) there is a risk that price signals and operating behaviour in the market may be distorted in the manner outlined below;

- Drive up the cost of export execution, particularly in the first four to five months of each shipping year (December to April) where a 'peak time premium' will be charged by the exporters for elevation capacity at particular ports.
- Increase uncertainty of elevation capacity execution.
- Reduce port elevator efficiency, as speculation will increase the rate of unexecuted bookings (which are currently running at zero YTD).
- Raise issues for smaller exporters that do not have the financial capacity or risk appetite to make speculative elevation capacity bookings. This is of significant concern as it contradicts some of the objectives of the Access Test and the WEMA.

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Supply chain efficiency effect – Higher costs

GrainCorp also has significant concerns about the effect speculative transfer and trading of elevator capacity will have on the efficient operation of its port elevators.

Increased speculation will reduce certainty and in turn reduce the ability of grain storage and handling services providers to undertake effective medium and long term logistical planning for export grain.

The complexity of the supply chain, and the need to manage changes in grain sourcing, variability of grain types and quality, variable volumes and complex rail and road logistics effectively, mean that export cargo accumulation can quickly become inefficient and costly.

This means that GrainCorp will have a reduced ability to undertake forward planning of the movement of a customer's grain stocks. Forward planning of grain movements can and does significantly increase supply chain efficiency. This is a factor referred to by CBH in the rationale for bypassing their own capacity 'market', and in support of the Base Load Capacity proposition.

As a result of the increased uncertainty, the supply chain will be forced to adopt more 'just in time' cargo accumulation, which will increase the cost and complexity of cargo accumulation, lead to a reduction in port elevator productivity and an increase in supply chain costs that will be passed back to growers.

The added uncertainty, and potential increase in supply chain costs, will also erode the competitiveness of eastern Australian grain exports, and will thus make Australia a less favoured source of grain supply, as customers seek lower cost, more efficient and more certain grain suppliers.

Higher costs to be passed back to growers

Speculators within an elevator capacity secondary market, particularly during peak times in the shipping year, would have an incentive to book elevation capacity to trade with other grain exporters, as when demand for port elevation is high, speculators will be able to charge significant premiums for elevation capacity bookings.

GrainCorp believes there is likely to be significant increased costs in "bidding" for elevation capacity with the creation of a secondary market, rather than seeking the efficient export of Australia's grains. Competition for elevation capacity at selected ports following harvest will drive the 'value' of elevation capacity well above the current tariff rate. GrainCorp can only estimate what additional cost speculators may seek to extract for elevation capacity bookings at peak times, but it is not unreasonable to postulate an additional cost of in excess of $10/T.

While the ACCC may view this as an efficient outcome, the ultimate result will be that any increased cost associated with booking peak time capacity would be a *new* cost.

As exporters are unable to pass these costs on to their end customers (given they are competing in an international market where prices paid by grain consumers are largely determined by international market forces), exporters will seek to offset any new costs and protect their margins *by passing them back to growers*.

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GrainCorp asks the ACCC and the Government to appreciate the risk to the grains industry as a whole, as well as the increased cost to growers that will arise from the "bidding-up" for export capacity by exporters.

Encouraging elevation capacity market speculation, not grain exporting

Any arrangement that will allow the transfer or trading of elevation capacity between exporters will have the propensity to facilitate speculation and gaming.

Some grain traders will *focus on trading elevation capacity* against their view of supply and demand, rather than exporting grain, as the potential profit from trading elevation capacity at peak times could equal or exceed the margin from trading the grain, with considerably less risk to the exporter.

For example, if an exporter is provided an opportunity to trade elevation capacity at *very low risk*, say $15/T compared with an average grain price of $300/T, then they will seek, without exception, to *trade the lower risk commodity* and to extract a return from it.

Other consequences of allowing transfer and trading of elevation capacity include:

- The entry of other participants (e.g. hedge funds that currently trade grain futures) to trade elevation,
- Traders potentially 'cornering' the elevation market at peak times by buying all the capacity at a port for a month (without the intention of exporting grain),
- Monopoly rent premium from the sale of the elevation capacity to actual grain exporters,
- Allowing exporters with significant financial capacity to fund large up front capacity bookings, which would be detrimental to smaller exporters, and
- Lead to a reduction in export competition from eastern Australia.

Increasing market uncertainty

It must be noted that grain growers will ultimately bear any increased costs resulting from higher export execution costs.

In addition to the risk created by the uncertainty of the proposed market, consideration must be given to the complexity of the structure of such a market and;

- how it would operate,
- what platforms and systems would be required to support the market,
- the rules, guidelines and safeguards required, the changes required to the Port Protocols,
- the length of time it would take to gain agreement from all / the majority of parties who will participate.

A significant concern of GrainCorp's is the potential disruption to the market that is;

a) being caused by speculation over the introduction of a transfer and trading 'market', and

b) the influence this speculation will have on forward capacity bookings and exporters commitment to transport capacity for next season.

GrainCorp is of the firm opinion that there is no possibility of safely developing a workable market platform, with well thought out rules that can be introduced;

a) In time to open the shipping stem for the forthcoming grain harvest (noting that cereals will start being harvested in Central Queensland in late August) and the 2011/12 shipping year, and

b) In a manner that all parties can be confident that the system will not precipitate significant administrative confusion that will disrupt not only port and supply chain operations, but export grain sales programs.

GrainCorp believes that a market for the transfer and trading of elevation capacity conceived and implemented in haste, will significantly raise the risk of unforeseen consequences arising, and increase the likelihood of international customers turning away from the Australian grain market.

GrainCorp Operations Limited

7 April 2011