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22 November 2004

Mr Tim Grimwade
General Manager – Adjudication Branch
Australian Competition and Consumer Commission
470 Northbourne Avenue
DICKSON ACT 2602

Attention: Mr David Hatfield

Dear Mr Grimwade,

GrainCorp Operations Limited, AWB Limited and Export Grain Logistics Pty Ltd – Applications for Authorisation A30223, A30224, A30225

We refer to our recent discussions and Mr Hatfield's request for additional supporting information on the methodology and key assumptions underlying the cost savings and efficiency improvements identified in the application. The parties are pleased to provide the further background as detailed below.

We have also been asked to release further information in relation to the ring-fencing of information. In accordance with your request, the parties are prepared to release schedule 2 of the JVSA which lists information to be ring-fenced by the joint venture company. A copy of the relevant schedule 2 is attached to this letter.

Further, in our discussion of earlier this week, the parties were asked whether they were agreeable to the Commission acknowledging it had been separately provided by the parties with confidential information included in the parties respective board papers confirming their respective intentions to continue competing in relation to storage and handling. The parties are happy for the Commission to make this acknowledgement on the basis that the actual materials provided by the parties remain confidential.

Methodology and Key Assumptions Underlying Cost Savings and Efficiencies

In the submission, the parties argue that the JVCO will be able to reduce supply chain costs and improve its efficiency through improved co-ordination of the grain export task. These benefits include a reduction in transport costs and an increase in rail export capacity for all users. Improved rail export capacity will in turn lead to an improvement in vessel loading performance as the time to accumulate grain at port will be reduced.

Reduction in transport costs

In informal discussions with the transport providers prior to the establishment of the JVCO, the parties posed the question as to what level of benefit could be gained through AWB and GrainCorp co-ordinating their export supply chain planning and in presenting a combined task for the transport providers. The major rail providers all responded positively and agreed that the proposition being put forward should indeed result in overall savings in the task. While it was agreed that we could not hold the rail providers to any firm cost reduction, rail provider estimates of the types of savings that could be captured were in the range of 5 -15%. Based on an average export task of around 7.5 million tonnes across the three States, costing in excess of $200 million per annum, these savings equate to approximately $10 - $30 million per annum, or an estimated $1.33 to $4 per tonne.

It is important to note that these benefits will be shared between the owners of the grain and the rail providers by negotiation. As stated in our submission, the rail providers may retain some of these savings to:

i. Improve the viability of providing rail services;
ii. Minimise future rail rate increases; and/or
iii. Re-invest in locomotives or other rolling stock.

However, given the strength of the major rail providers compared to the position of JVCO and the grain owners, we believe it will be largely up to the major rail providers to decide how much of this benefit will pass through to the JVCO. In any event, as JVCO is a non-profit entity, any reduction in transport charges or freight rebates will flow directly through to its customers, the grain owners. AWB's National Pool has an obligation to pass back any savings through its pool payments. Therefore reduced supply chain costs will provide improved returns and directly benefit over 9,000 growers across the three States.

Again, we repeat the point that any increase in export pool returns gained through a reduction in export supply chain costs will result in domestic prices becoming more reflective of competitive export pricing – a desirable competition outcome.

Increase in rail capacity

The JVCO will improve the co-ordination of the export supply chain, thereby improving the utilisation of rail assets and increasing rail capacity for all rail users, both export and domestic.

The rail task is variable, ranging from an average task of around 7.5 million tonnes per annum to a peak of 11 million tonnes per annum between seasons. In addition, variability in the task between months can be enormous and vary up to 1 million tonnes per month. Given this variability, grain exporters and therefore grain growers are exposed to capacity constraints in peak seasons and in peak periods during the year.
The ability for the rail providers to re-allocate assets to different port regions to service this task is constrained by the differing rail gauges, rail asset configurations, access arrangements and crewing limitations. Many of these constraints exist for the major operator Pacific National, just in terms of shifting assets between Victoria and New South Wales.

The parties hold the view that Pacific National, as the dominant provider of export grain rail services in Victoria and New South Wales, does not have the capacity, nor the commercial incentive to put in place capacity to handle peak movements. The parties also acknowledge however, that the cost to provide additional rail capacity to service peak exports is expensive and a poor use of limited assets.

As outlined in our submission, both GrainCorp and AWB incurred significant costs during the 2003/04 season in Victoria due to the lack of available rail capacity. GrainCorp incurred $1.2 million in demurrage and additional road costs. The demurrage costs were due to delays in cargo accumulation while the road costs represent the freight differential between road and rail for those road movements required to accumulate grain at port given the shortage in rail assets. If road transport was not utilised, vessel loading delays would have been greater and the resultant demurrage incurred significantly higher, particularly with vessel hire rates running at around $US 20,000 per day for an average sized vessel as used in the grain trade.

Similarly, AWB also incurred $1.24 million in demurrage arising from ship loading delays due to the lack of rail capacity. While AWB did not utilise road transport to make up this shortfall in rail capacity, under AWB's contract with Freight Australia, the rail operator was required to make up any rail capacity shortfall by engaging road transport at their own cost.

As can be seen by the Victorian example, any increase in rail asset utilisation would immediately deliver improved capacity out of the available rolling stock. This is turn shortens the time required to accumulate cargoes for all exporters and reduces the demurrage burden for all exporters and growers. Further, the avoidance of utilising expensive and inefficient (from a capacity and environmental perspective) road transport delivers lower transport costs for exporters.

Transport savings made through achieving better utilisation of rail assets flow directly back to the grain owners and via AWB's National Pool to the growers in the respective States. Similarly, any lowering of demurrage results in higher returns for National Pool participants, which impact upon over 20,000 grain growers (most of whom are small or family businesses).

Better utilisation of rail assets also leads to savings for the rail operator (which may have been included in their assessment of 5-15% savings) and the upcountry and port storage providers, in that they will clear storages quicker and therefore derive better workforce utilisation and asset utilisation.
Given rail transport capacity is often one limiting factor in terms of how much grain can be shipped in any one month, another area of potential benefit arising from improved rail asset capacity is that more grain will be able to be sold and shipped during periods of high demand and prices. The benefits that would accrue to growers through being able to make more sales during periods of higher demand include:

i. Potential to capture a higher sale price resulting in a higher return for growers, and
ii. Lower storage and carry costs – this includes exporters avoiding time-based storage charges of around $1.20 per tonne per month,

We trust that this answers the Commission's questions. If you require further detail, please let us know.

Yours sincerely,

John Crosbie **Neil Johns**

SCHEDULE 2

RING-FENCED INFORMATION

PART A: INFORMATION TO BE RING-FENCED FROM AWB

- Specific market and buyer information, including product requirements, specifications, pricing arrangements, customer contract information, market analysis and forecasts, funding mechanisms and end-user demand
- GrainCorp Group marketing and risk management strategies, grain accumulation strategies or transactions
- Any GrainCorp Group information unrelated to GrainCorp's Queensland, New South Wales and Victorian supply chain requirements
- Information relating to the GrainCorp Group's supply chain operations in other states

PART B: INFORMATION TO BE RING-FENCED FROM GRAINCORP

- Specific market and buyer information, including product requirements, specifications, pricing arrangements, customer contract information, market analysis and forecasts, funding mechanisms and end-user demand
- AWBI National Pool marketing and risk management strategies and transactions. National Pool's wheat physical and covered positions and any information relating to tender sales not publicly available
- Pool Performance Benchmarking (WIB) and Attribution model(s)
- AWBA's marketing, risk management and grain accumulation strategies or transactions. AWBA's individual grain positions and information pertaining to the application for relevant export licences
- Any AWB Group information unrelated to AWB's Queensland, New South Wales and Victorian supply chain requirements
- Information relating to the AWB Group's supply chain operations in other states including AWB Grainflow Pty Ltd