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Dear Dr Grimes

Mandatory code of conduct for bulk wheat port terminal access

The ACCC appreciates the opportunity to comment on the draft *Competition and Consumer (Industry Code – Port Terminal Access (Bulk Wheat)) Regulation 2014*, and associated early assessment Regulation Impact Statement (RIS).

The ACCC has also appreciated being able to assist the Department of Agriculture in the development of the draft code. As the enforcement agency for mandatory codes under the *Competition and Consumer Act (CCA)*, the ACCC is keen to ensure that the code will be effective. This will help to support competitive markets along the supply chain, improving the outcomes for growers.

Subsection 12(2) of the *Wheat Export Marketing Amendment Act 2012 (WEMA)* provides for the development of a mandatory code of conduct and states that the code should, amongst other things:

- deal with the fair and transparent provision to wheat exporters of access to port terminal services by the providers of port terminal services (subsection 12(2)(a)), and
- be consistent with the operation of an efficient and profitable wheat export marketing industry that supports the competitiveness of all sectors through the supply chain.¹

The access arrangements in the WEMA, which were introduced upon deregulation of the wheat export arrangements, were originally established to address concerns about both the

¹ WEMA, subsection 12(2)(a) and (c). Subsections (b) and (d) relate to compliance with continuous disclosure rules and consistency with guidelines made by the ACCC relating to industry codes of conduct.

vertical integration of certain port terminal service providers, and the degree of regional monopolisation and lack of competitive constraint of port terminal services.²

The ACCC considers that regulation of bulk wheat port terminals (whether via a code or access undertakings) should be effective and fit-for-purpose in addressing these concerns. In developing its thoughts on the draft code and the RIS, the ACCC has drawn on its experience over the last five years with the access undertakings that have been provided to it by wheat port terminal operators under Part IIIA of the CCA.

In this regard, there are four components of a code which the ACCC considers are important in the bulk wheat port terminal context:

1. fit-for-purpose regulation, through tiered arrangements that can accommodate different levels of regulation depending on the port terminal service provider's incentive and ability to exert market power
2. recourse to arbitration as a backstop where commercial negotiations for access fail
3. a non-discrimination provision to address the key concern with vertical integration
4. ACCC pre-approval of capacity allocation systems.

For the reasons set out below, the ACCC is supportive of a tiered mandatory code of conduct which includes these key components (identified as Option 3 in the RIS). The ACCC considers that these key components could also be achieved through the current access undertaking regime (Option 1). However, the ACCC is concerned that a one-size-fits-all code (Option 2) may not be effective or fit for purpose. The ACCC is also particularly concerned that removal of all industry-specific regulation (Option 4) may allow regional monopolies with market power to foreclose competition in related markets. The ACCC considers that Options 2 and 4 are therefore unlikely to ensure fair and transparent access or support the competitiveness of all sectors in the supply chain.

The ACCC notes that concerns have been expressed by industry regarding the scope of the current regime.³ In this regard, the ACCC considers that the code should be drafted to ensure that it effectively covers those entities that are intended to be covered; in particular, vertically integrated port terminal operators with market power.

1. Tiered arrangements

The ACCC considers that the level of regulation applied to a party should depend on the incentive and ability of the party to exert market power to damage or eliminate competition in the upstream grain purchasing market and the downstream grain selling market. This incentive and ability varies between different port terminal operators in the bulk wheat industry.⁴

² Replacement Explanatory Memorandum, WEMA, p. 6.

³ CBH Group, *Submission in response to the Competition Policy Review Issues Paper*, July 2014, accessed at http://competitionpolicyreview.gov.au/files/2014/06/CBH_Group.pdf, p. 5.

⁴ While the current access undertaking regime (Option 1) applies only to port terminal service providers which are an exporter or an associated entity of an exporter, a code under Options 2 or 3 will cover all port terminal service providers.

Vertically integrated port terminal service providers have greater incentive to exert market power in favour of their own operations compared to non-vertically integrated providers. Therefore, it is appropriate that a lower level of regulation be applied to non-vertically integrated providers (if properly defined). However, some vertically integrated port terminal service providers may be subject to competition. While these providers would have an incentive to act in favour of their own operations, they would not have the ability to do so in practice. The ACCC considers that these providers should also be subject to a lower level of regulation.

Consequently, the ACCC considers that tiered arrangements are important to ensure effective, fit-for-purpose regulation. The ACCC considers that this can be achieved through Option 3 in the RIS. The current access undertaking regime, which would be continued under Option 1, also provides flexibility to apply differing levels of regulation where appropriate for a particular context. The ACCC considers that a standardised 'one-size-fits-all' framework in accordance with Option 2 in the RIS is not necessary or appropriate for the bulk wheat industry. Where a sufficient level of competitive constraint exists, regulation should be limited.

In practice, the ACCC's assessment is likely to involve consideration of, amongst other things, whether the port terminal service provider is subject to competitive constraint or whether it has the ability to exert market power. The ACCC's decision to reduce regulation at GrainCorp's Carrington port at Newcastle is a practical example of how the ACCC may conduct such an exemption assessment.

2. Recourse to arbitration

Recourse to binding arbitration has proven to be a fundamental aspect of access undertakings under Part IIIA, including the regulation of bulk wheat ports. This is because arbitration provides a backstop in the event that negotiations fail. In the absence of such a backstop, port terminal operators may be able to offer unreasonable terms of access, and refuse to negotiate more reasonable terms, effectively preventing exporters from gaining access to the service. The access undertakings currently in place for vertically integrated bulk wheat port terminal operators all include recourse to arbitration, and the ACCC considers that this has provided an incentive for those operators to negotiate reasonable terms of access. For example, in 2010 Glencore Grain Pty Ltd stated that the threat of arbitration had facilitated commercial outcomes to disputes with port providers.⁵

The ACCC considers that Options 1 and 3 are appropriate in this regard, as both are able to provide for recourse to arbitration in the event that negotiations fail. The ACCC is concerned that Option 2 in the RIS does not include recourse to arbitration, and is therefore unlikely to be effective in ensuring vertically integrated port terminal operators provide access on fair and reasonable terms that will support the competitiveness of all sections through the supply chain. The ACCC considers that Option 4 similarly will not ensure that a vertically integrated port terminal service provider with market power negotiates reasonable terms for competitors to access its port terminal facilities.

3. Approval of capacity allocation systems

Under existing mandatory codes the ACCC can take enforcement action following a breach rather than ex ante action to prevent damage to competition happening. The ACCC

⁵ Glencore, *Submission to the PC on Wheat Export Marketing Arrangements*, 2 May 2010, p. 12.

considers that this may not adequately deal with certain issues in the wheat export context, particularly in relation to capacity management systems.

Capacity allocation has been the primary area of the ACCC's engagement with industry in recent times, when assessing new undertakings or variations to existing arrangements. The ACCC considers that up-front approval of capacity allocation systems is important because ex post enforcement action may not adequately remedy the damage to competition in related markets (or may not do so in a timely manner), once capacity has been allocated in an uncompetitive manner and then executed. An upfront approval role is more likely to be effective in preventing port terminal service providers from introducing capacity allocation systems that are discriminatory or hinder access. This approval requirement need only apply to vertically integrated port terminal operators with market power that have an incentive and ability to favour their own operations.

The ACCC considers that both Options 1 and 3 are able to achieve this objective. Under the current access undertakings, the ACCC approves the capacity allocation system up front and is able to object if the port terminal service provider makes changes that are discriminatory or hinder access. A mandatory code in accordance with Option 3 provides that, for vertically integrated port terminal service providers, capacity allocation systems must be approved by the ACCC. Where a provider is subject to sufficient competitive constraint, the ACCC may grant an exemption and the provider would no longer need to have its capacity allocation system approved. However, the ACCC is concerned that under Options 2 and 4 the ACCC will need to rely on ex post enforcement action under the code (Option 2) or the general provisions of the CCA (Option 4). The ACCC considers that this is not likely to allow the ACCC to effectively address, in a timely way, a vertically integrated port terminal service provider allocating capacity in a way which is uncompetitive.

4. Non-discrimination

Ensuring 'fair and transparent' provision of access to port terminal services is one of the key objectives of the code. The ACCC considers that to be effective the code should include a non-discrimination clause as one of the behavioural requirements, to support this objective.

The intention of a non-discrimination requirement is that a vertically integrated port terminal service provider should not offer favourable terms to its own trading division (or that of an associated business) that are not available to third party access seekers simply because they are not vertically integrated with the port. The ACCC considers this is important in order to prohibit preferential self-treatment by a vertically integrated port terminal service provider.

The ACCC notes that such a provision is not intended as a general prohibition on differentiated prices or terms of access determined via commercial negotiation between parties. Access seekers are therefore still able to commercially negotiate varying terms and conditions of access to suit their particular needs.

ACCC view on the options in the early assessment RIS

As noted earlier, the ACCC considers that any regulation should be fit-for-purpose and effective in achieving its policy aims. Accordingly, any code should apply an appropriate level of regulation having regard to the market problem, and effectively cover those entities that are intended to be covered.

As set out above, the ACCC considers that Option 3 (a code based on the exposure draft) is most likely to apply effective and fit-for-purpose regulation to address concerns regarding the vertical integration and lack of competitive constraint faced by some port terminal service providers, while allowing for the removal of regulation where it is not required.

The ACCC considers that Option 1 (retaining the current access undertaking arrangements) is also sufficiently flexible as to achieve a similar result, particularly given that regulation under an access undertaking can be tailored in order to be appropriate for particular circumstances.⁶ However, the ACCC understands that there may be concerns from industry regarding the scope and application of the current regime, which could potentially be addressed if a mandatory code of conduct is introduced.

The ACCC has concerns with Option 2 (a one-size-fits-all code) or Option 4 (removing industry-specific regulation altogether). An ineffective and inflexible code or the removal of industry-specific regulation may allow regional monopolies with market power to foreclose competition in related markets, such as the market for storage and handling services, or the purchase of wheat for export. This outcome would be inconsistent with the objective of an efficient and profitable wheat export marketing industry that supports the competitiveness of all sectors in the supply chain. An ineffective and inflexible code or the removal of industry-specific regulation is also unlikely to ensure fair and transparent access to port terminal services.

Ultimately, given that the export price for wheat is determined by global markets, foreclosing competition in the markets for marketing, storage and handling of wheat will reduce the options available to growers and limit their ability to achieve the best price for their product.

The ACCC will continue to work with the Department of Agriculture to develop an effective, fit-for-purpose mandatory code of conduct prior to 30 September 2014, taking into account the views expressed by stakeholders during consultation. Should a mandatory code of conduct be introduced, the ACCC will also carry out its educative, monitoring and enforcement roles under the Act.

Yours sincerely



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⁶ By way of example, the ACCC recently decided to accept GrainCorp's application to vary its undertaking to allow its Carrington terminal in Newcastle to be subject to less access regulation in recognition that there is a sufficient level of competition and capacity, both at the port and up-country, and the current level of regulation is no longer required. The matters the ACCC must have regard to in considering whether an access undertaking is appropriate are set out at section 44ZZA(3) of the *Competition and Consumer Act 2010*.