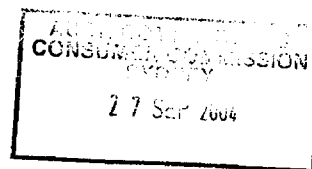


**Non-confidential Version**



**Export Logistics Joint Venture  
between  
GrainCorp Operations Limited  
and AWB Limited**

**Proposed joint venture to improve transport of export grain from  
country silos to export terminals**

**Submission in support of the application for authorisation under  
sections 88(1), 88(8) and 88(9) of the Trade Practices Act 1974**

27 September 2004

# Export Logistics Joint Venture between GrainCorp Operations Limited and AWB Limited

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## 1 Executive summary

### 1.1 Introduction and purpose of this Submission

This Submission is made by GrainCorp Operations Limited ABN 52 003 875 401 (“**GrainCorp**”) and AWB Limited ABN 99 081 890 459 (“**AWB**”), who have formed a joint venture company, Export Grain Logistics Pty Ltd ACN 109 812 197 (“**JVCo**”) which will, subject to this application, provide transport logistics services to GrainCorp and AWB in Queensland, New South Wales and Victoria for export bound grain.

### 1.2 Request for authorisation

This Submission is made in support of applications for authorisation by GrainCorp, AWB and JVCo, pursuant to sections 88(1), 88(8) and 88(9) of the *Trade Practices Act 1974 (Cth)* (“**TPA**”) for:

- (a) the acquisition of the ordinary shares of JVCo, a special purpose company with a share capital of \$2.00 with each of AWB and GrainCorp having a 50% shareholding; and
- (b) the export collaborative arrangements between GrainCorp and AWB pursuant to a Joint Venture Shareholders Agreement between GrainCorp, AWB and JVCo (“**Joint Venture Agreement**”), which joint venture arrangements are referred to in this Submission as the “**Transaction**”.

### 1.3 Duration of authorisation requested

The parties are seeking an authorisation for the period where AWB has power for export wheat under the Wheat Marketing Act 1989 (Cth) (“**WMA**”), or for a period of not less than five years, subject to the terms of the Undertaking discussed below.

### 1.4 Commercial rationale for JVCo

The formation of JVCo is necessary to facilitate improved co-ordination in the movement of export grain and introduce efficiencies for the export of that grain. To achieve this, JVCo will be set up as an independent company with a small number of expert staff. JVCo will operate as a break-even business in the sense that that it will not be a separate profit centre.

In summary, the Transaction will create:

- substantial efficiencies in the export supply chain for grains from the East Coast of Australia;
- increased efficiencies in the handling of rail freight tasks for export grains from upcountry silos to export port terminals;

- improved co-ordination between rail freight operators and grain storage and handlers to deal with Australia's export grain task;
- improved co-ordination between GrainCorp, AWB and Pacific National and Queensland Rail (and any other rail freight providers who wish to be involved), to facilitate the use and investment in rail infrastructure and rail lines in regional areas and communities of Australia, to support the efficiency of the Australian export grain industry;
- efficiencies in the use of available storage infrastructure and available bulk rail freight to maximise export grain volumes and minimise costs;
- an improvement in the rail export task which will decrease demurrage costs for grain exports which costs are associated with shipping delays from Australian ports; and
- an improved rail export task to increase efficiencies to enhance and improve the international competitiveness of Australian grain exports.

The parties believe that the Transaction has been structured so that it does not contravene the TPA. It achieves the efficiency goals sought by the parties, their grower based grain grower shareholders and industry participants (including rail freight service providers), without detrimentally affecting competition in the domestic environment. This is consistent with the Commission's approach to exports and the TPA.

In this context, the parties seek an authorisation so that the substantial efficiencies and public benefits associated with the Transaction are clearly understood and appreciated.

The parties appreciate the Commission's consideration of the Transaction and the Commission working with the parties to achieve a positive outcome for the Australian export grain industry.

## **1.5 Industry background**

AWB, because of its position as Australia's sole bulk wheat exporter under the WMA, is GrainCorp's largest customer. GrainCorp and AWB also compete in some areas in relation to grain storage and handling. While both parties agree that improvements can be made to supply chain co-ordination in the export grain supply chain on the East Coast (not including South Australia) of Australia, the transaction has been structured so that it does not involve any of the parties' operations in relation to domestic grain, where they will continue to compete.

The transaction does not mean that the two parties agree on all matters connected with the grain industry in Australia and how it operates. However the parties agree that by working together on the logistics of export grain, they can improve efficiencies and reduce costs to the benefit of growers and all users of the export grain supply chain. The parties believe that there is a clear benefit in seeking to address these matters in an appropriate and constructive manner.

## **1.6 Operation of JVCo**

Accordingly, the purpose of forming JVCo is, first and foremost, to improve efficiencies and to achieve logistics costs savings in for grain exports, through improved co-ordination of export grain storage and transport activities and increased access to information to facilitate the export grain task.

In summary, the JVCo will:

- be responsible for procuring transport logistics services for export grain;
- manage export supply chain activities and provide logistics planning and co-ordination services, including grain allocation and optimisation, cargo aggregation, service provider management and monitoring of performance and operational management; and
- acquire information from each of AWB and GrainCorp in relation to export grains to enable it to improve co-ordination and achieve efficiencies in the fulfilment of the above functions. Confidential information as between AWB and GrainCorp where these parties compete, will be subject to ring-fencing obligations as between the JVCo and the principals.

The Joint Venture Agreement which sets out these arrangements is attached as an Appendix to this Submission.

## **1.7 The Transaction will give rise to substantial public benefits**

The parties' rationale for implementing the Transaction is to address supply chain co-ordination issues that currently occur, in order to create more efficient logistical supply arrangements for grains to be exported from the East Coast of Australia.

In particular, the parties believe that the Transaction delivers a number of clear and substantial public benefits including:

- cost savings from more efficient transport of grain destined for export from up-country grain accumulation silos to port;
- better information and increased transparency on which to base investment decisions about grain storage and transport infrastructure; and
- improved use of existing infrastructure by improving train scheduling and co-operation.

There is an imperative to achieve these public benefits for this and future harvests for the following reasons:

- it is anticipated that Pacific National, which is in the process of integrating with Freight Australia, will not have sufficient resources to handle the 2004/05 crop in Victoria and New South Wales unless there is improved co-ordination between AWB and GrainCorp;

- the provision of rail services for export grain is under threat from line closures and lack of investment in rail and rail related infrastructure, particularly in rural regions and communities of Australia. The long term viability and provision of export rail services will be dependent on reducing rail costs and improving asset utilisation - an area where the New South Wales Government has adopted a sensible and practical approach and effectively directed AWB and GrainCorp to work together for this very reason;
- the implementation of the Transaction will lead to improved co-ordination of the export grain task, which the parties believe will provide considerable efficiencies, many of which will spread throughout the industry as the efficiencies obtained by rail freight providers and increased expenditure have a flow on effect to other industry participants; and
- if the Transaction did not proceed, the loss of such improved co-ordination will be higher supply chain costs to grain growers, delays in sales and potentially lost sales for Australia and higher shipping costs.

#### **1.8 No significant impact on competition**

The proposed joint venture arrangement is very limited in scope -- it relates to managing in a more efficient manner for export grain from up-country silos to export port facilities. In particular:

- the Transaction is a narrow joint venture through a very limited corporate entity (JVCo). It is not a merger between the parties and so the Transaction preserves flexibility for the future and retains the existing competitive position from a domestic perspective;
- the Transaction only relates to export grains;
- JVCo does not have any assets of any substantive nature - it will have only 4-6 expert staff;
- JVCo is not a separate profit centre so it does not create financial disincentives to compete as between the parties;
- the competitive evaluation of the Transaction is subject to Commission review through the Undertaking referred to below;
- the Transaction does not combine ownership of any assets; and
- the Transaction does not curtail independent decision making in relating to trading (including stock movements) and the supply and acquisition of storage services, which will continue to remain with the respective parties.

Accordingly, GrainCorp and AWB believe that the joint venture arrangements will not have the effect, or likely effect, of substantially lessening competition in any relevant market in Australia in contravention of any of the provisions of the TPA. In fact, the parties believe that the proposed arrangements should lead to a pro-competitive result for the industry -- in particular, a more competitive and efficient supply chain, which will deliver benefits to the Australian grain industry, in general, and grain growers specifically.

Importantly, from the Commission's perspective, the Transaction will still see AWB and GrainCorp as competitors in grain acquisition and marketing, and in up-country receipt and storage services.

In any event, even if it were suggested that the Transaction may lead to hypothetical incentives to decrease competition as between AWB and GrainCorp because the parties become closer under a joint venture, any such hypothetical lessening of competition is clearly outweighed by the real and substantive public benefits which arise through the Transaction.

#### **1.9 Other matters**

Ancillary to the Transaction and as the Commission is aware, GrainCorp and AWB also intend to enter into an Open Access Deed ("**Open Access Deed**") under which GrainCorp will provide AWB with non-exclusive long term rights of access to its upcountry and port facilities.

The Open Access Deed provides AWB with an opportunity to access GrainCorp's up-country storage and port facilities on a non-exclusive basis, on terms commensurate with the volumes AWB chooses to put through those facilities. AWB will continue to have the flexibility to decide to what extent it will use GrainCorp's services. The terms essentially reflect AWB's position as GrainCorp's largest customer under the WMA and will be on a non-exclusive basis.

The terms on which that access is provided will be commensurate with the volumes of grain that AWB chooses to pass through GrainCorp facilities and largely reflect the existing commercial position of AWB's ownership of export grains passing through those facilities. In this sense the Open Access Deed does not alter the dynamics as between the parties or other industry participants having regard to the operation of the WMA.

A confidential summary of the Open Access Deed is contained in Appendix Two. Confidentiality is claimed in relation to Appendix Two to this Submission.

#### **1.10 Conclusion on competition**

The parties have engaged in extensive upfront dialogue with the Commission and the Commission has undertaken extensive market inquiries since the Transaction was notified to the Commission on 16 June 2004.

Against this background, the parties categorically state that the Transaction is not intended to, and will not, lessen competition between them. The increased communication between them and rail freight service providers by virtue of a independent JVCo will create efficiencies and incentives to minimise overall supply chain costs for the movement of export grain.

The joint venture arrangements between GrainCorp and AWB under the Transaction are limited to logistics in relation to export grains only. Accordingly, the parties believe that any impact on competition would be very limited.

The parties believe that the proposed arrangements will result in incentives for grain industry participants to invest in . This will be a pro-competitive result.

#### **1.11 Scope of request for authorisation**

In the circumstances of the clear public benefits arising from the efficiencies associated with the Transaction, GrainCorp and AWB seek authorisation from the Commission in relation to the Transaction.

The parties seek authorisation for a period of not less than five years. In the event that the export wheat market is deregulated under the WMA, the parties are prepared to provide an Undertaking to the effect that the Commission may review the Transaction.

The Undertaking is proffered on the basis that while the parties do not believe there is an anti-competitive effect from the Transaction, it provides the Commission with an opportunity to review the matter in the event of deregulation, while also giving the parties the opportunity to demonstrate that the Transaction has had no such anti-competitive effects based on actual performance and conduct.

#### **1.12 Request for interim authorisation**

In addition, the parties seek an urgent Interim Authorisation for the 2004/2005 season. This is imperative given the:

- impending, above average, harvest in New South Wales and Victoria;
- need to publish Estimated Silo Returns in October 2004; and
- need to put in place logistics arrangements for this harvest with Pacific National and Queensland Rail.

More details on public benefits associated with the impending harvest are set out in Section Six. The parties believe the Commission should have sufficient information to review this application in an expedited manner, based on previous submissions, discussions and market inquiries made in the context of the informal clearance discussions which commenced in June 2004.

If the Commission were to grant an interim authorisation, the substantial public benefits set out in Section Six would be forthcoming this harvest and benefit Australian grain growers and the economy in general. If it did not, these public benefits would be lost. Conversely, given the structuring of the Transaction, it is difficult to point to any competition concerns, particularly in the short term. It would seem that any competition concerns would only be based on hypothetical assessments of a future lessening of competition. These issues would not arise in the short term and certainly not within the timeframe involved in the harvest. Accordingly, there should be little, if any, adverse domestic competition risk for an interim authorisation.

Notwithstanding the strong public benefits associated with the Transaction, if the Commission were to ultimately decide not to grant an authorisation, given the small size of the JVCo and nominal assets in that company, the parties are in a position to unwind the JVCo and terminate any supporting formation documents and assign any rail agreements to AWB and GrainCorp as appropriate at the end of the 2004/05 season i.e. 30 September 2005.

### **1.13 Structure of Submission**

This Submission contains twelve sections as follows:

- Section Two** - provides the background to this Transaction;
- Section Three** - provides background information on AWB;
- Section Four** - provides background information on GrainCorp;
- Section Five** - provides information in relation to JVCo;
- Section Six** - provides information in relation to the public benefit;
- Section Seven** - provides information in relation to relevant markets;
- Section Eight** - sets out an analysis of the effect of the proposed arrangements on the market for grain storage and handling;
- Section Nine** - sets out an analysis of the effect of the proposed arrangements on the market for grain marketing;
- Section Ten** - sets out an analysis of the effect of the proposed arrangements on the market for bulk freight rail services; and
- Section Eleven** - sets out an analysis of the effect of the proposed arrangements on the domestic market; and
- Section Twelve** - sets out a brief conclusion.
- Appendix One** - Joint Venture Agreement
- Appendix Two** - Summary of Open Access Deed



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## **2 Background to the Transaction**

### **2.1 Introduction**

In order for the Commission to understand the competition impact of the Transaction and be comfortable with the Transaction, the parties believe that it is important to explain the individual perceptions and issues that GrainCorp and AWB have with respect to the export grain supply chain and the grain industry in general.

The parties believe that the outcome of the Transaction -- that is, the creation of an independent JVCo which will manage logistics for export grains in a more efficient manner, at arm's length from the parties -- is a positive step forward for making the Australian export grain supply chain even more efficient.

Accordingly, set out below is an overview of the relevant industry structure, dynamics and the parties' respective commercial rationales for the Transaction. Further information on the parties is set out in Sections Three and Four of this Submission.

### **2.2 AWB and GrainCorp Relationship**

AWB and GrainCorp's primary relationship is one of service provider and customer, rather than as competitors. By virtue of the AWB export wheat rights, it is GrainCorp's largest customer, accounting for over 60% of GrainCorp's current business.

As a customer, GrainCorp and AWB have to work together to organise the movement of export grain from the country silo to the port terminal. This creates a close working relationship which is normal in a service provider and customer relationship. For example:

- AWB has significant information about GrainCorp's storages, operation and intentions for investment at storages as the largest buyer of GrainCorp's services;
- AWB is fully aware of GrainCorp's storage and handling terms and conditions before harvest as part of its storage and handling pricing negotiations. GrainCorp must provide all of its charging rates to AWB as they are deducted from growers' Pool payments as explained in more detail in Section Four; and
- GrainCorp has to work with AWB's storages for export grain movements. This includes the management of export wheat from AWB Grainflow's and other storages through GrainCorp's Site Assembly Plans.

## 2.3 Industry structure and Industry changes

In 1999, AWB was privatised by the Federal Government, although the statutory arrangements in relation to the Single Desk for wheat exports were retained under the WMA. Following privatisation, AWB embarked on a program of significant investment in grain bulk storage and handling facilities in Eastern Australia and negotiation of rail rates with existing and new rail providers.

GrainCorp has also sought to improve its competitive position in grain bulk storage and handling through the merger with GrainCo Australia Limited (“GrainCo”) and improvements in its storage and handling and port operations.

The grain industry has also undergone consolidation. As the Commission is aware, two recent mergers that will have an impact on the grain industry: Pacific National (following Pacific National’s acquisition of ATN and Freight Australia), will be the largest rail provider in New South Wales and Victoria, and the merged ABB and AusBulk company, as well as being the second largest listed grain company, will hold the largest share of export barley.

The acquisition of Freight Australia by Pacific National is of significance as it decreases the number of rail operators in New South Wales and Victoria servicing AWB and GrainCorp to one party - a fact previously stated to the Commission. Difficulties in rail access arrangements in Victoria exacerbate that situation. The Transaction is a way of commercially moving forward in this environment and working with Pacific National.

In the context of these industry changes, the parties believe that the result of having JVCo as a neutral joint venture company managing the parties’ logistics services for export grain, will be improved rail efficiency and improved efficiencies for the parties and the industry in general. In particular, JVCo will be in a better position to optimise the export grain supply chain decision making. The JVCo will co-ordinate export rail agreements and logistics by an independent, ring-fenced entity which will:

- address GrainCorp’s concerns in relation to rail rates applied to sites around Eastern Australia; and
- address AWB’s concerns in relation to the efficient use of storage and handling, port and rail infrastructure services.

Further, the creation and operation of the JVCo will not change the competitive positions of the parties. Importantly, the formation of JVCo does not adversely:

- affect competition in the provision of bulk-handling services by either of the participants or any other operator;
- affect the ability and incentives of each of the participants, or any other operator, to invest in bulk-handling and other infrastructure; or
- affect competition between the participants, or any other operators, in grain trading and marketing in Australia.

The JVCo will simply “stand in the shoes” of AWB in acquiring transport logistics services for National Pool (i.e. export) wheat under the WMA.

The parties believe that there is very little, if any, negative impact on competition resulting from the Transaction, as it is limited to delivering a more efficient and independently managed logistics supply chain for export wheat. The joint venture should not, therefore, have an impact in any material sense on AWB’s current market position in the acquisition of these services, in particular export rail rates.

#### **2.4 GrainCorp’s commercial rationale**

GrainCorp’s commercial rationale for entering the Transaction is to drive efficiencies in export supply chain logistics services.

Given AWB’s ownership of all export wheat under the WMA and GrainCorp’s industry position, GrainCorp believes that it does not have access to the same level of transparency of rail rates for its silos as AWB Grainflow silos. This disparity is occurring in the context of an industry which is seeking greater transparency for freight rail rates and where freight rail companies are consolidating. Increased transparency is traditionally viewed as facilitating competition.

As noted earlier, both parties have their individual views of how the Australian grain industry operates and GrainCorp expressly acknowledges that that AWB does not accept GrainCorp’s views of some aspects of the operation of the Single Desk which are inherent in this Submission.

Nevertheless, GrainCorp’s rationale for entering the Transaction may be summarised as follows:

- GrainCorp believes that it does not have full access to information which would enable it to assess whether the same level of rail rates for GrainCorp’s silos as AWB Grainflow silos are being applied based on Pacific National’s views of those silos and their respective individual operating characteristics (eg location, size, hours of operation and loading speeds);
- GrainCorp believes that JVCo will facilitate more transparency in the negotiation and presentation of export rail rates for regulated wheat exports to growers and other industry participants. Currently export rail rates are solely negotiated by AWB. The joint venture company will create an independent process in setting these rates, which would address GrainCorp’s concerns that there is not sufficient clarity with respect to how AWB negotiates those rates with respect to its own, and others’ facilities; and
- the increased transparency and associated efficiencies would provide GrainCorp with better information and certainty as to whether to invest in upgrading grain storage.

## **2.5 AWB's commercial rationale**

AWB's commercial rationale involves putting in place arrangements to achieve supply chain cost savings for Australia's growers and to secure the medium to long term competitiveness of its export grain trading business in the international markets, through.

- lower supply chain costs. AWB as manager of the National Pool has an obligation to minimise supply chain costs. To date this has been largely achieved through more efficient bulk handling services and lower rail rates through the introduction of competitive rail operators. There is a significant opportunity for further efficiency gains and cost savings through better coordination;
- increased confidence in rail freight determinations by Pacific National and AWB provide clear rewards for grain storage handlers such as GrainCorp (and other participants) in increasing investment in grain storage by creating a clear link to rail costs; and
- supply chain investment. AWB has made a significant investment in 21 silos and a 50% share in MPT. Further significant investment to obtain a commercial return, particularly in ports, will be difficult. In any event, however, more efficient information flows allow industry participants to make independent, informed decisions as to the optimal use of capital.

## **2.6 A contractual approach would not deliver the same benefits as a joint venture**

In developing the most appropriate method of achieving the above objectives, the parties considered whether individual contracts with the rail freight service providers or, alternatively, a joint venture would be the best way of delivering the benefits sought.

It should be noted there have been tri-partite rail contracts between AWB, the storage provider and the rail freight provider in Western Australia and South Australia.

Both parties believe that the efficiencies and logistics cost savings which JVCo will deliver could not be effectively achieved by individual agreements between the parties and the rail freight providers. The JVCo will provide the best vehicle to bring together GrainCorp (as the operator of infrastructure) and AWB (as the manager of the National Pool and holder of the rail contracts). The parties decided that forming a joint venture to manage export grain logistics would be the preferred route given:

- the requirements to ring fence this task to meet AWB's pool management policies;
- the need for JVCo to operate as an independent and neutral party (i.e. pay the invoices) with the services providers, to enable incentives and other pricing criteria to be passed through to the parties; and

- the need to put in place a neutral party to execute and independently co-ordinate rail and related storage and supply chain activities, to ensure rail contractual obligations are met.

## **2.7 Conclusion**

Accordingly, the Transaction represents the most appropriate course within the overall structure of the Australian grain industry under the WMA of seeking to achieve efficiencies in the export supply chain and reducing supply chain cost for growers participating in the export wheat pools.

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## **3 Background information on AWB**

### **3.1 Introduction**

The Australian Wheat Board was established as a statutory authority in 1939. In June 1998, the assets and liabilities of the Australian Wheat Board (other than the Wheat Industry Fund) were transferred to AWB and AWB International ("AWBI"), then wholly-owned subsidiaries of the Australian Wheat Board.

On 1 July 1999, the Australian Wheat Board ceased to be a Government-controlled entity and AWB became a grower-owned and controlled corporation. AWB listed on the Australian Stock Exchange in August 2001 and is now Australia's major national grain asset manager and one of the world's largest wheat managers and marketers.

### **3.2 AWB's operations**

Details in relation to AWB's activities are set out below. There are six key business streams that represent the AWB business.

#### **1 National Pool management services**

AWBI is a separate, wholly-owned subsidiary of AWB which is responsible for the operation of the National Pool on behalf of growers and other suppliers who deliver wheat to it.

The Single Desk is established by the WMA, under which AWBI is appointed as the sole marketer of Australian export bulk wheat. AWBI is under an obligation to accept all wheat that is offered to it for inclusion into the National Pool and that meets the quality standards set by it.

Under the WMA, AWBI's responsibility is to maximise net pool returns for growers who deliver wheat into the National Pool, by securing, developing and maintaining export markets for wheat and minimising costs.

In general, AWBI's management of the National Pool involves the following six activities:

- aggregating grain parcels for sale on international markets;
- managing commodity (eg wheat) price risk through physical sales and financial hedging on global commodity exchanges;
- managing currency risk;
- providing market and service information to grain growers and AWB customers;
- optimising logistics (including storage, handling and transport costs); and
- managing accounts and other services for growers who deliver to each pool.

These services are provided to AWBI by AWB, through its wholly owned subsidiary AWB Services Pty Ltd.

## **2 Grain acquisition and trading**

AWB and AWB (Australia) Limited participate in grain acquisition and trading in a number of ways.

First, the companies provide growers with a number of services functions. Pre-harvest, the companies provide a range of contract products that give growers greater price flexibility. The companies also provide growers with cash sales options before and during the harvest.

Second, the companies themselves actively participate by acquiring and trading deregulated domestic grain and non-wheat export grain.

## **3 Finance and risk management products**

AWB also provides various funding, treasury and risk management products to growers including:

- finance products - the provision of limited recourse finance secured against a grower's wheat delivery to an AWB managed pool; and
- risk management products - the provision of derivatives that manage pool risk exposures and cash flows, that allow growers to tailor their risk exposure.

## **4 Storage and handling**

AWB owns and operates grain storage and handling facilities at 21 locations in Queensland (3), New South Wales (10), Victoria (4) and South Australia (4).

In the 2003/2004 harvest season, AWB grain storage and handling facilities received approximately 1.7 million tonnes of grain.

## **5 Export port facilities**

AWB has a 50% interest in the bulk grain export terminal at the MPT. MPT is a joint venture operation with ABA. It is operated by AusBulk (itself a participant in the ABA joint venture).

## **6 Landmark acquisition**

On 29 August 2003, AWB announced that it had acquired Landmark from Wesfarmers Limited. Landmark is Australia's largest supplier of farm inputs including fertiliser and chemicals. It also has significant interests in wool and livestock marketing, rural property and real estate sales and finance and insurance.

### **3.3 Further information**

Further information in relation to AWB is also available at [www.awb.com.au](http://www.awb.com.au).

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## **4 Background information on GrainCorp**

### **4.1 Introduction**

GrainCorp is an Australian agribusiness company which is listed on the Australian Stock Exchange. GrainCorp's core business is the provision of bulk grain storage and handling services for domestic and export markets. GrainCorp's other products and services include:

- grain accumulation and grain marketing, to both domestic and overseas customers;
- flour milling and mixing through Allied Mills, a joint venture between GrainCorp and Cargill Australia Limited; and
- merchandising activities (eg, GrainCorp operates 27 rural service centres which offer farm input needs such as fertiliser, agricultural chemicals, seeds and seasonal finance).

Further details in relation to each of those activities are set out below.

### **4.2 Grain storage and handling**

#### ***Storage and handling***

GrainCorp owns and operates approximately 355 grain storage facilities in New South Wales, Victoria and Queensland.

Subject to a divestiture process agreed with the Commission in relation to the GrainCo transaction, GrainCorp currently has an interest in six storage and handling facilities in New South Wales and Victoria through Australia Bulk Alliance ("ABA"), a joint venture (held in equal shares) with AusBulk.

In the 2002/2003 harvest season, GrainCorp received approximately 11.5 million tonnes of grain, including approximately 6 million tonnes of grain for export.

#### ***Export port facilities***

Following its merger with GrainCo Australia in October 2003, GrainCorp owns and operates seven export port terminals located at:

- Newcastle, NSW;
- Port Kembla, NSW;
- Brisbane, Queensland;
- Mackay, Queensland;
- Gladstone, Queensland;
- Portland, Victoria; and
- Geelong, Victoria.



GrainCorp is also divesting by virtue of arrangements agreed with the Commission as part of its acquisition of GrainCo, its indirect 25% interest in the Melbourne Port Terminal, which is owned in equal shares by ABA and AWB.

#### **4.3 Grain trading**

On 1 October 2003, GrainCorp merged its grain trading activities with those previously conducted by GrainCo (through MarketLink, a joint venture between GrainCo (75%) and Con Agra (25%)).

Accordingly, following that merger, GrainCorp now holds the exclusive rights to administer the legislated vesting and export rights of the New South Wales Grains Board (“NSWGB”) and, therefore, the exclusive right to market domestic malt barley and export barley, canola and sorghum produced in NSW as the NSWGB’s agent until October 2005.

GrainCorp asked the New South Wales Government’s permission to introduce open permits for all regulated grains. With the consent of the New South Wales Government and New South Wales farmers, GrainCorp has now voluntarily deregulated domestic malt barley and export canola and sorghum through an open permit system.

#### **4.4 Flour milling and mixing**

In 2002, GrainCorp and Cargill established a joint venture to purchase Goodman Fielder’s flour milling business which was then called Milling Australia. That business now trades as Allied Mills.

#### **4.5 Merchandising activities**

GrainCorp operates a network of 27 rural service centres which offer farm input needs such as fertiliser, agricultural chemicals, seeds and seasonal finance.

#### **4.6 Further information**

Further information in relation to GrainCorp is available at [www.graincorp.com.au](http://www.graincorp.com.au).

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## **5 Background on the export logistics joint venture**

### **5.1 Introduction**

GrainCorp and AWB have finalised arrangements under the Joint Venture Agreement in relation to the creation of JVCo which would, subject to authorisation, provide various export logistics services for export grains.

The parties have also provided the Commission with copies of the relevant agreement, being the Joint Venture Agreement which is subject to regulatory approvals.

Further details in relation to this joint venture arrangement are set out below.

### **5.2 Export logistics joint venture**

GrainCorp and AWB propose to appoint JVCo as the exclusive provider of export logistics services to their respective businesses. Accordingly, apart from the acquisition element of the Transaction, it also has a technical exclusive dealing element.

The joint venture solely relates to managing the transport of export grain from up country silos to port. It will not affect the parties' respective activities in relation to domestic grain or grain storage. In particular, GrainCorp and AWB will remain free to compete with each other (and other participants in the grain industry) in relation to:

- ***the provision of upcountry grain storage and handling services and the provision of export port services.*** AWBI, AWB Australia Limited ("AWBAU") and GrainCorp Marketing will continue to enter into agreements with storage providers for their grain and will be responsible for the payment of storage fees direct to their storage provider; and
- ***grain marketing to both domestic and overseas customers (in the non-regulated grains).*** AWBI, AWBAU and GrainCorp Marketing will continue to sell grain to domestic and overseas customers, control the movement of their grain and enter into stock swaps for their grain pursuant to appropriate customer approvals.

The main features of the JVCo can be summarised as follows:

- JVCo will be incorporated and jointly owned by the parties;
- JVCo will only employ a small number of staff (4 to 6) to provide specific services. The JVCo, to minimise costs, may contract support services (eg accounting and systems) from the parties,
- contract exclusively with AWB Services Limited ("AWBS") and GrainCorp to manage and co-ordinate export transport activities in Eastern Australia with the objective of achieving supply chain and logistics efficiencies and cost savings;

- JVCo will not seek to be a separate profit centre with all rail and operating costs to be paid by AWBS and GrainCorp in proportion to the tonnage of grain serviced by JVCo;
- it will enter into contracts as principal in relation to the movement of grain with all rail providers (and limited road contracts if rail is not available). These contracts could include a combination of take or pay or spot rail services. These services will be sourced from Pacific National in New South Wales and Victoria and Queensland Rail in Queensland and other rail providers;
- JVCo will nominate the rail provider for a particular task and will be responsible for the payment of rail rates. JVCo will determine rail rates for all silos receiving AWB and GrainCorp export grain, based on the rates and contracts provided by the relevant rail providers;
- it may enter into agreements in relation to grain outloading operations with GrainCorp, AWB Grainflow and Australian Bulk Alliance and other entities that provide grain storage services to improve storage and rail interface and to set performance criteria and financial incentives to flow between rail and storage;
- it will manage and co-ordinate grain logistics for AWBS and GrainCorp in relation to export grain in Queensland, New South Wales and Victoria and will be responsible for the payment of rail invoices. However, as noted earlier, JVCo will not service domestic grain. The JVCo will have access to AWBI, AWBAU and GrainCorp Marketing stock information as part of this function on a ring fenced and strictly confidential basis; and
- it will operate as a neutral and independent operator, keep all confidential information confidential and distribute any cost savings to the shareholders in accordance with the volumes of each shareholder's grain handled by JVCo.

### **5.3 Shareholders Agreement**

A copy of the Joint Venture Agreement is attached as Appendix One to this Submission. Confidentiality is claimed in relation to the schedules to the agreement.

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## **6 Public Benefits associated with Joint Venture**

### **6.1 Introduction**

The joint venture arrangements are intended to provide GrainCorp and AWB with substantial opportunities to reduce supply chain costs for export grain with no impact on the domestic industry, through a structured, co-operative approach. The Transaction documents and arrangements have been structured to maximise public benefits and minimise any public detriment.

### **6.2 Supply chain co-ordination**

The parties believe that significant inefficiencies currently occur in the export grain supply chain due to its fragmented nature. There is a 'dis-connect' between the owners of individual parcels of grain, the owner and operator of grain storage and handling infrastructure and the acquirer of rail transport services. This means that some of the decision makers (i.e., in this case GrainCorp and AWB) lack:

- the ability to link the two functions involved with rail movements - that is placing orders for rail and the loading of rail;
- commercial incentives to minimise the overall grain export grain supply costs; and
- access to all information that is relevant for the efficient co-ordination of the export grain task.

Specific examples of these inefficiencies include:

- poor rail cycle times as trains wait many hours for loading and/or unloading. This could be improved by providing JVCo access to rail freight incentives from Pacific National to compensate for costs in operating facilities in a manner to match the rail timetable. For example, increasing remuneration for unloading trains at the port terminal outside the normal business hours where additional costs are incurred;
- poor use of (limited) rail resources with uneven month to month demand for rail transport by the AWB. This could be improved by improved shipping forecasts, use of grain sub-terminals for intermediate grain aggregation, use of port terminals for extended grain storage and combining rail orders for a number of customers for two or more silos in the same area;
- lack of investment at GrainCorp silos to load trains faster. This could be improved by greater transparency of rail freight commercial factors and incentives to more closely align commercial incentives to increase investment; and

- delays in shipping, with significant demurrage costs incurred by AWB, if there are delays caused in delivering grain to the port terminal by reason of decreased co-ordination between the storage owner and the rail provider. This could be reduced by an improved storage and rail interface and co-ordination and improved rail performance.

These inefficiencies are exacerbated by the current problems experienced with merger integration issues as between Pacific National and Freight Australia, which mean that GrainCorp and AWB must take a greater involvement as customers and supply chain participants in ensuring an efficient export grain task.

Both parties believe that efficiencies and logistics cost savings can be achieved in the export supply chain by JVCo developing commercial solutions to address the inefficiencies that currently exist in the export supply chain. These are set out below.

### **6.3 Reduction in supply chain costs**

The JVCo will be able to reduce supply chain costs through the adoption of the following practices:

#### ***Improved coordination***

JVCo will co-ordinate loads to match and optimise transport, storage and shipping arrangements by:

- creating an alignment of “commercial drivers” to ensure optimal supply chain decision making (for example, hours of rail discharge at ports);
- matching export loads and sites to achieve full train loads against different rail operators; and
- taking into account supply chain costs in allocating transport.

#### ***Information flows***

One impediment to optimising the export grain supply chain is that decision makers do not have access to all information that is relevant for the efficient co-ordination of the export grain task. For example:

- AWB, as the manager of the Single Desk, cannot access all logistics information across the entire grain supply chain to maximise value and avoid “bottlenecks” (such as port congestion and shipping demurrage); and
- GrainCorp, as the operator of the majority of the export grain supply chain infrastructure, lacks important information about the export wheat task of the National Pool.

The information held by AWB and the disclosure of which would assist GrainCorp in optimising the export grain supply chain decision making includes:

- rail transport requirements and performance criteria;
- shipping programs for export wheat;
- marketing information about the level of export demand; and
- demurrage penalties and dispatch rewards for ship-loading.

Conversely, the information held by GrainCorp, the disclosure of which would assist AWB in optimising the export grain supply chain decision making includes:

- up-country grain storage operations and performance criteria;
- readiness for shipping status of each parcel of grain;
- costs of expanding storage and creating more segregations; and
- shipping program for export grain sold by GrainCorp to export customers (in the sense that this facilitates train logistics movements and silo outloading.

efficiencies and logistics costs savings that will be achieved by the proposed arrangements through enhanced access to information for JVCo include:

- improved planning and scheduling of the bulk grain handling, transport and shipping arrangements in relation to export wheat;
- more detailed pricing of bulk handling and transport services that allows cost driven decision making in relation to each component of the export grain supply chain; and
- optimal investment and innovation decisions.

***Common transport operating criteria***

The joint venture will incorporate transport costs and minimise supply chain costs through the joint negotiation of common operating criteria, for example:

- rail discounts for storage services, such as 24 hour loading;
- rail discounts for speed of loading, such as 400 tonnes per hour (“TPH”) and 1,000TPH;
- rail discounts for unit train operations, such as balloon loops;
- grain buyer performance in terms of loading orders and order timing; and
- incentives for rail performance.

## 6.4 Quantum of Benefits

The Transaction will allow the parties to reduce export logistics cost and increase rail capacity to service the variable export grain task between seasons and within a season.

### *Reduction in transport costs*

Based upon discussions with Pacific National and Queensland Rail, it is estimated that the coordination of export grain movement activities between AWB, GrainCorp and the rail freight provider will reduce rail freight supply chain costs in the order of 5-15% as the efficiencies contemplated by the Transaction are realised. Based on an average export task of 7.5 million tonnes, costing in excess of \$200 million per annum, these efficiencies equate to approximately \$10 - 30 million pa, or an estimated \$1.33 to \$4 per tonne of export grain moved.

As noted above, these efficiencies almost entirely arise through increased co-ordination of export grain transportation, rather than any aggregation of volumes of export grain as between AWB and GrainCorp. As discussed in Section Ten of this submission, it is uncertain whether the aggregation of export grain volumes will deliver any cost benefits to the parties because of the differing characteristics of the grain that AWB and GrainCorp export and whether the rail freight service provider will agree to provide reductions. Any such benefits are in addition to the co-ordination and efficiency estimates provided above.

The parties anticipate that these savings will be shared between the owners of the grain and the rail provider by negotiation, where:

- the rail provider may retain some of these savings to:
  - improve the viability of providing rail services, particularly on branchlines;
  - minimise future rail rate increases, particularly in New South Wales at the end of the rail contract in 2007 put in place by the New South Wales Government for the sale of FreightCorp to Pacific National; and
  - incentives for increased re-investment in locomotives and wagons.
- the JV could provide a mechanism, where there is a net cost saving, to reimburse the storage provider to provide agreed services to reduce rail costs. For example, this might constitute a payment to operate grain storages 24 hours a day;
- all savings in transport costs obtained by the JVCo will be passed back to the owners of grain, as it is a non-profit entity, in the form of lower rail rates and rebates; and

- AWB's National Pool has an obligation to pass back any savings through its pool payments. Reduced supply chain costs generated by the JVCo's activities across the three States of Victoria, New South Wales and Queensland will provide improved returns for over 9,000 grain growers.

Given that Australian grain prices are generally underpinned by export prices, the parties note that a reduction in export pool costs will not only increase pool returns but will increase the floor price for the grain market in general. This will benefit all grain growers including those selling their grain by cash into the domestic market.<sup>1</sup>

### *Increase in rail export capacity*

The proposed JVCo, through improved co-ordination, will be an important vehicle for increasing utilisation of rail assets and increasing rail capacity for all exporters of grain.

AWB and GrainCorp now face a dominant provider of bulk rail freight services in New South Wales and Victoria following Pacific National's acquisitions of ATN and Freight Australia. Furthermore this company has sole access to Victorian rail track given the access arrangements in that State, in respect of which the parties have expressed their concerns to the Commission. Nonetheless, the Transaction provides an opportunity to work with Pacific National and to see if Pacific National addresses these concerns.

The grain export task is variable. It can vary from an average task of 7.5 million tonnes per annum to a peak of over 11 million tonnes per annum in between seasons and vary up to 1 million tonnes per month within an average season. Given the nature of the grain task, grain exporters and grain growers are exposed to lack of capacity to service the peak seasons and peaks within a season.

The parties hold the view that Pacific National, as the dominant provider of export grain rail services in New South Wales and Victoria, does not have the capacity, nor as the sole provider at this time, has the commercial incentive to put in place sufficient capacity to handle peak movements.

Private rail operators only have a commercial incentive to supply capacity to service average grain production and not the peaks. The parties do acknowledge that the cost to provide additional rail capacity to service peak exports is expensive and a poor use of limited assets.

Both GrainCorp and AWB incurred significant costs in the 2003/04 harvest in Victoria from lack of rail capacity from that year alone. GrainCorp incurred \$1.2 million in demurrage and additional road costs (to replace rail). AWB also incurred \$1.24m in demurrage arising from ship loading delays due to lack of rail capacity. These costs are borne by grain growers who delivered into the National Pool as reduced pool returns. Further, we are aware that additional road costs have been met by Freight Australia to meet AWB's ship loading programme.

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<sup>1</sup> Given the service agreement between AWB and AWBI, reduced export pool costs will also be rewarded with marginally increased service fees to AWB.



It is estimated that in the forthcoming 2004/2005 season, with a potentially larger harvest than last year, this lack of rail capacity could cost New South Wales and Victorian grain growers over \$20 million in higher costs, arising from.

- delays in ship loading resulting from the late delivery of export grain by rail, leading to additional shipping demurrage costs of up to \$8 million next season, and
- delayed export grain sales due to rail capacity restrictions, which will lead to increased storage and carry costs of approximately \$5 pt for one third of exports or \$13 million next season.

In the context of the National Pool, these costs would be passed onto all growers through lower pool returns, impacting upon over 20,000 grain growers. However, the Transaction provides AWB and GrainCorp with the opportunity to address this issue and avoid such costs being incurred.

#### **6.5 Increased investment in grain storage to service exports of grain by rail**

Under the Transaction, JVCo will create an independent and transparent process for determining the freight deductions that will apply at each silo for export grain owned by AWB and GrainCorp. These export rail rates are published by the AWB pool before harvest for the use of growers and grain traders. They are therefore transparent and available to all industry participants.

While both parties have their own views on the way in which export rail rates are currently negotiated and presented to industry participants, they believe that through appropriate co-operation and exchange of appropriate information, transparency can be further improved.

Transparent export rail rates and pricing signals for performance standards will create an improved environment for investment in up-country silos by all existing and potential competitors. This will enable storage providers to determine the viability of investment with certainty and security.

From GrainCorp's perspective this will encourage GrainCorp investment at its sites to improve rail elevation and outloading infrastructure to meet the future requirement of rail. Up to now, GrainCorp has been reluctant to make this investment given GrainCorp's perceived uncertainty of obtaining lower export rail rates at a silo (for AWBI National Pool wheat) for this investment. Key areas of investment that GrainCorp has planned, and have informed AWB as a major customer, under the Transaction include:

- a new rail discharge facility at Newcastle Port on the balloon loop. This would reduce discharge time by one half and increase port receival capacity from 3-4 trains a day to up to 7 trains a day. This facility would cost approximately \$12 million;
- fast rail discharge pits at all sub-terminals. This will enable grain to be transhipped from the rail branch lines to main lines efficiently. This would cost approximately \$8 million for 4 sub terminals;

- fast outloading spouts (from 200tph to 800tph) at all major silos. This will reduce loading time to 3 hours for a unit train. This would cost around \$20 million for 40 major silos;
- unit train siding to handle 40 wagon trains at selected major silos. This will enable block train operation. This would cost \$10 million at 10 silos; and
- a joint review of the Project Broadacre concept to explore the potential to maximise the joint venture for the use of branchlines and existing GrainCorp sub-terminals.

## **6.6 Conclusion on public benefits**

The Transaction provides an opportunity for substantial efficiencies to be achieved. Some of these efficiencies achieved through improved co-ordination are urgent short term requirements in relation to this forthcoming harvest - a necessity just to manage this harvest. In the medium term, the increased efficiencies will deliver significant public benefits to participants at all levels of the export grains supply chain, as well as enhancing the competitiveness of Australia's grain exports and the international competitiveness of Australia's grain industry in general.