ACCC final position

GrainCorp Operations Limited and Quattro Ports at Port Kembla

Exemption assessments of bulk wheat terminals under the Port Terminal Access (Bulk Wheat) Code of Conduct

1 October 2015

Contents

Summary

The ACCC has reached a final position that GrainCorp Operations Limited (GrainCorp) and Quattro Ports (Quattro) should be exempt service providers of port terminal services provided by means of their respective port terminal facilities at Port Kembla under the Port Terminal Access (Bulk Wheat) Code of Conduct (the Code). The ACCC's view is that it is appropriate that these exemptions for GrainCorp and Quattro at Port Kembla be granted concurrently at the time Quattro becomes a port terminal service provider as defined by the Code (that is, when Quattro's ship loader is capable of handling bulk wheat).

Under these exemptions, GrainCorp and Quattro will be subject to a lower level of regulation at their respective Port Kembla facilities, as Parts 3 to 6 of the Code will not apply to those facilities.

In reaching its final position, the ACCC has had regard to the matters listed at subclause 5(3) of the Code and has formed the view that:

- GrainCorp's Port Kembla port terminal currently faces limited competitive constraints, as there is no directly competing port terminal facility. While containerised exports at Port Botany provide some competition, there is little overlap with the grain catchment areas of the next closest bulk grain ports at Newcastle and Melbourne.

- Competition from Quattro is likely to increase the competitive constraint faced by GrainCorp and limit its ability to exercise market power in the provision of port terminal services, particularly given the significant level of spare capacity expected to be available across the two Port Kembla facilities.

- Quattro's Port Kembla terminal will also face significant competition from GrainCorp, as the dominant incumbent provider of port terminal services at Port Kembla, as well as some competition from containerised grain exports.

The ACCC's views are based on analysis of current and expected capacity constraints and usage at Port Kembla and the extent to which port terminals at Port Kembla would compete with other port terminals for bulk wheat in overlapping catchment areas. The ACCC has also considered the extent of any competitive constraint imposed by container exports and domestic demand for wheat.

The ACCC's view is that exempting Quattro from Parts 3 to 6 of the Code in relation to port terminal services at Port Kembla will increase its operational flexibility and decrease its compliance costs.

In the absence of competition from Quattro, the ACCC's view is that the full set of obligations in the Code should apply to GrainCorp's facility to constrain its market power in the provision of port terminal services at Port Kembla. However, with the entry of Quattro as a competing port terminal service provider, the ACCC considers that it will be appropriate to exempt GrainCorp at the time that Quattro becomes covered by the Code. Exempting GrainCorp from Parts 3 to 6 of the Code in relation to port terminal services at Port Kembla would similarly increase GrainCorp's operational flexibility and decrease its compliance costs. Exemptions for both facilities would also allow GrainCorp and Quattro the opportunity to compete with each other on commercial terms.

The ACCC considers that if it exempts both GrainCorp and Quattro once Quattro's facility is capable of handling bulk wheat exporters of bulk wheat will be likely to have fair and transparent access to port terminal services at Port Kembla. Competition between Quattro and GrainCorp is likely to drive the more efficient operation and use of both Port Kembla facilities in the absence of full regulation under the Code.

The ACCC will separately consider recent fee changes by GrainCorp at its up-country storage and handling facilities. These fee changes were raised by Quattro in a public submission. The changes include an additional outturn fee where grain is delivered by rail to a third party port (such as Quattro's). GrainCorp's up-country fees are not covered by the Code, which regulates access to port terminal services.

The ACCC's full assessments of the matters under subclause 5(3) of the Code regarding each port terminal are set out in chapters 2 and 3 of this document.

ACCC monitoring

Once the ACCC makes final determinations to exempt Quattro and GrainCorp in relation to the Port Kembla terminals, the ACCC considers that it will be appropriate for it to undertake monitoring of Port Kembla bulk wheat port terminal services to continue to assess the level of competition at these facilities into the future.

In particular, the ACCC would be concerned if it saw evidence that there had been significant increases in market concentration in the grain export market that may reduce the level of competition for grain grown by Australian farmers.

The ACCC will remain able to monitor the level of shipping activity and market concentration at Quattro and GrainCorp's Port Kembla terminals through examining daily ship loading statements provided to the ACCC. The ACCC also proposes to periodically consult with industry to seek information about exporters' ability to access port terminal services at Port Kembla.

The ACCC has considered NSW Farmers' request that the ACCC undertake price monitoring. The ACCC does not have a formal direction to request cost information and monitor prices for bulk wheat port terminal services under Part VIIA of the *Competition and Consumer Act,* as is the case in certain other industries. However, the Code requires that all port terminal service providers publish reference prices. The ACCC intends to monitor trends in these prices for both exempt and non-exempt ports as part of its general industry monitoring.

1. Introduction

The Port Terminal Access (Bulk Wheat) Code of Conduct was made under section 51AE of the Competition and Consumer Act 2010 (CCA). It commenced on 30 September 2014 and regulates the conduct of bulk wheat port terminal service providers (PTSPs). The Code replaced the previous regulatory framework under the *Wheat Export Marketing Act 2008* (WEMA) where four PTSPs (including GrainCorp) were subject to ACCC-approved access undertakings.

The purpose of the Code is to regulate the conduct of PTSPs (as defined in the Code) to ensure that exporters of bulk wheat have fair and transparent access to port terminal services.[1]

1.1 GrainCorp's exemption application

GrainCorp's Port Kembla bulk wheat port terminal is located at Port Kembla in NSW, and includes the following facilities – intake/receival facility, grain storage facility, weighing facility, shipping belt and two ship loaders.

GrainCorp submits that it is appropriate that GrainCorp be determined to be an exempt service provider at Port Kembla because exemption will:

- place GrainCorp on a level playing field with competing alternative markets (domestic and container packing), neither of which are subject to regulation
- promote grain industry competition by allowing GrainCorp to provide competitive services to exporters for bulk grain exports, noting Quattro has already announced it has agreed medium-term take-or-pay commitments with Noble, Cargill and Emerald for "substantial volumes"
- support lower supply chain costs by allowing GrainCorp to operate its port terminals more flexibly. GrainCorp submits that more flexibility and efficient operations at port will allow increased investment in improving port and supply chain infrastructure.[2]

GrainCorp submits that its ability to exercise market power in NSW and Port Kembla is limited given:

- excess port elevation capacity
- impending competition for port elevation services for bulk grain from Quattro's Port Kembla facility
- strong competition from competing alternative domestic and container packing markets
- excess upcountry storage capacity
- excess container packing capacity.[3]

[1] Subclause 1(2) of the Code.

[2] GrainCorp Operations Limited, *Submission in support of exemption*, 2015, p.3.

[3] GrainCorp, *Submission in support*, p. 3.

Further details of GrainCorp's exemption application are set out as relevant throughout this document. GrainCorp's full submission in support of its exemption application is available on the ACCC's website at:
https://www.accc.gov.au/regulated-infrastructure/wheat-export/.

1.2 Quattro's exemption application

Quattro's Port Kembla bulk wheat port terminal is located at Port Kembla in NSW. It is currently under construction, and is expected to include the following facilities – intake/receival facility, grain storage facility, weighing facility, shipping belt and ship loader.

Quattro submits that it should be an exempt service provider at its Port Kembla facility because:

- Part 3 obligations (i.e. non-discrimination and no hindering obligations, dispute resolution procedures) place an 'undue burden' on Quattro
- the time and cost of upfront compliance with the Code will hinder Quattro in its critical start-up period
- the obligation to enter protracted negotiations for access, and submit to costly arbitration can be exploited by competitors to impede Quattro's operational efficiency at a time when Quattro will need to make rapid commercial decisions in response to competitive market pressures.[4]

Quattro also submits that:

- surplus capacity is likely to neutralise any ability for Quattro to impose unilateral terms on exporters in the event of an exemption
- there is competition for port elevation services with GrainCorp's Port Kembla and Newcastle facilities, Newcastle Agri Terminal, and Emerald's Melbourne Port Terminal.[5]

Further details of Quattro's exemption application are set out as relevant throughout this document. Quattro's full submission in support of its exemption application is available on the ACCC's website at https://www.accc.gov.au/regulated-infrastructure/wheat-export/.

1.3 ACCC exemption assessment process

1.3.1 Legislative framework

In making an exemption determination under the Code, the ACCC must have regard to the matters specified in subclause 5(3) of the Code. These matters are:

(a) the legitimate business interests of the port terminal service provider

(b) the public interest, including the public interest in having competition in markets

(c) the interests of exporters who may require access to port terminal services

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[4] Quattro Ports, *Submission in support of exemption*, 2015, p. 5.

[5] Quattro, *Submission in support,* p. 2.

(d) the likelihood that exporters of bulk wheat will have fair and transparent access to port terminal services

(e) the promotion of the economically efficient operation and use of the port terminal facility

(f) the promotion of efficient investment in port terminal facilities

(g) the promotion of competition in upstream and downstream markets

(h) whether the port terminal service provider is an exporter or an associated entity of an exporter

(i) whether there is already an exempt service provider within the grain catchment area for the port concerned

(j) any other matters the ACCC considers relevant.

1.3.2 Timeline for assessment

A timeline of the ACCC's assessment of GrainCorp and Quattro's exemption applications is shown in the table below.

Table 1: ACCC assessment

Date	Action
14 April 2015	GrainCorp lodged an exemption application for its Port Kembla terminal
24 April 2015	Quattro lodged an exemption application for its Port Kembla terminal
7 May 2015	The ACCC published its issues paper and invited public submissions by 29 May 2015.
15 May – 13 June 2015	Submissions received from interested parties
18 June 2015	The ACCC published three public submissions on its website
30 July 2015	The ACCC published draft decisions on the exemption applications and invited public submissions on its draft views by 14 August 2015.
1 September 2015	The ACCC published two public submissions in response to its draft decisions on its website.
7 September 2015	The ACCC published one further public submission received from Quattro on its website.
1 October 2015	The ACCC published a final position paper on the exemption applications.

1.4 Public consultation processes

The ACCC released an issues paper on 7 May 2015 seeking public submissions on GrainCorp and Quattro's exemption applications and related key issues. The ACCC received public submissions from the following parties in response to its Issues Paper:

- Australian Grain Exporters Association (AGEA)
- Glencore Grain Pty Ltd (Glencore)
- NSW Farmers' Association (NSW Farmers)

On 30 July 2014 the ACCC released draft decisions that GrainCorp and Quattro should be exempt service providers at Port Kembla once Quattro's facility is covered by the Code. The ACCC received three public submissions in response, from:

- GrainCorp
- NSW Farmers
- Quattro Ports

Public submissions are available on the ACCC's website at https://www.accc.gov.au/regulated-infrastructure/wheat-export/wheat-export-projects/port-kembla-wheat-ports-exemption-assessments.

1.5 ACCC approach to the exemption assessments prior to Quattro's terminal becoming operational

The ACCC notes that Quattro's Port Kembla terminal is currently still under construction.

The ACCC has the option of delaying its assessment of one or both of the Port Kembla terminals until such a time as Quattro's facility is operational and its impact on the competitiveness of the zone has been demonstrated. However, the ACCC considers that there are a number of reasons why it is important to assess Quattro's exemption application at this time, including that it will give Quattro greater certainty regarding its regulatory obligations prior to the commencement of those obligations.

1.6 NSW Farmers proposed alternative to exemptions

NSW Farmers submits that it is currently premature to exempt the port facilities from the requirements at Parts 3 to 6 of the Code. In particular, NSW Farmers is concerned about removal of the requirement that a PTSP not discriminate against an access seeker in favour of itself, or an exporter of which it as associated entity.

In response to the ACCC's issues paper, NSW Farmers proposed that the ACCC consider the following approach as an alternative to granting exemptions:

> *NSW Farmers recommends the ACCC consider whether it would be open for it to make the regulatory decision to a) not exempt the facility, and b) reduce the regulatory burden of the code. This could be done by approving any policy and procedure for managing demand published under cl 8 of the code as a capacity allocation system for the purposes of cl 25*.[6]

The ACCC's draft decisions noted that the ACCC had considered NSW Farmers' proposal and its draft view was that this approach would not be appropriate.

[6] NSW Farmers' Association, *Submission in response to ACCC Port Kembla issues paper,* 2015, p. 3

NSW Farmer's submission in response to the ACCC's draft decisions noted that it:

> *invites the ACCC to reconsider its draft position with regard to the proposal put forward by NSW Farmers as an alternative to exemption the Port Kembla facilities.*[7]

The ACCC's view remains that this approach is not appropriate for the following reasons.

Firstly, the Code provides for two levels of regulation to apply to port terminal services: either the full level of regulation (that is, the entire Code will apply) or, if an exemption is granted, a lower level of regulation where only Parts 1 and 2 of the Code apply. The ACCC considers that the effect of adopting the NSW Farmers approach would be to create an alternative third level of regulation somewhere between an exemption and the full level of regulation in the Code.

The ACCC considers that monopoly regulation should be fit-for-purpose and should apply different requirements depending on a party's incentive and ability to exert market power. However, the ACCC has some concern that in this case the NSW Farmers proposal is not consistent with the intent of the exemption process as set out in the Code. If the ACCC does not exempt a PTSP, all of the obligations in Parts 3 to 6 of the Code will apply to the PTSP. While the ACCC has some flexibility in approving different types of capacity allocation systems, these assessments are made when a capacity allocation system is proposed by a port terminal service provider, and the ACCC must have regard to the matters listed at subclause 25(3) of the Code.[8] The ACCC cannot approve a capacity allocation system without making such an assessment.

Secondly, the ACCC considers that where a vertically-integrated PTSP is subject to sufficient competitive constraint, it may have incentives to discriminate in favour of its own trading division but will be constrained in its ability to actually do so. In this case, regulation is not required as it would simply duplicate the constraint provided by the competitive environment. Similarly, a PTSP subject to competition would have an incentive to negotiate reasonable terms of access in order to compete effectively, and a regulatory requirement for recourse to arbitration would not be necessary.

The ACCC considers that it is unlikely there would be a situation where the level of competitive constraint would be sufficient to support removal of this *ex ante* approval role, yet insufficient to support the removal of the *ex post* non-discrimination provisions and the arbitration provisions.

The ACCC has considered the appropriateness of granting an exemption to GrainCorp and/or Quattro at their respective Port Kembla facilities having regard to the matters set out at subclause 5(3) of the Code. In particular, the ACCC has considered the level of competitive constraint faced by both GrainCorp and Quattro in providing port terminal services. Points raised by NSW Farmers regarding whether these respective exemptions should be granted are discussed throughout chapters 2 and 3 of this document, which also set out the ACCC's final views.

For both facilities, the ACCC remains of the view that exemptions should be granted once Quattro's facility is capable of handling bulk wheat, and that it would not be appropriate or necessary to retain the non-discrimination and arbitration provisions while removing the capacity allocation approval process even if this were a possibility under the Code.

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[7] NSW Farmers' Association, *Submission in response to ACCC Port Kembla draft decisions*, 2015, p. 3.

[8] Subclause 25(2) of the Code provides that all capacity allocation systems that allocate capacity for more than six months in advance must be approved by the ACCC.

2 ACCC exemption assessment of Quattro's Port Kembla terminal

This chapter sets out the reasons why the ACCC has reached a final view that it should determine, under subclause 5(2) of the Code, Quattro to be an exempt service provider of port terminal services provided by means of its Port Kembla facility once it is covered by the Code. The ACCC's assessment is set out against the matters in subclause 5(3)(a) to 5(3)(a)(i) of the Code, which the ACCC must have regard to in assessing an exemption application.

The ACCC's draft decisions document sets out the ACCC's assessment of the level of competition in port terminal services at Port Kembla, including the impact of the bulk wheat supply chain, container exports and domestic demand for grain. These assessments are at chapters 2 and 3 of the draft decisions document.[9] The ACCC considers that this industry and competition analysis remains appropriate to inform the ACCC's final exemption assessment of Quattro's facility.

(a) the legitimate business interests of the port terminal service provider

Subclause 5(3)(a) of the Code requires the ACCC to have regard to the PTSP's legitimate business interests in deciding whether to grant an exemption.

The ACCC considers that an exemption will be in a PTSPs legitimate business interests where there are reasons why it is not necessary for the PTSP to be subject to all of the Code's obligations. For example, obligations in the Code intended to prevent a PTSP exercising market power may not be necessary where competition already provides sufficient constraint on the PTSP's ability to exercise market power. The ACCC considers that removal of unnecessary regulatory obligations is in a PTSPs legitimate business interests.

The ACCC considers when having regard to the legitimate business interests of the PTSP (as required under subclause 5(3)(a) of the Code), the following may be relevant:

- the ongoing commercial viability of services provided from the relevant port terminal facility
- the likely impact that obligations to comply with Parts 3 to 6 of the Code may have on any investment decisions made by the PTSP
- the likely impact of the costs incurred by the service provider if it were subject to the requirements of Parts 3 to 6 of the Code, including any opportunity costs arising from having to comply with these Parts of the Code
- the likely impact of greater regulation (through the application of Parts 3 to 6 of the Code) on the service provider's ability to compete in the provision of port terminal services or other upstream and downstream markets.

The ACCC also considers that the impact that Parts 3 to 6 will have on Quattro's operational flexibility, costs, and competitiveness as a new entrant service provider are all relevant to Quattro's legitimate business interests.

[9] The ACCC's draft decisions document is available at: https://www.accc.gov.au/regulated-infrastructure/wheat-export.

Quattro submits that compliance with Parts 3 to 6 of the Code will unreasonably impede its flexibility and impose costs.

On its legitimate business interests, Quattro submits:

> *Granting an exemption to Quattro's Port Terminal at Port Kembla would:*
>
> - *Allow Quattro and its investors to compete commercially for the export of bulk grain, especially in the critical start-up period;*
> - *Support operational flexibility to improve service and reduce supply chain costs;*
> - *Provide small operators and exporters improved access to fobbing capacity which has been limited by the terms and conditions imposed by the existing bulk handling companies;*
> - *Provide equity with the competing export container packers that are not regulated; and*
> - *As a new start-up company minimise the level of regulation and costs imposed by such to allow Quattro to more effectively compete against operators with established systems.*
>
> *Quattro submits that Parts 3 to 6 of the Code are an impediment to Quattro's legitimate business interests.*[10]

Operational flexibility

The ACCC notes that parties are able to exercise a degree of flexibility in operating port terminal services even where they must comply with all requirements in the Code. Non-exempt service providers are able to set prices, terms and conditions, and negotiate access agreements with exporters that are different to their standard terms.

Non-exempt service providers are also able to (subject to ACCC approval processes) select their method of capacity allocation and length of time that it is allocated for. For instance, the ACCC decided that it was appropriate for GrainCorp to move from a single year allocation method to long-term arrangements, which had the potential benefits of providing greater certainty for users in planning their long-term grain export programs and assist in supply-chain planning.[11]

The ACCC acknowledges, however, that while there is scope for flexibility in providing port terminal services where the entire Code applies, a service provider will have greater operational flexibility if only Parts 1 and 2 apply to them. If Quattro is not required to comply with Parts 3 to 6 of the Code it would be able to engage more freely in direct commercial negotiations and vary operational rules as it considers necessary for particular exporters. For example, exempt service providers would have the flexibility to facilitate slot trades and reorder the priority with which vessels will be berthed and loaded without having to comply with notification timeframes and requirements, making them more responsive to the needs of their customers.

[10] Quattro, *Submission in support*, p. 14.

[11] Australian Competition and Consumer Commission, Media release - *ACCC allows GrainCorp to introduce long-term port access agreements*, 30 November 2012 available at: https://www.accc.gov.au/media/media-releases.

Compliance costs

Regarding the impact that complying with Parts 3 to 6 of the Code will have on Quattro's costs, the ACCC acknowledges that parties subject to a higher level of regulation will likely have a higher level of compliance costs. These costs are generally at their highest prior to and during the initial phase of regulation, where compliance documents and procedures need to be developed. The ACCC acknowledges that PTSPs would understandably like to limit their costs.

In Quattro's specific circumstances, the ACCC notes that because Quattro is not currently regulated under the Code it would be required to develop an entirely new compliance program.

The ACCC considers that compliance costs may be particularly significant for a smaller player only operating a single port terminal facility, given that they will be proportionately higher compared to overall costs and revenue. A larger player operating multiple port terminal facilities may be able to spread compliance costs over its facilities.

Conclusion

As a general proposition, the ACCC considers that it is in a PTSP's legitimate business interests to reduce regulatory costs where regulation is not necessary, such as where there are sufficient competitive constraints.

It is therefore the ACCC's view that an exemption for Quattro would increase Quattro's operational flexibility and reduce its Code compliance costs.

The ACCC considers that if there are reasons why it is not necessary for Quattro to be subject to the full level of regulation in the Code, such as if Quattro faces a sufficient level of competitive constraint, an exemption would be in Quattro's legitimate business interests. The ACCC's consideration of the level of competitive constraint and other matters relevant to an exemption is set out below.

(b) the public interest, including the public interest in having competition in markets; and (g) the promotion of competition in upstream and downstream markets

The ACCC considers that subclauses 5(3)(b) and 5(3)(g) of the Code relate to the promotion of competition in markets, including the market for bulk wheat port terminal services as well as for upstream, downstream and related markets.

Relevant upstream markets include the grain acquisition market, where grain is acquired prior to it being exported or on-sold, as well as other markets such as the grain storage and handling services market and the transport of grain to port market. Related markets also include container grain exports and domestic demand for grain.

The following issues are relevant when having regard to subclauses 5(3)(b) and 5(3)(g) of the Code:

- Whether there is sufficient competition in the provision of bulk wheat export port terminal services, such that the full application of the Code may not be required to promote competition for those services or in upstream and downstream markets (such as the grain acquisition market).
- Whether reducing regulation will allow the PTSP to better compete in upstream or downstream markets such that it would also promote competition. This consideration

overlaps with the ACCC's consideration of legitimate business interest (subclause 5(3)(a) discussed above).

- Whether the competitive situation in upstream and downstream markets would allow a vertically integrated PTSP to exercise market power in the provision of services at port in the absence of Parts 3 to 6 of the Code applying, and whether that competitive situation would change as a result of an exemption.

These considerations (in particular considerations around the effect in the grain acquisition market) will overlap with the ACCC's consideration below of subclauses 5(3)(c) and 5(3)(d) of the Code concerning access seekers.

Competition in bulk wheat export operations

The ACCC notes from its analysis of the port terminal services and consideration of upcountry and related markets[12] that:

- Quattro's Port Kembla terminal is expected to provide similar services to GrainCorp's existing facility and will accommodate similar sized vessels. However, Quattro's facility will likely have slower loading rates. Both Port Kembla terminals have road and rail access. Quattro and GrainCorp's terminals are located in adjacent berths. The ACCC expects that the grain catchment area for the two Port Kembla terminals will be identical and that these facilities will be in direct competition for exporters' volumes.

- Analysis of the relevant catchment areas indicates that there is little overlap in the grain catchment areas for the Port Kembla terminals and the Melbourne and Newcastle port terminals. The long distances that wheat is transported in NSW mean that road is a less viable alternative and exporters are more reliant on rail access. While some substitution between the Port Kembla terminals and the Melbourne and Newcastle ports may still occur in practice, exporters will likely face higher transport costs to shift grain from the Port Kembla grain catchment area to alternative ports, meaning these ports are unlikely to provide a significant constraint on PTSPs in Port Kembla.

- Based on historic throughput by Quattro shareholders, it is likely that there will be some spare capacity available at Quattro's Port Kembla terminal. Further, in the absence of Quattro shareholder volumes using GrainCorp's terminal, there will be a significant level of spare capacity available at the adjacent GrainCorp terminal. Overall, there is likely to be a significant level of spare capacity available both on an annual basis and during peak periods across the two Port Kembla terminals. This significant level of spare capacity suggests that Quattro will face commercial incentives to compete with GrainCorp's facility to maximise throughput volumes at its facility.

Accordingly, the ACCC considers that data suggests that third party exporters will be able to obtain capacity at peak times of year at one of the two terminals, and will not be required to shift all capacity to a time not conducive to obtaining a good price for grain internationally.

Competition in upstream and downstream markets

The ACCC has also considered the nature of competition in upstream and downstream markets. The ACCC has considered whether the competitive situation in the upcountry

[12] See chapters 2 and 3 of the ACCC's 30 July 2015 draft decisions, available at: https://www.accc.gov.au/regulated-infrastructure/wheat-export.

storage and handling, and transport markets, might provide Quattro with market power that could be leveraged into its port services, if an exemption was granted, to limit the ability of exporters to participate in the upstream grain acquisition market. Equally, the ACCC must consider the effect on those markets of granting the exemption at port.

The ACCC also considers that related markets, such as container exports and domestic demand, can also affect the promotion of competition in bulk wheat port terminal services as well as upstream and downstream markets.

Based on its analysis of upcountry and related markets[13], the ACCC considers that:

- Quattro shareholders Cargill and Emerald operate upcountry storage and handling facilities in the Port Kembla catchment area, suggesting some degree of vertical integration. However, neither of these parties are particularly large upcountry players. The dominant provider of upcountry storage facilities in the Port Kembla catchment area is GrainCorp, which will operate in direct competition with Cargill and Emerald at port. There are several other companies with integrated storage operations also offering container packing or transport services, or both. The ACCC considers that with GrainCorp's extensive network, along with the various independent storage providers, exporters have storage options outside of the Quattro shareholders' networks.

- Both road and rail options are available to marketers to transport grain to Quattro's Port Kembla facility. However, due to the long distances involved rail is likely to be the more cost effective and preferred option. The ACCC understands that Quattro's shareholders have trains operating in NSW. However, the majority of export grain trains in NSW are utilised by Quattro's key competitor, GrainCorp. There are also a number of other trains operated by various rail providers to transport grain for export and domestic use.

- The ACCC considers that Quattro and its shareholders will face a significant level of competition upcountry and does not appear to have the ability to exercise market power in upcountry markets. Quattro's shareholders are therefore unlikely to be in a position to leverage market power from their upcountry networks into provision of port terminal services at Port Kembla.

- Containerised grain exports in NSW are significant, with wheat exports via containers representing around 20 per cent of total wheat exports from NSW.[14] This is lower than the proportion of container exports in Victoria (approximately 30 per cent). The ACCC considers that containerised exports represent a viable alternative export path for some grain produced in the Port Kembla catchment area. Containerised exports will therefore provide a further competitive constraint on Quattro's bulk export operations at Port Kembla.

- There is strong and consistent demand for grain in southern and central NSW for stock feed and flour milling.[15] Domestic users of grain face lower supply chain costs compared to the export markets and are able to pay growers an amount that is at least equivalent to the export parity price. The level of constraint that domestic users place on bulk and container exports is generally restricted by the size of domestic demand, which is relatively consistent over time and does not encompass the entire crop, leaving an exportable surplus.

[13] See chapter 3 of the ACCC's 30 July 2015 draft decisions, available at: https://www.accc.gov.au/regulated-infrastructure/wheat-export.

[14] Data from Australian Crop Forecasters.

[15] See section 3.4 of the ACCC's 30 July 2015 draft decisions.

The ACCC considers that if an exemption were granted to Quattro, it would not be to the detriment of current levels of competition in the grain acquisition market, or to upcountry and related markets.

A lower level of regulation could also enable Quattro to compete more effectively with GrainCorp in the provision of port terminal services. The ACCC notes that Quattro shareholders Emerald and Noble currently export very low volumes from Port Kembla. Once the Quattro facility is operational, Emerald and Noble may seek to export larger volumes and in doing so would provide increased competition for the current three largest exporters (GrainCorp, Cargill, and Glencore).

To the extent that the Quattro facility enables its shareholders to establish a stronger presence in grain exports at Port Kembla, it may also enable Quattro's shareholders to expand their upcountry networks and provide a greater degree of competition to GrainCorp as the dominant incumbent. This may also promote competition between GrainCorp, Quattro shareholders, and other exporters of bulk and containerised grain in related markets.

The ACCC notes concerns raised by NSW Farmers about Quattro's vertical integration with upcountry service providers Emerald and Cargill and the potential for exclusive closed loop practices, as well as the potential incentive for Quattro to use its vertical integration to favour its shareholders.

In response to the ACCC's draft decisions, NSW Farmers submitted that:

> *NSW Farmers is concerned that the ACCC's competition analysis with regard to Quattro's shareholders fails to consider the implication of their balance sheet on the incentives to operate closed loop marketing arrangements and to use its shareholding influence in Quattro to facilitate such behaviour."*[16]

As noted in the ACCC's draft decisions, the ACCC recognises the potential incentive for Quattro to use its vertical integration to favour its shareholders' operations. However, given that Quattro will be subject to competition from the dominant incumbent (GrainCorp) and there will be a significant level of spare capacity at Port Kembla, the ACCC remains of the view that there will be sufficient competitive constraint to prevent Quattro exercising market power to the detriment of competitors in related markets. In particular, the ACCC considers that Quattro's incentives to compete with GrainCorp in order to maximise throughput at its facility will likely minimise the potential for detrimental outcomes due to vertical integration.

Due to the competitive constraints noted above, the ACCC considers that if an exemption were granted to Quattro at its Port Kembla facility, it would not be to the detriment of current levels of competition in the grain acquisition market, or to upcountry and related markets. Further, given the likelihood that Emerald and Noble will seek to export larger volumes given their stake in the Quattro Port Kembla facility, there will be at least four major exporters in the zone. There is likely to be five major exporters assuming Glencore continues to export significant volumes. This is an increase in competition relative to the current environment where there are three major exporters operating at Port Kembla. The ACCC considers that increased competition between exporters is also likely to result in increased competition to acquire farmers' grain.

On the level of competitive constraint provided by containerised exports, NSW Farmers submits in response to the draft decisions that:

[16] NSW Farmers, *Submission in response to draft decisions*, 2015, p. 6.

> *NSW Farmers is sceptical that the unregulated export of containerised grain provides significant downward pressure on port costs due to the higher marginal cost associated with execution of these trades.*[17]

and that

> *NSW Farmers re-emphasises its concern that due to the higher marginal costs associated with the export of containerised grain that its longer term competitive constraint is likely to be weaker than assumed by the ACCC. In support of this argument NSW Farmers is aware that there are a number of container packing entities that are likely to reconsider their operations at the conclusion of existing take or pay agreements with rail providers.*[18]

The ACCC considers it likely that containerised exporters will continue to provide a viable alternative pathway to market for at least some grain produced in the Port Kembla catchment area, and that this is evidenced by the ongoing use of container exports out of NSW. Accordingly, while there may be fluctuations in the level of containerised exports, the ACCC considers that the container market will represent some level of constraint on Quattro's operations. In the absence of a competing port terminal for bulk exports, the level of constraint provided by containerised exports alone may not be sufficient to warrant an exemption for Quattro's Port Kembla facility. However, this competitive constraint from containerised exports is in addition to the significant competitive constraint provided by the adjacent GrainCorp facility.

Conclusion

In light of the above factors, the ACCC's view is that there will be significant constraints on Quattro and its shareholders such that competition at port and upcountry will not be reduced if an exemption were granted to Quattro at Port Kembla. The ACCC considers that given the existence of GrainCorp's port terminal and upcountry supply chain infrastructure along with a number of independent upcountry storage providers, exporters should have sufficient alternative options to continue to participate in the grain acquisition market if an exemption is granted to Quattro. Furthermore, the competitive situation in upcountry storage and handling will not be diminished by granting the exemption.

(c) the interests of exporters who may require access to port terminal services; and (d) the likelihood that exporters of bulk wheat will have fair and transparent access to port terminal services

The ACCC generally considers that granting an exemption will not be detrimental to the interests of exporters requiring access to port terminal services if they can still compete in the grain export market on their relative merits. As noted above, this consideration overlaps with considerations above concerning the public interest and promotion of competition in upstream and downstream markets.

Competition on the relative merits of exporters would be hindered if terms and conditions of access favour one or more exporters (and in particular the port operator's own trading arm) other than according to their merits, thereby distorting the competitive process.

The ACCC will also consider the bargaining power of exporters and whether exporters have a viable alternative to export or market grain.

[17] NSW Farmers, *Submission in response to draft decisions*, p. 4.

[18] NSW Farmers, *Submission in response to draft decisions*, p. 7.

Public submissions received from AGEA and Glencore in response to the ACCC's issues paper supported granting an exemption to Quattro's Port Kembla terminal.

Quattro is vertically integrated in wheat export to some degree as three of its four shareholders are bulk wheat exporters. Quattro will therefore have an incentive to favour its shareholders over other third party exporters at its Port Kembla facility.

However, the ACCC considers there is also likely to be a significant amount of available capacity across both Port Kembla terminals, with strong competition from GrainCorp's Port Kembla terminal as well as (to a lesser extent) containerised exports. Therefore, the ACCC considers Quattro will have incentives to allow other parties to access capacity at its terminal in order to maximise throughput and compete with the GrainCorp facility. In particular, the ACCC's analysis of port terminal services and the exporters using these services[19] indicates that:

- Once Quattro commences operations, the Port Kembla terminals will have significant spare capacity at both peak and non-peak times. To date, Quattro's exporting shareholders have exported on average 600 tonnes per annum, which is less than Quattro's estimates of capacity at 1.1-1.3 mtpa.

- Quattro may have some incentives to prioritise access by its exporting shareholders Cargill, Emerald, and Noble. The ACCC notes that this will result in a minimum of three competing exporters receiving capacity at Quattro's facility, and that none of these exporters currently have a dominant position exporting grain from Port Kembla. Emerald and Noble have historically exported very small volumes from Port Kembla and will have an incentive to increase their annual exports. Cargill, while a more significant player, has on average exported 32 per cent of total exports which is less than the 42 per cent exported by GrainCorp. The ACCC therefore considers that an increase in port terminal capacity obtained by Quattro's shareholders will increase the level of competition faced by GrainCorp as the current dominant player.

- The significant level of spare capacity expected to be available across the two Port Kembla terminals also suggests that smaller exporters are likely to be able to negotiate sufficient access at Quattro's terminal and/or GrainCorp's terminal. While Quattro may have incentives to prioritise access by its shareholders, it may also have incentives to attract additional exporters to use its facility to maximise throughput and recover its investment. For example, Glencore, ADM, CBH and JKI have historically exported from Port Kembla. Quattro may offer to provide access to these parties on favourable terms in order to attract them to use its facility rather than GrainCorp's facility, and thereby maximise throughput and profitability of its facility. In particular, Glencore has historically been a large exporter from Port Kembla and both Quattro and GrainCorp may see benefits in attracting Glencore's business. Should parties be unable to obtain capacity at Quattro's terminal, a significant level of spare capacity is expected to be available at GrainCorp's adjacent facility.

- Containerised exports represent a further alternative pathway to export grain from the Port Kembla catchment area.

In light of the above factors, the ACCC's view is that granting the exemption would not be detrimental to the interests of exporters requiring access to port terminal services at Port Kembla. The ACCC considers that Quattro is likely to have incentives to provide access to its facility on reasonable terms in order to maximise throughput, and that the full level of

[19] See chapter 3 of the ACCC's 30 July 2015 draft decisions.

regulation under the Code is not necessary to ensure fair and transparent access to Quattro's facilities.

(e) the promotion of the economically efficient operation and use of the port terminal facility; and (f) the promotion of efficient investment in port terminal facilities

Subclauses 5(3)(e) and 5(3)(f) of the Code require the ACCC to have regard to the promotion of the efficient operation and use of its facility, and future investments in port terminal facilities when deciding whether to grant an exemption.

The ACCC considers that when having regard to the matters listed at subclauses 5(3)(e) and 5(3)(f) of the Code, the following are relevant:

- whether competition among PTSPs will drive efficient operation and use of the port terminal facility in the absence of full regulation under the Code
- whether a requirement to comply with Parts 3 to 6 of the Code would result in lesser uptake of the port terminal service than would otherwise be efficient
- whether efficient investment in port terminal facilities will be influenced by a reduction in regulation.

Promotion of the efficient operation and use of Quattro's facility

Regarding the impact of Quattro's exemption on the efficient operation and use of its facility, Quattro submits:

> *The strong competition in Port Kembla and greater NSW region will drive efficient operation and use of port terminal facility. Quattro Port Kembla port terminal will increase competition in the region through increasing Port Kembla's port export capacity by over 40%. An exemption from the Code for Quattro Port Kembla will further promote economic efficiency.*[20]

Glencore also submits that exemption will promote the efficient use of Quattro's facility:

> *In circumstances where they face competitive constraints, exemption from Parts 3 - 6 of the Code will assist infrastructure owners to engage commercially and flexibly with third party exporters. This, in turn, facilitates the efficient allocation and use of port terminal infrastructure with reduced potential for regulatory distortions.*[21]

As outlined under the above discussion of subclauses 5(3)(b) and (g) of the Code, the ACCC's view is that the level of competition that Quattro will face due to GrainCorp's competing Port Kembla terminal and competition from containerised exports will drive the efficient operation and use of Quattro's facility in the absence of obligations to comply with Parts 3 to 6 of the Code.

As noted in the discussion of subclause 5(3)(a) of the Code, exempting Quattro from having to comply with Parts 3 to 6 of the Code will provide it with greater flexibility in the way it allocates capacity. For example, Quattro would be able to facilitate slot trades as well as additions and changes to its shipping stem at short notice. This greater flexibility makes it more likely that Quattro will be able to meet the different needs of its customers and therefore is likely to drive higher utilisation.

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[20] Quattro, *Submission in support*, p. 15.

[21] Glencore Grain , *Submission in response to ACCC issues paper*, 2015, p. 2.

With preliminary estimates putting the cost of the Quattro development at $75 million,[22] Quattro will also have a commercial incentive to maximise the throughput of its facility. Quattro submits:

> *Quattro is an incorporated joint venture of four independent companies. Quattro has a commercial objective to generate a profit.*[23]

On this commercial imperative, Glencore submits:

> *Glencore considers that a key commercial objective for infrastructure owners at Port Kembla, other States and globally is to maximise the throughput and utilisation of their infrastructure.*[24]

NSW Farmers provides qualified support for the incentives faced by an infrastructure owner to maximize throughput:

> *While it is acknowledged that port terminal service providers have an incentive to optimise throughput of grain through its storage and logistics assets; this incentive is not mutually exclusive to behaviour that can impede competition for farmers' grain by increasing the costs and the risks faced by third party competitors.*[25]

NSW further submitted in response to the ACCC draft decisions:

> *NSW Farmers disagrees with the draft decisions' assessment that the level of competition will protect farmers from increased port costs; particularly where those costs have arisen as a result of inefficient capacity investment. Further, NSW Farmers is concerned that the commencement of Quattro's port facility, by itself, will not result in the competitive tension that creates downward movement in those port costs.*[26]

The ACCC notes NSW Farmers' concerns about inefficient capacity investment and the effect on port costs. The ACCC considers that parties investing in port terminal facilities that face competition are unlikely to make inefficient investments that would result in a net increase in their port costs compared with continuing to use the existing facility.

Furthermore, while Quattro may have a number of strategic reasons for developing its own port terminal facility, the facility represents a significant upfront financial investment that will require ongoing financial support to remain viable. The ACCC therefore considers that Quattro will have a strong financial incentive to maximise throughput of its facility. In order to compete with the existing GrainCorp facility, the ACCC also considers that Quattro will have incentives to keep its costs down and make efficient investments in order to attract exporters to use its facility and maximise its return on investment. It is unlikely that applying the full level of obligations in Parts 3 to 6 of the Code would improve Quattro's existing incentives to keep its costs down in the context of competition from the GrainCorp facility, once its facility is operational.

As noted in the discussion of subclauses 5(3)(c) and 5(3)(d) of the Code the ACCC's view remains that Quattro is likely to have incentives to provide access to its facility on reasonable terms in order to maximise throughput, and that the full level of regulation under the Code is not necessary to ensure fair and transparent access to Quattro's facilities.

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[22] ABC News, $75 million upgrade at Port Kembla will double its grain export and make handling more efficient by rail, at http://www.abc.net.au/news/2014-08-20/nrn-port-kembla-upgrade/5683460.

[23] Quattro, *Submission in support*, p. 15.

[24] Glencore, *Submission in response to issues paper*, p.2.

[25] NSW Farmers, *Submission in response to issues paper*, p. 13.

[26] NSW Farmers, *Submission in response to draft decisions,* p, 4.

Promotion of efficient investment in port terminal facilities

The ACCC considers that Quattro's exemption would promote efficient investment in port terminal facilities.

Quattro submits:

> *Quattro Port Kembla is itself a new investment in port terminal facilities, one which will bring an additional 1.3 million tonnes of annual export capacity to NSW. Quattro's ability to be economically sustainable relies heavily on the removal of regulatory restrictions which would burden Quattro with significant compliance costs in its initial start-up phase.*
>
> *Quattro submits that an exemption to the Code in relation to its Port Kembla facility would represent a positive signal to future investment in NSW port terminal facilities.*[27]

The ACCC notes that Quattro's facility has been developed at a port where there was already spare capacity, including during peak periods.

Beyond stating its 'objective of becoming a leading Australian port developer and operator' Quattro has not submitted further on why it has considered developing a facility at a Port with spare capacity.[28]

The ACCC notes that there are many reasons why parties may consider significant infrastructure investment in a non-capacity constrained environment is nevertheless a strategically sound decision. For instance, developers with an existing grain export business may place a premium on being assured of access to export services when required, and having the flexibility to secure and transfer that access at relatively short notice. Surety of access to export facilities may allow these exporters to deal more confidently with grain purchases and allow them to develop their global brand.

While not opposed to the development, NSW Farmers submits its concern that Quattro's investment may not be efficient and that the costs will be passed on to farmers:

> *…while NSW Farmers is not opposed to the duplication of grain storage and handling infrastructure, through investments such as Quattro's Port Kembla facility, concerns exist over the cost to industry arising from the requirement to cover the construction and maintenance costs of this facility. Specifically the concern is that in the absence of a properly functioning competitive market for port terminal services the cost of duplication will be borne by farmers regardless of whether the excess capacity is required to take advantage of Australia's bulk grain export opportunities.*[29]

The ACCC notes that a determination to exempt Quattro's facility will not change the fact that Quattro has made certain investments. The ACCC must consider whether a determination to exempt will promote efficient investment in port terminal infrastructure.

Regarding the NSW Farmers submission that the cost of duplicate facilities will be borne by farmers, the ACCC acknowledges that duplicative investment can be inefficient. However in this situation Quattro as a new entrant will be looking to develop its market share, including attracting business away from the incumbent service provider. In these circumstances the ACCC considers that any intention by the new entrant to recoup its fixed costs through higher charges will be constrained by the competition it faces from the incumbent facility.

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[27] Quattro, *Submission in support*, p. 16.

[28] Quattro, *Submission in support*, p. 2.

[29] NSW Farmers, *Submission in response to issues paper*, p. 9.

Further, containerised exports shipped out of New South Wales are no longer regulated, and make up 20 per cent of total wheat exports. This will also place some constraint on Quattro's bulk export programme. If Quattro is not required to comply with Parts 3 to 6 of the Code it will be placed on a more level playing field with container exports, as well as with domestic users, and may promote further efficient investment in its bulk wheat facilities.

Conclusion

The ACCC's view is that Quattro's exemption will:

- allow it to provide more flexible services and meet the demands of its customers, likely leading to more efficient operation and use of Quattro's facility

- demonstrate that new entrants will likely be provided with the flexibility to compete with dominant incumbent service providers

- place Quattro on a more level playing field with the container and domestic markets, which are not regulated.

Accordingly, the ACCC considers that exemption will promote the efficient operation and use of Quattro's infrastructure, and encourage efficient future investment in port terminal facilities.

(h) whether the port terminal service provider is an exporter or an associated entity of an exporter

Subclause 5(3)(h) of the Code requires the ACCC to have regard to whether an applicant for exempt service provider status is vertically integrated in grain exportation. The extent to which a vertically integrated operator favours, or is likely to favour, its own trading division will influence the ACCC's decision on whether it is appropriate that the provider should be exempt from having to comply with Parts 3 to 6 in providing access to its services.

Quattro is an incorporated joint venture between Noble Resources, Qube, Emerald Grain and Cargill Australia.

On the extent of its vertical integration, Quattro submits:

> *Quattro in its own right is not an exporter of grain. Although three of Quattro's investors are exporters of grain, it is expected that they will collectively utilise less than two thirds of Quattro Port Kembla's export capacity.*
>
> *In addition, as stated above, Quattro's ability to grant preference to its investors (to the detriment of other exporters) is restricted by the fact that Quattro operates in the largest and most competitive domestic grain market in Australia; one with numerous supply chain alternatives. With the excess up-country and export facility currently available at GrainCorp's Port Kembla and Newcastle facility, Quattro is naturally incentivised to provide transparent and fair access in order to promote use of its new facility.*[30]

The ACCC notes that three of Quattro's shareholders (Cargill, Emerald and Noble) are active grain exporters. Qube will provide logistics for the Quattro venture and does not export grain.

[30] Quattro, *Submission in support*, p. 16.

The ACCC acknowledges that Quattro's first motivation will be to satisfy the export requirements of Emerald, Cargill and Noble, and will therefore likely provide preferential access to those parties. The ACCC notes that these parties otherwise compete against one another in the grain acquisition and export market and that none of Quattro's shareholders own a controlling interest in the Quattro facility.

As discussed, the ACCC considers that Quattro will have strong commercial incentives to attract third-party exporters in order to drive utilisation of its facilities and profit from its investment. The ACCC acknowledges that Quattro would have not regulatory obligation to provide those third parties with any particular standard of service. Accordingly, while the ACCC does not consider that Quattro has incentives to operate a closed loop facility it would have the discretion to increase prices and decrease the level of service to certain parties.

On the other hand, given the likely level of spare capacity at GrainCorp's facility following Quattro's entry, Quattro is likely to find it necessary to provide access on favourable commercial terms in order to attract third-party customers.

The ACCC acknowledges that in the absence of an obligation to comply with Parts 3 to 6 of the Code, small exporters may be less likely to secure favourable terms than those with the ability to export larger volumes. The ACCC notes that to date smaller exporters at Port Kembla have not been a significant presence and on average accounted for approximately six per cent of total exports. Nevertheless, these exporters have been able to perform relatively small-scale shipping programs at Port Kembla. Further, historical shipping data is not necessarily reflective of future market shares. The ACCC considers that the increase in total available port capacity, coupled with the PTSPs ability to more flexibly allocate that capacity, may incentivise historically small-scale exporters to increase their tonnages, and new players for market share emerge. The ACCC also considers that in the event that small-scale exporters are unable to secure access on reasonable terms at Quattro's facility, they will likely be able to secure access at GrainCorp's facility.

Conclusion

The ACCC's view is that although Quattro is vertically integrated with three grain exporters who may secure preferential access to the facility, these three exporters compete with each other in the bulk export and grain acquisition markets. Quattro may also face strong commercial incentives to attract third-party customers due to the level of spare capacity and competition from GrainCorp's facility.

Accordingly the ACCC does not consider that Quattro's level of vertical integration requires it to be subject to Parts 3 – 6 of the Code.

(i) whether there is already an exempt service provider within the grain catchment area for the port concerned

The ACCC generally considers that, where there is already an exempt service provider within a grain catchment area, or where the Code does not otherwise apply to a service provider in a catchment area, this may support an exemption. The ACCC will, however, consider this matter on a case by case basis, taking into account the full extent of competitive constraint affecting each facility.

The ACCC considers that the catchment area for Quattro's Port Kembla terminal generally includes southern and central NSW.[31] The ACCC considers that the catchment area for Quattro's Port Kembla terminal will be the same as for GrainCorp's Port Kembla terminal,

[31] See chapter 3 of the ACCC's 30 July 2015 draft decisions.

but that there is limited overlap between this catchment area and the catchment areas for the Melbourne and Newcastle port terminals.

Therefore, while there are currently exempt service providers at Melbourne and Newcastle, these ports provide a very limited degree of competition to the Port Kembla terminals.

Currently there are no bulk wheat port terminal service providers servicing the Port Kembla catchment area that are exempt under the Code.

The ACCC is, however, concurrently assessing an exemption application for GrainCorp's Port Kembla facility (see chapter 3). The ACCC's view is that it will be appropriate to exempt GrainCorp's Port Kembla terminal concurrently with Quattro becoming covered under the Code. Even in the absence of such an exemption for GrainCorp, the ACCC considers that there are a number of reasons that support an exemption of Quattro's Port Kembla terminal as discussed in this chapter.

(j) any other matters the ACCC considers relevant

The ACCC does not consider that there are any other matters relevant to its assessment of Quattro's Port Kembla terminal exemption application.

3 ACCC exemption assessment of GrainCorp's Port Kembla port terminal

This chapter sets out the reasons why the ACCC has reached a final view that it should, pursuant to subclause 5(2) of the Code, determine that GrainCorp is an exempt service provider of port terminal services provided by means of its Port Kembla facility once Quattro's facility is capable of handling bulk wheat. The ACCC's assessment is set out against the matters in subclause 5(3)(a) to 5(3)(i) of the Code, which the ACCC must have regard to in assessing an exemption application.

The ACCC considers that the presence of Quattro's Port Kembla terminal makes a significant difference to the assessment of whether or not it is appropriate to reduce the level of regulation applying to GrainCorp at Port Kembla. Although the ACCC considers it is likely that Quattro will commence operations and provide a degree of competitive constraint on GrainCorp's business, Quattro's facility is still under construction and it has not yet commenced operations. The ACCC has therefore considered the appropriateness of exempting GrainCorp with and without Quattro's presence.

The ACCC's draft decisions document sets out the ACCC's assessment of the level of competition in port terminal services at Port Kembla, including the impact of the bulk wheat supply chain, container exports and domestic demand for grain. These assessments are at chapters 2 and 3 of the draft decisions document.[32] The ACCC considers that this industry and competition analysis remains appropriate to inform the ACCC's final exemption assessment of GrainCorp's facility.

(a) the legitimate business interests of the port terminal service provider

GrainCorp submits that exemption is in its legitimate business interests because it would:

- *Allow GrainCorp to compete commercially for the export of bulk grain;*
- *Support operational flexibility to improve service and reduce supply chain costs;*
- *Provide equity with competing export container packers that are not regulated; and*
- *Reduce the level of regulation and cost of compliance.*[33]

As noted in the ACCC's discussion of whether exemption would be in Quattro's legitimate business interests, the ACCC considers that while there is scope for flexibility in providing port terminal services where the entire Code applies, exemption will generally increase a service provider's operational flexibility, and reduce its compliance costs.

The ACCC also noted in that discussion that these benefits will be in a PTSP's legitimate business interests where there are reasons why it is not necessary for the PTSP to be subject to all of the Code's obligations. For example, it would be in a PTSP's legitimate business interests to reduce regulatory requirements where competition already provides sufficient constraint on a PTSP's ability to exercise market power.

The ACCC notes that GrainCorp is currently subject to all of the Code's obligations and therefore has an established compliance regime. GrainCorp will be required to continue its existing compliance processes unless and until the ACCC makes a final determination to

[32] The ACCC's draft decisions document is available at: https://www.accc.gov.au/regulated-infrastructure/wheat-export.

[33] GrainCorp, *Submission in support*, p. 4.

exempt GrainCorp. In the short term, GrainCorp's incremental costs of continuing to comply with the obligations in Parts 3 to 6 of the Code are unlikely to be high, as GrainCorp already has processes in place to facilitate compliance. However, an exemption could be expected to reduce GrainCorp's ongoing regulatory compliance costs, which may be increasingly significant over the longer term.

In 2013 GrainCorp signed long term agreements for 1.4 mtpa capacity at Port Kembla for three years. These agreements run until 30 September 2016. If GrainCorp were granted an exemption prior to renegotiating these agreements, it would have a greater degree of flexibility in these negotiations. If GrainCorp were subject to sufficient competitive constraint, allowing this flexibility would be consistent with its legitimate business interests.

Conclusion

It is the ACCC's view that an exemption for GrainCorp would increase its operational flexibility and decrease its Code compliance costs.

The ACCC considers that if there are reasons why it is not necessary for GrainCorp to be subject to the full level of regulation in the Code, such as if GrainCorp faces a sufficient level of competitive constraint, an exemption would be in GrainCorp's legitimate business interests. The ACCC's consideration of the level of competitive constraint and other matters relevant to an exemption is set out below.

(b) the public interest, including the public interest in having competition in markets; and (g) the promotion of competition in upstream and downstream markets

The ACCC considers that subclauses 5(3)(b) and 5(3)(g) of the Code relate to the promotion of competition in markets, including the market for bulk wheat port terminal services as well as for upstream, downstream and related markets.

Relevant upstream markets include the grain acquisition market, where grain is acquired prior to it being exported or on-sold, as well as other markets such as grain storage and handling services and the transport of grain to port. Other related markets include container grain exports and domestic demand for grain.

The ACCC also notes that its consideration of these markets (in particular considerations around the effect in the grain acquisition market) overlaps with the ACCC's consideration below of subclauses 5(3)(c) and 5(3)(d) of the Code concerning access seekers.

Competition in bulk wheat export operations

The ACCC considers that the degree of competition faced by GrainCorp's Port Kembla terminal is currently limited. However, the ACCC considers that GrainCorp's Port Kembla terminal will face a significant level of competition from Quattro's proposed Port Kembla facility once it is operational.

The ACCC notes from its analysis of port terminal services and consideration of upcountry and related markets[34]:

- there is little overlap in the grain catchment areas for the Port Kembla terminals and the Melbourne and Newcastle port terminals. The long distances that wheat is transported in NSW mean that road is a less viable alternative and exporters are more reliant on rail access. While some substitution between the Port Kembla terminals and the Melbourne and Newcastle ports may still occur in practice, in doing

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[34] See chapters 2 and 3 of the ACCC's 30 July 2015 draft decisions.

so exporters will likely face higher transport costs to shift grain from the Port Kembla grain catchment area to alternative ports. Emerald's Melbourne port terminal and NAT and Louis Dreyfus' facilities at Newcastle therefore provide only a limited degree of competition for GrainCorp's Port Kembla terminal.

- In average and low throughput years capacity utilisation rates at GrainCorp's Port Kembla facility are relatively low and there is likely to be a significant amount of spare capacity available for use by third party exporters, even during peak periods. In high throughput years there is some level of capacity constraint at GrainCorp's Port Kembla facility. However, in the absence of one or more clear alternative port terminals, spare capacity may not provide a sufficient incentive for a port terminal service provider to offer reasonable terms of access to its competitors in the export market.

However, once the Quattro facility is operational:

- Quattro will provide broadly similar services to GrainCorp's existing facility and will accommodate similar sized vessels. GrainCorp's existing facility will have some competitive advantage due to faster loading rates. Both terminals will be located in adjacent berths and will have equivalent road and rail access. The ACCC expects that the grain catchment area for the two Port Kembla terminals will be identical and that these facilities will be in direct competition for exporters' volumes.

- The ACCC expects that Quattro shareholders will shift their volumes from GrainCorp's Port Kembla terminal to the Quattro terminal. In the absence of Quattro shareholder volumes, there will be a significant level of spare capacity available at GrainCorp's Port Kembla terminal, even in high throughput years. Overall, there is likely to be a significant level of spare capacity available both on an annual basis and during peak periods across the two Port Kembla terminals. This significant level of spare capacity suggests that GrainCorp will face commercial incentives to compete with Quattro's facility to maximise throughput volumes at its facility. In particular, Glencore has historically been a large exporter from Port Kembla, and both Quattro and GrainCorp may see benefits in attracting Glencore's business. The ACCC considers that third party exporters will be able to obtain capacity at one or both of the Port Kembla terminals at peak times of year, and will not be required to shift all capacity to a time not conducive to obtaining a good price for grain internationally.

Competition in upstream and downstream markets

The ACCC has also considered the nature of competition in upstream and downstream markets. The ACCC has considered whether the competitive situation in the upcountry storage and handling and transport markets might provide GrainCorp with market power that could be leveraged into its port services, if an exemption was granted, to limit the ability of exporters to participate in the upstream grain acquisition market. The ACCC has also considered the effect on those markets of granting the exemption at port.

The ACCC also considers that related markets, such as container exports and domestic demand, can also affect the promotion of competition in bulk wheat port terminal services as well as upstream and downstream markets.

Based on its analysis of upcountry and related markets, the ACCC considers that:

- GrainCorp has a strong presence in the provision of storage and handling services across southern and central NSW. GrainCorp faces competition in some areas from facilities owned by GrainFlow, a subsidiary of Cargill, and Emerald Grain. There are several other companies with integrated storage operations in the Port Kembla catchment area also offering container packing or transport services, or both. Nevertheless, the ACCC notes that GrainCorp is the dominant provider of storage and handling services in the catchment area, operating 79 per cent of sites identified by GTA as freight-advantaged to Port Kembla despite a reduction in the total number of GrainCorp sites under its Project Regeneration. The ACCC therefore considers there is currently not sufficient competition in upcountry storage and handling that would provide a constraint on GrainCorp's ability to exercise market power while it remains a monopoly PTSP at Port Kembla.

- In the absence of any competitive or regulatory constraint on GrainCorp's operations at Port Kembla, GrainCorp may be able to utilise its market power at Port Kembla to further increase its dominance in upcountry networks. However, the ACCC considers that parties seeking to export grain from Port Kembla do currently have some alternative options to using GrainCorp's upcountry network, and future users of Quattro's facility will likely be able to take advantage of these alternatives. The ACCC therefore considers that GrainCorp's dominance upcountry is unlikely to limit Quattro's ability to compete with GrainCorp in the provision of port terminal services. Further, to the extent that the Quattro facility enables its shareholders to establish a stronger presence in grain exports at Port Kembla, it may also enable Quattro's shareholders to expand their upcountry networks and provide a greater degree of competition to the GrainCorp as the dominant incumbent.

- Both road and rail options are available to marketers to transport grain to GrainCorp's Port Kembla facility. However, due to the long distances involved rail is likely to be the more cost effective and preferred option. GrainCorp utilises the majority of export grain trains in NSW, estimated at 53 per cent. However, the ACCC understands that Quattro's shareholders have trains operating in NSW and there are also a number of other trains operated by various rail providers to transport grain for export and domestic use.

- Containerised grain exports in NSW are significant, with wheat exports via containers representing around 20 per cent of total wheat exports from NSW.[35] This is lower than the proportion of container exports in Victoria (approximately 30 per cent). The ACCC considers that containerised exports represent a viable alternative export path for some grain produced in the Port Kembla catchment area. Containerised exports therefore provide some competitive constraint on GrainCorp's bulk export operations at Port Kembla.

- There is strong and consistent demand for grain in southern and central NSW for stock feed and flour milling.[36] Domestic users of grain face lower supply chain costs compared to the export markets and are able to pay growers an amount that is at least equivalent to the export parity price. The level of constraint that domestic users place on bulk and container exports is generally restricted by the size of domestic demand, which is relatively consistent over time and does not encompass the entire crop, leaving an exportable surplus.

As set out in relation to the Quattro exemption assessment on page 15, the ACCC notes NSW Farmers' concerns that containerised exports do not provide a significant competitive constraint.[37] The ACCC considers that containerised exports alone would not provide a sufficient competitive constraint to warrant an exemption for GrainCorp at its Port Kembla facility. However, once Quattro's facility is operational the ACCC expects it will significantly

[35] Data from Australian Crop Forecasters.

[36] See section 3.4 of the 30 July 2015 draft decisions.

[37] NSW Farmers, *Submission in response to draft decisions*, p.7.

increase the competitive constraint faced by GrainCorp when providing port terminal services at its Port Kembla facility.

The ACCC also notes concerns raised by NSW Farmers about vertical integration and the potential for exclusive closed loop practices, as well as the potential incentive for GrainCorp to use its vertical integration to favour its own export operations.

In response to the ACCC's draft decisions, NSW Farmers submits that:

> *Noting that the types of anti-competitive behaviour… are enabled by the interlinking of the control of upcountry storage and handling networks to the access of cargoes for execution at port; NSW Farmers believes that misuse of the dominance held upcountry by GrainCorp is not adequately restrained by the presence of an alternative port terminal facility in the commencement of Quattro.*[38]

As noted in its draft decisions, the ACCC recognises the potential incentive for GrainCorp to use its vertical integration to favour its own export operations. In the absence of a directly competing facility the ACCC considers this incentive is likely to be of concern. However, with the introduction of Quattro's facility and the subsequent increase in competition and spare capacity at port, the ACCC considers that competitive pressures will constrain GrainCorp's ability to exercise market power to the detriment of competitors in related markets.

There are currently three major exporters at Port Kembla with, between them, 96 per cent of volumes on average (GrainCorp, Cargill and Glencore). As noted in relation to the Quattro exemption assessment, once the Quattro facility is operational, it is likely that Emerald and Noble will seek to export larger volumes at the Quattro facility given their stake in the facility. Given their investment in the facility, Quattro shareholders will have an incentive to increase their volumes and will likely compete more vigorously to acquire farmers' grain.

In this regard, the ACCC notes two recent fee changes by GrainCorp in relation to its upcountry facilities. Firstly, GrainCorp has reduced the additional cost previously faced by parties seeking to deliver grain from third party upcountry storage facilities to GrainCorp port terminals.[39] The ACCC considers that this is likely a response to the increased competition faced by GrainCorp at its port terminals. The ACCC remains of the view that GrainCorp's incentives to compete with Quattro to maximise throughput at its Port Kembla facility will likely outweigh the potential for detrimental outcomes at port due to vertical integration.

Secondly, in Quattro's response to the ACCC's draft decisions, it submits that:

> *… we always believed that the focus of your review on Port Terminals only, was too narrow and created the potential for Graincorp to capitalise on their vertically integrated operations by shifting the barrier to entry from the Port to the "up-country" grain accumulation terminals. Within days of your notification that Graincorp would be granted exemption they restructured their charges to materially increase fees for using their up-country facilities if the grain was not handled through one of Graincorp's port terminal.*[40]

Quattro's submission relates to GrainCorp's 31 August 2015 changes to its upcountry fees (specifically, the introduction of a "Third Party Export Rail Outload Fee" of $2.50). The ACCC notes that GrainCorp's up-country fees are not covered by the Code, which regulates access to port terminal services. At the time of making these fee changes GrainCorp was not an exempt port terminal service provider at Port Kembla, and has not yet been granted an

[38] NSW Farmers, *Submission in response to ACCC draft decisions*, p. 6.

[39] GrainCorp's 2014/2015 Country Storage and Handling Agreement is Fee Overview is available at: http://www.graincorp.com.au/storage-and-logistics/agreement-forms.

[40] Quattro, *Submission in response to draft decisions,* p. 1.

exemption at that facility. If the ACCC did not grant an exemption to GrainCorp at its Port Kembla facility, it would not affect GrainCorp's ability to charge particular fees at its upcountry facilities. Consequently, Quattro's ability to compete with GrainCorp in the port terminal services market is unlikely to be improved by such a decision.

The ACCC therefore considers that these changes are a separate issue to the Port Kembla exemption assessments. The ACCC is considering GrainCorp's recent fee changes outside of this exemption process.

However, if the competitive constraint expected to be provided by Quattro was not effective due to GrainCorp exercising any upcountry market power it may have, then it may not be appropriate to grant an exemption to GrainCorp at its Port Kembla terminal. The key question therefore is whether it will still be viable for exporters to use Quattro's Port Kembla terminal following GrainCorp's upcountry fee changes. After conducting market inquiries, the ACCC has formed the view that exporters are still likely to be able to obtain sufficient grain to use Quattro's facility, either from outside GrainCorp's upcountry storage system and/or by covering the additional cost of obtaining grain from within GrainCorp's system. Therefore, while Quattro will be somewhat disadvantaged due to the additional GrainCorp upcountry charge, it is still likely that Quattro's facility will provide competitive constraint on GrainCorp at its Port Kembla facility. Consequently, exporters are still likely to be able to access port terminal facility either at GrainCorp's facility or Quattro's facility once it is operational, even in the absence of the full set of requirements in the Code.

As noted at section 5, the ACCC intends to monitor the level of competition at Port Kembla after granting exemptions. If GrainCorp's upcountry fee differentials did over time limit Quattro's ability to provide a competitive constraint on GrainCorp at its port terminal, the ACCC may decide to revoke GrainCorp's exemption.

The ACCC also notes the concerns previously raised about a lack of choice for certain growers about the upcountry sites that they can deliver grain to.[41] While the ACCC recognises that particular growers may face this problem, a decision to not exempt GrainCorp's Port Kembla facility will not result in any additional constraint upcountry and will not address any market power GrainCorp may currently have in particular upcountry locations. The purpose of the Code is to regulate the conduct of port terminal service providers to ensure that exporters of wheat have fair and transparent access to port terminal services. Where GrainCorp faces sufficient competitive constraint at port, it is likely to provide access to third party exporters on reasonable terms. Therefore, the ACCC does not consider that a decision to grant an exemption once Quattro's facility is capable of handling bulk wheat would lead to a detrimental impact on overall competition in upcountry storage and handling.

Conclusion

Overall, the ACCC considers that there are currently limited competitive constraints in relation to bulk wheat export port terminal services at GrainCorp's Port Kembla terminal. Existing constraints chiefly arise due to the presence of containerised exports. Furthermore, differences in transportation costs between Port Kembla and the Newcastle and Melbourne terminals suggest that other existing ports will not generally constrain the behaviour of GrainCorp in respect of its Port Kembla facility.

However, the ACCC considers that Quattro's Port Kembla facility is likely to have a significant effect on the level of competition in the provision of port terminal services at Port Kembla. In the short to medium term, GrainCorp is likely to remain the dominant provider of port terminal services due to its incumbent status and larger port terminal capacity. However,

[41] NSW Farmers, *Submission*, pp. 10-12.

the ACCC considers that competition from Quattro is likely to constrain GrainCorp's ability to exercise market power in the provision of port terminal services, particularly given the significant level of spare capacity expected to be available across the two Port Kembla facilities.

To the extent that the Quattro facility enables its shareholders to establish a stronger presence in grain exports at Port Kembla, it may also enable Quattro's shareholders to expand their upcountry networks and provide a greater degree of competition to the GrainCorp as the dominant incumbent upcountry.

In light of the above factors, the ACCC's view is that the increased competitive constraint likely to be provided by Quattro's Port Kembla facility, combined with the existing competitive constraint from containerised exports, is likely to provide sufficient constraint on GrainCorp's operations at its Port Kembla facility. This competitive constraint would likely be sufficient to maintain at least the current level of competition in upcountry storage and handling.

With the arrival of Quattro's facility, the ACCC considers that exporters will likely have sufficient alternative options to GrainCorp's Port Kembla terminal and upcountry assets to continue to participate in the grain acquisition market if an exemption were granted. In these circumstances, the ACCC considers that it will be appropriate to exempt GrainCorp's Port Kembla facility from the time that Quattro is covered by the Code and also granted an exemption.

Furthermore, the competitive situation in upcountry storage and handling would not be diminished by granting the exemption at such a time, although growers in particular locations may continue to have limited options for delivering their grain other than through GrainCorp's network.

(c) the interests of exporters who may require access to port terminal services; and (d) the likelihood that exporters of bulk wheat will have fair and transparent access to port terminal services

If an exemption were granted to GrainCorp at its Port Kembla terminal, the interests of exporters requiring access to port terminal services will not be affected if they can still compete in the grain export market on their relative merits. As noted above, this consideration overlaps with considerations above concerning the public interest and promotion of competition in upstream and downstream markets.

As a vertically integrated terminal operator and exporter, GrainCorp has an incentive to favour its own trading arm over other exporters at its Port Kembla facility. The ACCC is considering the likelihood of this occurring, and exporters being unable to negotiate on fair terms, if Parts 3 to 6 of the Code did not apply at GrainCorp's Port Kembla facility.

Public submissions received from AGEA and Glencore in response to the ACCC's issues paper supported granting an exemption to GrainCorp's Port Kembla terminal.

The ACCC's considers that competition provides a strong incentive for a firm to act fairly and reasonably with its customers and to provide fair and transparent access to services. In the absence of competition, there is limited constraint on a firm's incentives to favour its own trading arm over third party customers.

Competition on the relative merits of exporters would be hindered if terms and conditions of access favour one or more exporters (and in particular the port operator's own trading arm) over others other than according to their merits, thereby distorting the competitive process. The ACCC will also consider the bargaining power of exporters and whether exporters have a viable alternative to export or market grain.

The ACCC's views on the incentives for GrainCorp to not to favour its own trading arm over third party exporters at its Port Kembla facility draw on the analysis in chapters 2 and 3. Relevant findings from these chapters include:

- Over the last five years GrainCorp's trading arm has been the largest exporter through its Port Kembla terminal, exporting 42 per cent of total volumes on average. Other exporters do appear to have been able to access significant capacity, with the next largest exporters having been Cargill, with 32 per cent, and Glencore, with 22 per cent. These proportions are largely similar during the peak period, indicating that to date GrainCorp has not prevented its competitors gaining access to the Port Kembla terminal during peak periods. Together, these three largest exporters comprise approximately 96 per cent of total exports from Port Kembla.

- GrainCorp's Port Kembla facility has generally been underutilised, particularly during low and average production years and during non-peak times of the year. Given this, GrainCorp would likely be incentivised to increase throughput at its Port Kembla facility during these times.

- However, during peak times in particularly large harvest years there may be some capacity constraint at Port Kembla, and GrainCorp may have an incentive to favour itself in order to provide its own trading arm with the opportunity to obtain the best possible prices for grain in downstream markets.

- Cargill and Glencore, the next largest exporters at Port Kembla, represent a significant proportion of total throughput. Should GrainCorp wish to maintain this throughput, these large customers should have the ability to negotiate with GrainCorp for access to sufficient port capacity. Based on its current reliance on third party customers to provide throughput, GrainCorp would be unlikely to completely foreclose third party access and either settle for significantly less throughput at its terminal or make up a significant degree of throughput through its own grain network.

- Exporters other than GrainCorp, Cargill and Glencore make up a small proportion of total throughput at Port Kembla (approximately 6 per cent on average). Smaller exporters, including Quattro shareholders Emerald and Noble, would likely be able to access spare capacity at GrainCorp's facility during non-peak times and low or average production years. However, smaller exporters may face difficulties accessing highly demanded peak shipping slots in a large harvest year. If GrainCorp could increase grain through its upcountry networks to the Port Kembla terminal, it would seem likely that these smaller exporters would be the most vulnerable in terms of gaining access to sufficient capacity.

- Containerised exports represent an alternative pathway to export some grain from the Port Kembla catchment area, and therefore provide some competitive constraint on GrainCorp's bulk export operations at Port Kembla.

Once Quattro commences operations, the Port Kembla terminals will have significant spare capacity at both peak and non-peak times. At this time, the ACCC considers that:

- GrainCorp will be subject to a greater level of competitive constraint, as competition from Quattro's Port Kembla facility will add to existing competition from containerised exports. GrainCorp will therefore have increased incentives to allow other parties to access capacity at its terminal in order to maximise throughput and compete with the Quattro facility.

- The significant level of spare capacity expected to be available across the two Port Kembla terminals suggests that smaller exporters would also be more likely to be able to negotiate sufficient access at GrainCorp's terminal and/or Quattro's terminal. Should parties be unable to obtain capacity at GrainCorp's terminal, spare capacity is expected to be available at Quattro's adjacent facility.

The ACCC considers that given the need for GrainCorp to secure some throughput from other marketers in most years, it is unlikely that GrainCorp would completely foreclose access to its facility even in the absence of the competing Quattro facility. However, in the absence of a clear substitute port which could service a number of marketers from the Port Kembla catchment area, GrainCorp may have an incentive to alter its terms and conditions of access for third party exporters to maximise profits.

The ACCC's draft view is that granting an exemption to GrainCorp's facility in the absence of the competitive constraint expected to be provided by Quattro's facility may be detrimental to the interests of exporters requiring access to GrainCorp's Port Kembla terminal.

However, the ACCC considers that, to compete with Quattro's facility, GrainCorp will have incentives to provide access to its facility on reasonable terms in order to maximise throughput. The ACCC's draft view is that the full level of regulation under the Code will not be required to ensure fair and transparent access to GrainCorp's facilities.

(e) the promotion of the economically efficient operation and use of the port terminal facility; (f) the promotion of efficient investment in port terminal facilities

Regarding the impact on the efficient operation and use of GrainCorp's facility, GrainCorp submits that exemption would:

> *Support lower supply chain costs by allowing GrainCorp to operate its Port Terminals flexibly. More flexibility and efficient operations at port will allow increased investment in improving port and supply chain infrastructure.*[42]

As noted in the ACCC's draft views on an exemption's impact on GrainCorp's legitimate business interests, the ACCC considers that an exemption would improve GrainCorp's flexibility and reduce its compliance costs.

The ACCC considers that exemption may promote investment in port terminal facilities, with the strength of the incentive tied to the extent of competitive pressures from either a competing bulk service provider or alternative markets.

On those alternative markets, GrainCorp submits:

> *…bulk grain export competes with the cost competitive domestic and containerised grain export markets. These alternative markets account for most of NSW's average grain production (at least 75%).*[43]

The ACCC considers that containerised exports and domestic demand represent some competitive constraint on GrainCorp's bulk export business. The ACCC notes that these alternative avenues to market grain are not subject to regulation. An exemption would therefore place GrainCorp's bulk export services on more of a level playing field with those other avenues to market, and may promote further investment in bulk wheat facilities.

[42] GrainCorp, *Submission in support*, p. 4.

[43] GrainCorp, *Submission in support,* p. 5.

The ACCC notes NSW Farmers' submission in response to the draft decisions expressing concerns about inefficient capacity investment and the effect on port costs.[44] As stated in relation to the exemption assessment for Quattro, parties investing in port terminal facilities that face competition are unlikely to make inefficient investments that would result in a net increase in their port costs. The ACCC similarly considers that GrainCorp will have incentives to keep its operating costs down and make efficient investments in order to attract exporters to use its facility and maximise its return on investment.

Accordingly, the ACCC remains of the view that the extent of competitive pressures and therefore the incentive on GrainCorp to invest will be significantly influenced by whether or not Quattro commences operations.

Conclusion

The ACCC's view is that the degree of competition that GrainCorp would face from Quattro, combined with the competitive pressures from other downstream markets (as outlined in the discussion of the matters at subclause 5(3)(b) and 5(3)(g) of the Code) is likely to promote the efficient operation of, use of, and investment in, GrainCorp's facility in the absence of full regulation under the Code.

For instance, with the introduction of the Quattro facility at Port Kembla, GrainCorp would not only be facing competition from alternate markets, but from an alternative supplier of bulk port terminal services. GrainCorp would therefore likely face even greater incentives to operate its facility efficiently as well as maintain and improve its infrastructure so as to maximise throughput.

(h) whether the port terminal service provider is an exporter or an associated entity of an exporter

The ACCC notes that the significance of GrainCorp's status as a vertically integrated service provider depends on the level of capacity constraint at its facility and the level of competition it faces for business.

On its vertical integration status and its implications for competition, GrainCorp submits:

> *GrainCorp is vertically integrated as a port service provider and an exporter of grain in NSW. However GrainCorp's ability to exercise market power in NSW and Port Kembla is limited given:*
>
> - *Variable grain production;*
> - *Strong competition from competing alternative domestic and container packing markets, particularly in low production years;*
> - *Excess country storage capacity;*
> - *Excess container packing capacity;*
> - *Excess port elevation capacity; and*
> - *Impending competition for port elevation services for bulk grain from Qube's Quattro Grain Port Terminal (**Quattro**) at Port Kembla (expected to be operational for the coming harvest).*[45]

[44] NSW Farmers, *Submission in response to draft decisions*, p. 4.

[45] GrainCorp, *Submission in support*, p. 3.

Conclusion

The ACCC notes that GrainCorp's vertical integration creates incentives to favour its own trading division.

The ACCC considers that GrainCorp's vertical integration would be problematic without Quattro's presence. The ACCC notes that without Quattro's arrival there will be less spare capacity at GrainCorp's facility, and exporters would have no other alternatives to export bulk grain. In these circumstances GrainCorp would be more likely to provide preferential access to its trading division.

Accordingly, the ACCC considers that in the absence of Quattro's facility and the additional capacity it is expected to provide, GrainCorp's vertically-integrated status may detract from some exporters ability to secure fair and transparent access at Port Kembla.

However, in view of the amount of likely available capacity at Port Kembla with the arrival of Quattro, the ACCC considers that Quattro's entry will limit the extent to which GrainCorp is able to favour its own exporting business. That is, the amount of likely spare capacity will create an incentive for GrainCorp to attract the business of third party exporters. GrainCorp will therefore need to balance any incentive to favour its own trading division against its desire to maximise the use of its facility.

(i) whether there is already an exempt service provider within the grain catchment area for the port concerned

The ACCC considers that the relevant grain catchment area for GrainCorp's Port Kembla terminal generally includes southern and central NSW. The ACCC considers that the catchment area for GrainCorp's Port Kembla terminal will be the same as for Quattro's Port Kembla, but that there is limited overlap between this catchment area and the catchment areas for the Melbourne and Newcastle port terminals.

Therefore, while there are currently exempt service providers at Melbourne and Newcastle, these ports provided a very limited degree of competition to the GrainCorp's Port Kembla terminal.

At present, no bulk wheat port terminal services provider servicing the Port Kembla catchment area is exempt under the Code.

The ACCC has, however, concurrently assessed an exemption application for Quattro's Port Kembla facility (see chapter 2). The ACCC's view is that GrainCorp and Quattro should be exempt service providers in relation to services provided at their respective Port Kembla terminals once Quattro is covered by the Code..

(j) any other matters the ACCC considers relevant

Following consideration of the matters at subclauses 5(3)(a) to 5(3)(i) of the Code, the ACCC has formed the view that an exemption for GrainCorp's Port Kembla facility would not be appropriate in the absence of the increased competitive constraint expected to be provided by Quattro's facility. However, the ACCC expects that with the addition of Quattro's facility at Port Kembla there is likely to be sufficient spare capacity and overall competitive constraint (from Quattro's facility and containerised exports) to support an exemption for GrainCorp at its Port Kembla terminal.

The ACCC has therefore considered the timing implications for an exemption for GrainCorp's facility given that Quattro's facility is not yet operational. Specifically, the ACCC has considered whether it would be appropriate to grant an exemption to GrainCorp at its

Port Kembla facility prior to, at the same time as, or some time after completion of Quattro's facility.

The ACCC notes GrainCorp's submission that the Quattro terminal is currently not subject to the Code and is able to negotiate with customers without the Code's prescribed access requirements and transparency. GrainCorp submits that it is currently competitively constrained by operating within the requirements of the Code. GrainCorp repeated this concern in response to the ACCC's draft decisions:

> *GrainCorp submits that delaying the exemption for its terminal in this manner extends the discriminatory regime that has already had a significant commercial impact on the company. Quattro's submission highlights that it has already reached agreements with two of its investors, who accounted for average annual exports of approximately 500,000 tonnes out of Port Kembla. These investors will be exporting from the Quattro terminal in the future. GrainCorp is currently unable to make agreements with such flexibility.*
>
> *In particular, we submit that it is critical we are able to have the exemption as soon as possible, to enable us to commence negotiations with our export customers on long term agreements; in order to provide commercial certainty to them and to us.*[46]

As noted above, while the Code provides some flexibility to negotiate the terms of access, if GrainCorp were granted an exemption prior to renegotiating its current long term agreements, it would have a greater degree of flexibility in those negotiations.

The ACCC understands that development of Quattro's Port Kembla terminal is well advanced. However, the ACCC considers there remains some uncertainty regarding when the terminal will commence operations, and operational matters such as exactly how much capacity the facility will provide..

Once Quattro's facility is complete, the ACCC considers there is likely to be sufficient certainty about the specific characteristics and capabilities of Quattro's facility and when its services will be available to exporters. The ACCC considers that it will be appropriate to grant exemptions to both GrainCorp and Quattro at that time. In the absence of material delays to the completion of Quattro's terminal, the ACCC expects that this decision would be made prior to GrainCorp's renegotiation of long term agreements with customers (current agreements expire in September 2016). If there were significant delays to the completion of Quattro's terminal (e.g. during the peak shipping period for the 2015-16 year), the ACCC also considers that this would similarly warrant delaying an exemption for GrainCorp's facility to ensure exporters could continue to access port terminal services at Port Kembla in the absence of Quattro's facility.

[46] GrainCorp, *Submission in response to ACCC draft decisions*, p. 1.

4 ACCC final position

Given the above assessments, having regard to the matters at subclause 5(3) of the Code, the ACCC has reached the following final position.

Quattro's Port Kembla port terminal facility

The ACCC's final position is that Quattro should be an exempt service provider of port terminal services provided by means of its port terminal facility located at Berth 104, Port Kembla, from the date it is covered by the Code.

GrainCorp's Port Kembla port terminal facility

The ACCC's final position is that GrainCorp should be an exempt service provider of port terminal services provided by means of its port terminal facility located at Berth 103, Port Kembla, at the same time that Quattro is determined to be an exempt service provider.

5 ACCC monitoring and future assessments

The ACCC has formed the view that Quattro and GrainCorp's Port Kembla terminals will be subject to a sufficient level of competition to be exempt from Parts 3 to 6 of the Code, but that GrainCorp's Port Kembla facility should not be granted an exemption until Quattro's facility is covered by the Code. However, the ACCC recognises that it is not possible to ensure particular market outcomes following an exemption decision.

The ACCC therefore considers that it will be appropriate for it to monitor the Port Kembla wheat port terminals after making any exemption determination(s).

The ACCC considers that it will be important to examine the competitive outcomes at these facilities, and in upstream and downstream markets, that result for these facilities and the associated port zone in the future.

In particular, the ACCC will monitor the market concentration of exporters shipping wheat from both the Port Kembla terminals. The ACCC would be concerned if, in the future, one of the current major vertically integrated exporters increased their export market shares at their respective port facility at the expense of other exporters seeking access at these terminals. Doing so may lead to a reduction in competition in the acquisition of grain for export and affect the ability for farmers to achieve adequate returns when selling their grain.

The ACCC has the ability under the Code to revoke exemptions once granted. Similar to the process for granting an exemption, the ACCC may revoke an exemption determination after having regard to the matters to matters (a) to (j) of subclause 5(3) of the Code, if it is satisfied that the reasons for granting the exemptions no longer apply. If the ACCC grants exemptions to one or both of the Port Kembla terminals and subsequently considers from its monitoring that competitive outcomes have not resulted, it may conduct an inquiry into whether an exemption should be revoked.

5.1 Monitoring

The ACCC's monitoring of the Port Kembla terminal services following any exemption determination(s) may include a number of aspects. In particular, the ACCC intends to pursue two main monitoring activities.

5.1.1 Industry analysis

The ACCC is provided with the shipping activity at port terminals under the Code, including GrainCorp's Port Kembla facility. Part 2 of the Code requires PTSPs to, among other things, provide daily ship loading statements to the ACCC. Both exempt and non-exempt port terminal operators must report this information to the ACCC (and publish it on their website) on a daily basis.

Through port loading statements, the ACCC is able to examine:

- the number and frequency of exporters using a port terminal
- the quantity and type of grain being exported
- the timing of shipments by exporters.

This information allows the ACCC to understand the nature and concentration of shipping activity and exporters' market shares throughout the year, and to compare these over time. In particular, the ACCC will be able to examine changes in the use of the facilities in a deregulated environment, and contrast it to the levels of market concentration and the outcomes achieved under the Code and the previous undertaking regime.

The ACCC notes that, from 1 October 2015, this loading statement information will also be required to be provided by any other port terminal facilities not currently covered by the Code, including the Quattro Port Kembla facility once it is complete. Accordingly the ACCC will be receiving data from both bulk export facilities at Port Kembla (and others across Australia) that will allow it to examine the industry in a thorough way. The ACCC can also utilise other industry data and information to assess the level of shipping activity at a particular port terminal.

While the ACCC does not consider that market shares are determinative of the competitive situation in a port zone, it considers that examining this information will give some indication of whether other third party exporters continue to be able to access the Port Kembla terminal facilities. There are currently three major exporters operating at Port Kembla. As noted above, the ACCC would be concerned by evidence that GrainCorp and/or one or more Quattro shareholders were respectively taking a much larger proportion of export capacity at the two ports at the expense of other exporters and potentially limiting the competition for grain grown by Australian farmers. The ACCC would also be concerned by evidence of an increased concentration of exports among exporters at Port Kembla, to the exclusion of other exporters.

In examining this data, the ACCC may utilise tools such as x-firm concentration ratios or the Herfindahl-Hirschmann Index (HHI), or calculate changes in such measures, to provide an indication of whether there are competition concerns. The ACCC will need to consider the appropriate methods of calculation for such measures, such as how to account for spare capacity and alternative export paths.

The ACCC notes that tools such as the HHI do not replace the ACCC's obligation to consider the full range of matters under subclauses 5(3) and 5(6) of the Code.

NSW Farmers submits that the ACCC's ongoing monitoring function should include price monitoring:

> *NSW Farmers proposes that in addition to the industry monitoring already proposed in the draft decisions the ACCC should commence price monitoring of port terminal services. This will provide greater transparency to industry as to the impact of competition on reducing the port costs borne by farmers and monitor behaviour to determine if discriminatory practices can be observed in the behaviour of port terminal operators to the detriment of operation of upstream market's ability to distribute value back to the farm gate.*[47]

The ACCC notes that it does not have a formal direction to request cost information and monitor prices for bulk wheat port terminal services under Part VIIA of the CCA. However, the Code requires that all PTSPs publish reference prices. The ACCC intends to monitor trends in these prices for both exempt and non-exempt ports as part of its ongoing monitoring function.

5.1.2 Consultation with industry

The ACCC also intends to periodically approach exporters at Port Kembla to seek information about their ability to access port terminal services at GrainCorp's and Quattro's respective port terminals in an environment subject to a lower level of regulation under the Code. This may include regularly scheduled meetings with other industry participants in

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[47] NSW Farmers, *Submission in response to ACCC draft decisions*, p. 4.

upstream and downstream markets, such as farmers groups, to gauge the effect of granting the exemptions.

The ACCC also encourages industry participants to approach the ACCC directly with any concerns they may have in regards to securing fair and transparent access to GrainCorp's and Quattro's Port Kembla port terminal services.

If significant concerns are raised by industry (in any forum) about the ability of third party exporters to access one or both of the two facilities, the ACCC may conduct further market inquiries, or could consider a public process to assess whether to revoke an exemption for the relevant port terminal facility.

Appendix: The Code

The Code applies to PTSPs, where a PTSP is defined as:

> the owner or operator of a port terminal facility that is used, or is to be used, to provide a port terminal service.

where:

> **port terminal service** means a service (within the meaning of Part IIIA of the CCA) provided by means of a port terminal facility, and includes the use of a port terminal facility.

and:

> **port terminal facility** means a ship loader that is:
>
> (a) at a port; and
>
> (b) capable of handling bulk wheat;
>
> and includes any of the following facilities, situated at the port and associated with the ship loader, that are capable of handling bulk wheat:
>
> (c) an intake/receival facility;
>
> (d) a grain storage facility;
>
> (e) a weighing facility;
>
> (f) a shipping belt.

The Code has six Parts which apply to all PTSPs (in the absence of any exemption being granted):

- Part 1 of the Code contains general provisions about the Code and its application.
- Part 2 of the Code requires all PTSPs to deal with exporters in good faith, publish a port loading statement and policies and procedures for managing demand for their services, and make current standard terms and reference prices for each port terminal facility publically available on their website.
- Part 3 of the Code places a number of requirements on a PTSP including:
    - to not discriminate in favour of itself or its trading business, or hinder third party exporters' access to port terminal services
    - to enter into an access agreement or negotiate the terms of an access agreement with an exporter to provide services if an exporter has applied to enter into an access agreement and certain criteria are satisfied
    - to deal with disputes during negotiation via specified dispute resolution processes including mediation and arbitration.
- Part 4 of the Code requires a PTSP to have, publish and comply with a port loading protocol which includes an ACCC approved capacity allocation system.
- Part 5 of the Code requires PTSPs to regularly publish expected capacity, stock information about various grains held onsite at a port terminal facility and key performance indicators.

- Stocks information about grain held in upcountry storage sites is outside the scope of the Code, which provides no obligations on PTSPs in relation to non-port infrastructure.

- Part 6 of the Code sets out requirements relating to retaining records such as access agreements and variations to those agreements.

Exemption from the Code

The Code provides for processes whereby the ACCC or the Minister for Agriculture may exempt a PTSP from Parts 3 to 6 of the Code in relation to port terminal services provided by means of a specified port terminal facility. Exempt service providers face a lower level of regulation as they remain subject to only Parts 1 and 2 of the Code.

The exemption processes under the Code only provide for the ACCC or the Minister for Agriculture to grant an exemption from Parts 3 to 6 of the Code. An exemption cannot be granted from individual Parts of the Code. For example, it would not be possible to only grant an exemption from Part 4 of the Code.

ACCC exemption

Under clause 5(2) of the Code, the ACCC may make a determination to exempt PTSPs in relation to port terminal services provided by means of specified port terminal facilities (an exemption determination). In doing so the ACCC must have regard to matters listed at subclause 5(3) of the Code (see section 1.5). The ACCC can also revoke an exemption determination under subclause 5(6) of the Code.

On 1 October 2014 the ACCC determined that GrainCorp is an exempt service provider in relation to its Carrington (Newcastle) Port Terminal Facility. The ACCC determined that although GrainCorp is vertically integrated as a PTSP and an exporter, it would have limited ability to exercise market power at the Carrington facility due, in part, to effective competition in the provision of bulk grain port terminal services at the Port of Newcastle.[48] This determination followed the ACCC's earlier decision, under the previous access undertakings regime, to reduce GrainCorp's regulatory obligations regarding its Carrington facility.[49]

On 25 June 2015 the ACCC also determined Emerald Grain Pty Ltd (Emerald) to be an exempt service provider at its Melbourne Port Terminal, and GrainCorp to be an exempt service provider at its Geelong port terminal.[50]

Ministerial exemption

Subclause 5(1) of the Code provides that the Minister for Agriculture may determine that a PTSP is an exempt service provider of services supplied by means of a specified port terminal facility if the Minister is satisfied that the provider is a cooperative that has:

(a) grain-producer members who represent at least a two-thirds majority of grain-producers within the grain catchment area for the port concerned; and

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[48] ACCC, *Determination: Exemption in respect of GrainCorp's Carrington (Newcastle) Port Terminal Facility*, 1 October 2014.

[49] ACCC, *Decision to accept: GrainCorp Operations Limited's Application to Vary the 2011 Port Terminal Services Access Undertaking*, 18 June 2014.

[50] ACCC, *Determinations: Exemptions in respect of Emerald's Melbourne Port Terminal Facility, GrainCorp's Geelong Port Terminal Facility, GrainCorp's Portland Port Terminal Facility*, 25 June 2015.

(b) sound governance arrangements that ensure the business functions efficiently and that allow its members to influence the management decisions of the cooperative.

The ACCC does not have any role in exemptions under subclause 5(1).

On 17 November 2014 the Minister for Agriculture found that Co-operative Bulk Handling Limited's (CBH) port terminal facilities located at Albany, Esperance, Geraldton and Kwinana satisfactorily meet the criteria for exemption under subclause 5(1) of the Code. The Minister therefore determined that CBH is exempt from Parts 3 to 6 of the Code in relation to services provided by means of those facilities.