

## **Pacific National**

### **Position Paper on the GrainCorp/AWB Joint Venture**

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#### **1. Executive Summary**

In broad terms, Pacific National's position on the proposed AWB/GrainCorp joint venture is as follows:

- (a) Pacific National does not oppose authorisation of the joint venture.
- (b) Pacific National agrees that:
  - (i) substantial inefficiencies exist in the grain supply chain; and
  - (ii) these inefficiencies should be addressed.
- (c) Pacific National has concerns about whether the joint venture will of itself be able to achieve many of the benefits and efficiencies claimed by AWB and GrainCorp; and
- (d) Pacific National believes the joint venture gives rise to potential competitive detriment which needs to be addressed through appropriate safeguards in relation to transparency, objectivity and ringfencing if the Australian Competition and Consumer Commission ("**Commission**") is to authorise the joint venture.

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#### **2. Background material - presentation to ACCC**

On 25 November 2004, Pacific National made a presentation to the Commission setting out its views on the grain supply chain. A non-confidential version of this presentation has been provided to the Commission.

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#### **3. Assessment of claimed benefits/efficiencies**

[CONFIDENTIAL]

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#### **4. Safeguards sought by Pacific National**

##### **4.1 Overview**

Pacific National seeks three conditions be put on the authorisation to address the potential for competitive detriment:

- (a) competitive neutrality for service providers to EGL;
- (b) transparency and objectivity in selection criteria for service providers to EGL; and
- (c) ringfencing of commercially sensitive third party information within EGL.

## 4.2 Concerns arising under Joint Venture Shareholders Agreement

Under the Joint Venture Shareholders Agreement, a number of concerns arise. Two examples are:

- (a) service providers, including rail providers, are to be selected on the basis of terms in confidential Schedule 1. This schedule is confidential and therefore unknown to third party service providers, but known to joint venture participants who may, if they so choose, compete with third parties for the provision of services to EGL; and
- (b) the ring-fencing provisions appear to only protect AWB information being disclosed to GrainCorp and vice versa. Third party information is not protected, so that EGL would be able to reveal, for example, confidential third party information it obtains to AWB and GrainCorp.

In order to address these concerns, Pacific National would like to see the Commission put conditions on its authorisation of the joint venture as set out below.

## 4.3 Competitive neutrality

Pacific National believes that competitive neutrality should be maintained by the AWB/GrainCorp joint venture.

By competitive neutrality, we mean that neither AWB nor GrainCorp should enjoy a competitive advantage over competitors or potential competitors in the provision of grain supply chain logistics services (such as rail haulage) to EGL by virtue of their position as shareholders of EGL.

## 4.4 Ring-fencing and confidential information

Pacific National is of the view that authorisation of the joint venture should be conditional upon the setting up of appropriate ring-fencing arrangements designed to protect third party information.

Naturally there is an inherent problem with disclosure to the board of EGL given common directors with its shareholders.

The ring-fencing arrangements should be designed to protect both:

- (a) confidential information disclosed by third parties to EGL in negotiations or tender for the provision of services to EGL; and
- (b) confidential information collected by EGL in the performance of a service contract between EGL and a third party service provider.

External disclosure by EGL should be prohibited with limited exceptions for, for example, disclosure to external consultants or advisors provided they are not also consultants or advisors to AWB or GrainCorp. There is a particular concern here if certain services, such as legal or accounting services, are to be provided to EGL by its shareholders, that third party commercially sensitive information be quarantined from shareholders; and

In terms of internal disclosure, disclosure should be limited to individual officers or employees of EGL, and withheld from any individual officer or employee of AWB or GrainCorp who does not have a legitimate interest in EGL's business. Relevant safeguards would need to be in place in terms of transferring and seconded employees.

Appropriate exceptions could be made if required for the purposes of negotiating or administering service contracts, but only to the extent necessary to do so.

#### **4.5 Objectivity and transparency**

Conditions must be imposed to ensure that EGL does everything necessary to ensure that it deals with third parties and shareholders on a fair and non-discriminatory basis.

To this end, conditions of the authorisation should be that:

- (a) EGL will not make any decision or act in any manner that unfairly discriminates in favour of its shareholder, or unfairly discriminates against any third party competitor of the shareholders in relation to the terms or conditions on which services are provided to EGL;
- (b) in performing their functions, the relevant officers of EGL must not have regard to the interests of their shareholders in such a way that is unfair to the interests of third party service providers;
- (c) criteria must be established by EGL on which it will choose service providers. These criteria must be publicly available and all decisions as to choice of service providers must be made by EGL based on these stated criteria and no other criteria;
- (d) safeguards should exist to ensure these criteria are drafted objectively and not in such a way as to prevent or hinder a third party from competing with one of the shareholders;
- (e) EGL must deal with third parties in the same way as it deals with its shareholders and if shareholders have access to any relevant information, then that information must also be provided to third parties.

NON-CONFIDENTIAL VERSION

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# Grain Supply Chain Performance And Issues

Presentation to the ACCC 25th November 2004

Pacific National  
Sydney  
November 2004

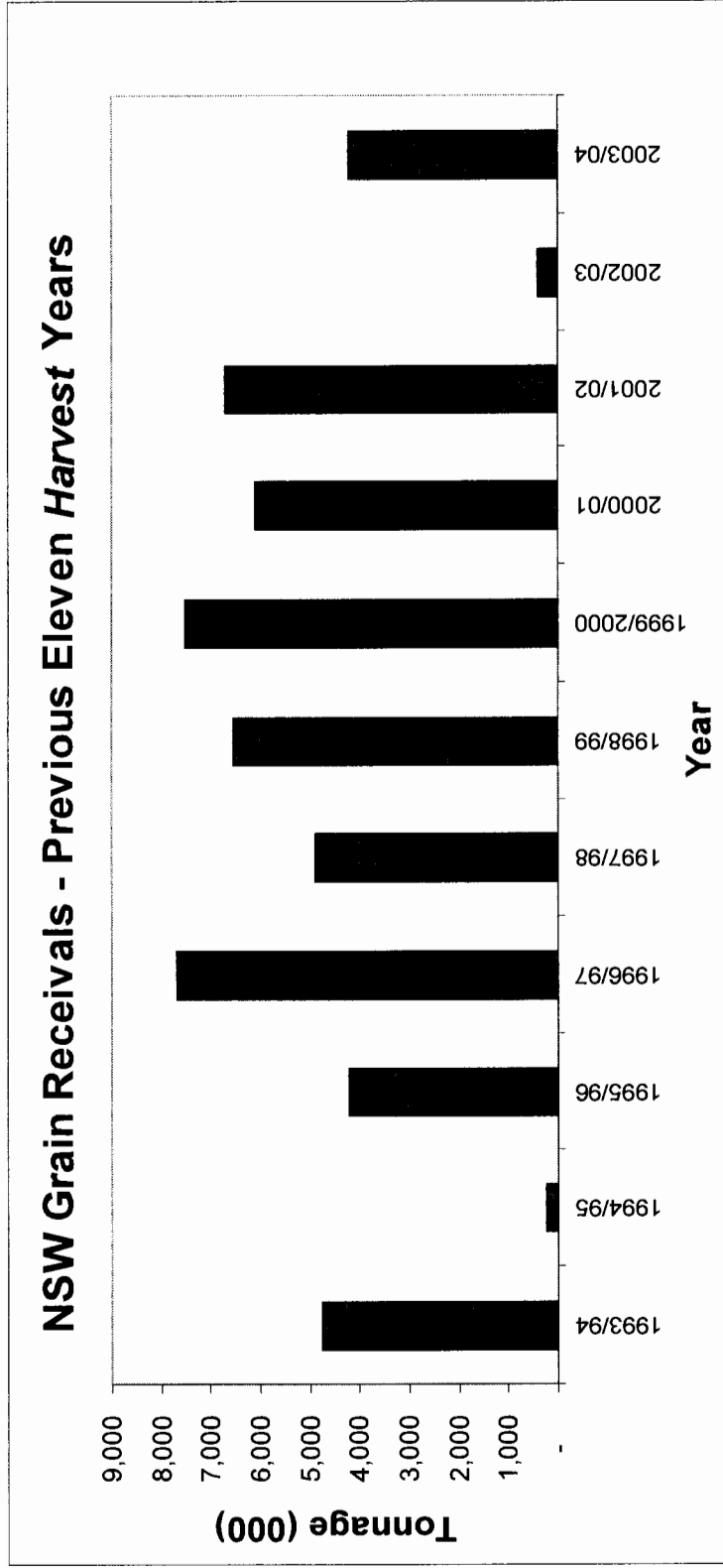
**I. GRAIN SUPPLY CHAIN**

Grain Supply Chain...

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## HIGH YEAR TO YEAR HARVEST VARIABILITY CREATES INEFFICIENCIES AND RISK FOR ALL SUPPLY CHAIN PARTICIPANTS

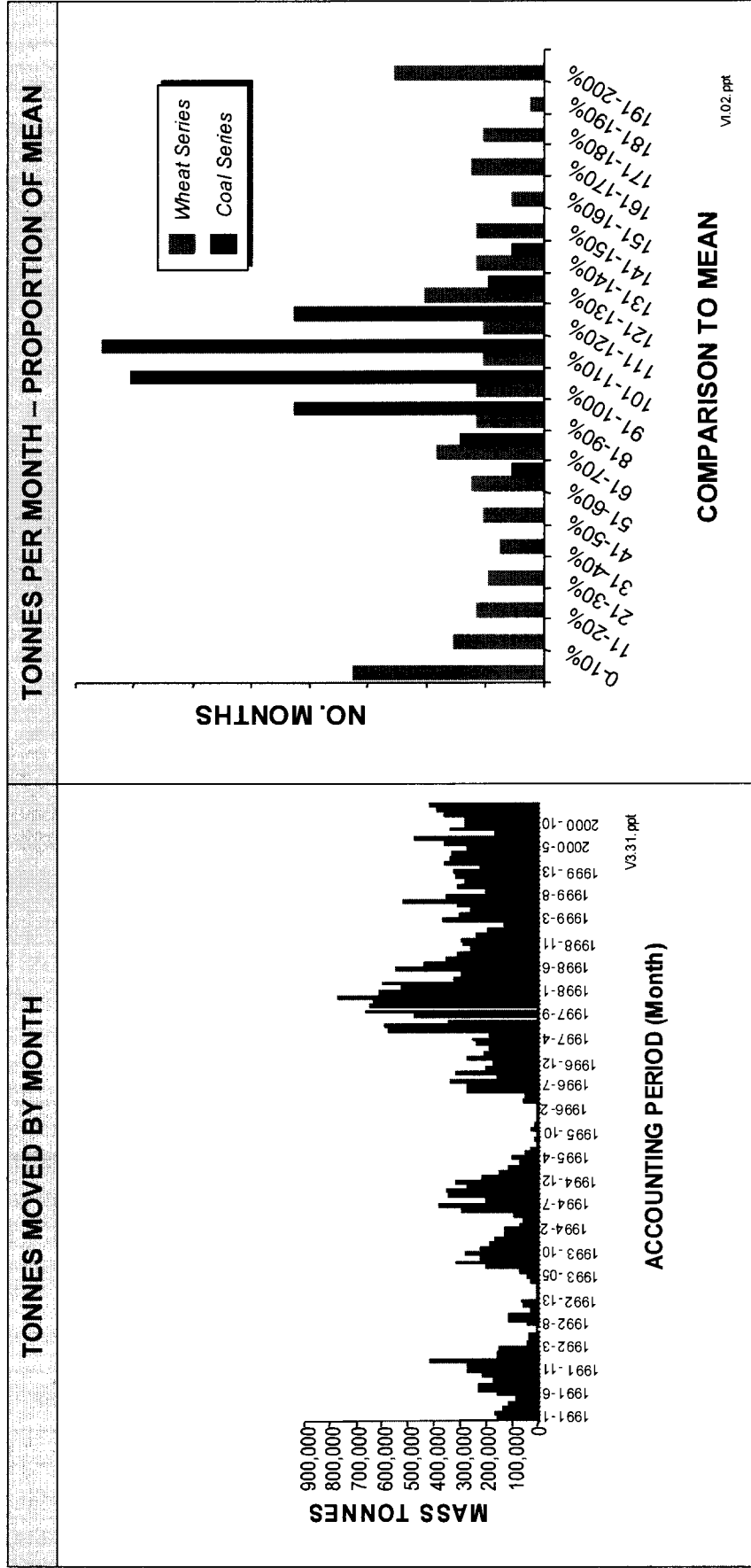
- Econometric analyses indicate that rainfall is responsible for > 90% of volume.



Grain Supply Chain...

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**INTRA-SEASONAL VARIABILITY, WHICH IS CONTROLLED BY EXPORT MARKETERS AND BULK HANDLERS, IS EQUALLY VARIABLE**



Grain Supply Chain...



**SUPPLY CHAIN PARTICIPANTS HAVE EXPANDED THEIR ROLES TO ENTER NEW AREAS**

	GRAIN SUPPLY CHAIN									
	HISTORIC FUNCTION					DESIRED FUNCTION				
	Off Farm Trucking	Silos	Rail Linehaul	Domestic Trading	Domestic User	Ports	Shipping	O/S Marketing		
Other Rail Operators			●							
Pacific National										
Traders		●				●				
Bulk Handlers										
AWB				●					●	
AWB	▲	▲		●		▲				
Bulk Handlers	▲	●	▲	▲						
Traders	▲	▲		▲						
Pacific National			●							
Other Rail Operators	▲		▲							

● = Traditional function      ▲ = Expanded Role



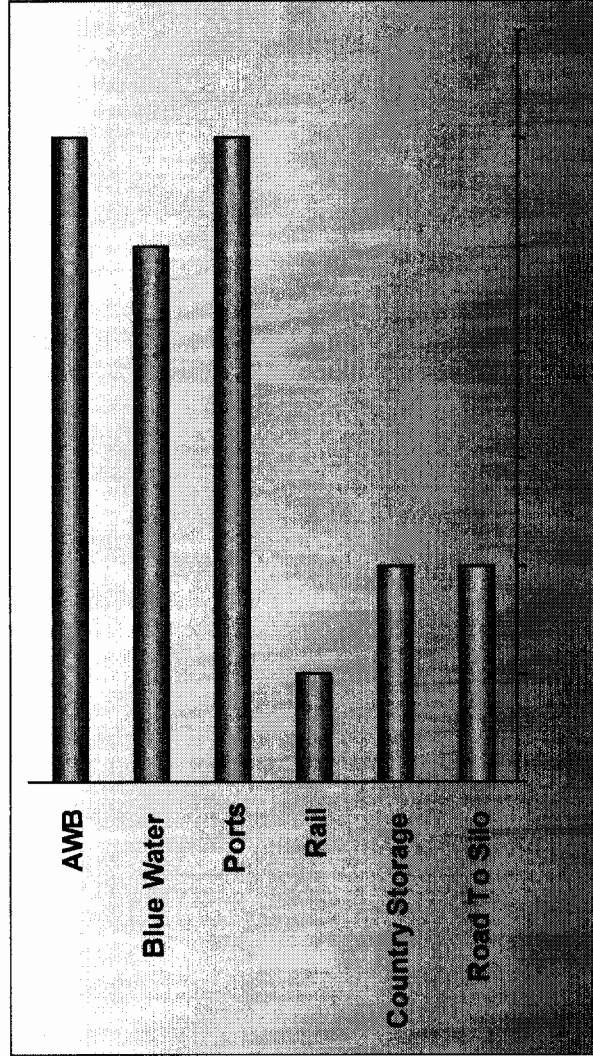
Grain Supply Chain...

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**EVEN ON A HIGHLY DEPRECIATED ASSET BASE, "ABOVE RAIL" IS MARGINALLY PROFITABLE, AND LOSES MONEY IF "BELOW RAIL" REAL COSTS ARE INCLUDED. THE VALUE IS ELSEWHERE IN THE SUPPLY CHAIN**

- Since this is based on the written down values, there is not the returns to allow rail to re-invest based on the current assignment of value

**Relative returns per tonne (avg of seasons on current estimated cost and revenues)**

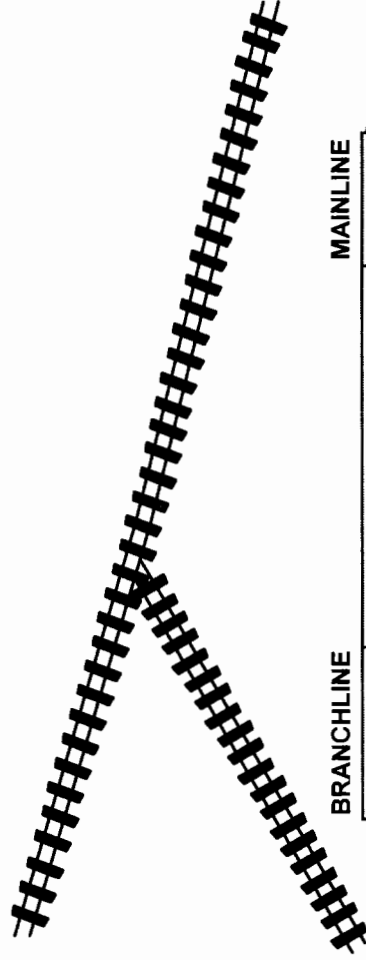


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**II. EXISTING RAIL PERFORMANCE**

## THREE FACTORS HAVE INHIBITED INVESTMENT IN THE RAIL COMPONENT OF THE SUPPLY CHAIN FROM SILO OUTLOADER TO PORT

- Investment returns require complementary investment in silos, track, and “above rail” assets
- Bulk handler’s operating model is also generally inconsistent with low cost rail operations:
  - High cost silos; restricted opening hours and slow outloaders
  - Selection of sites for cargo assembly
- Falling real prices for rail services

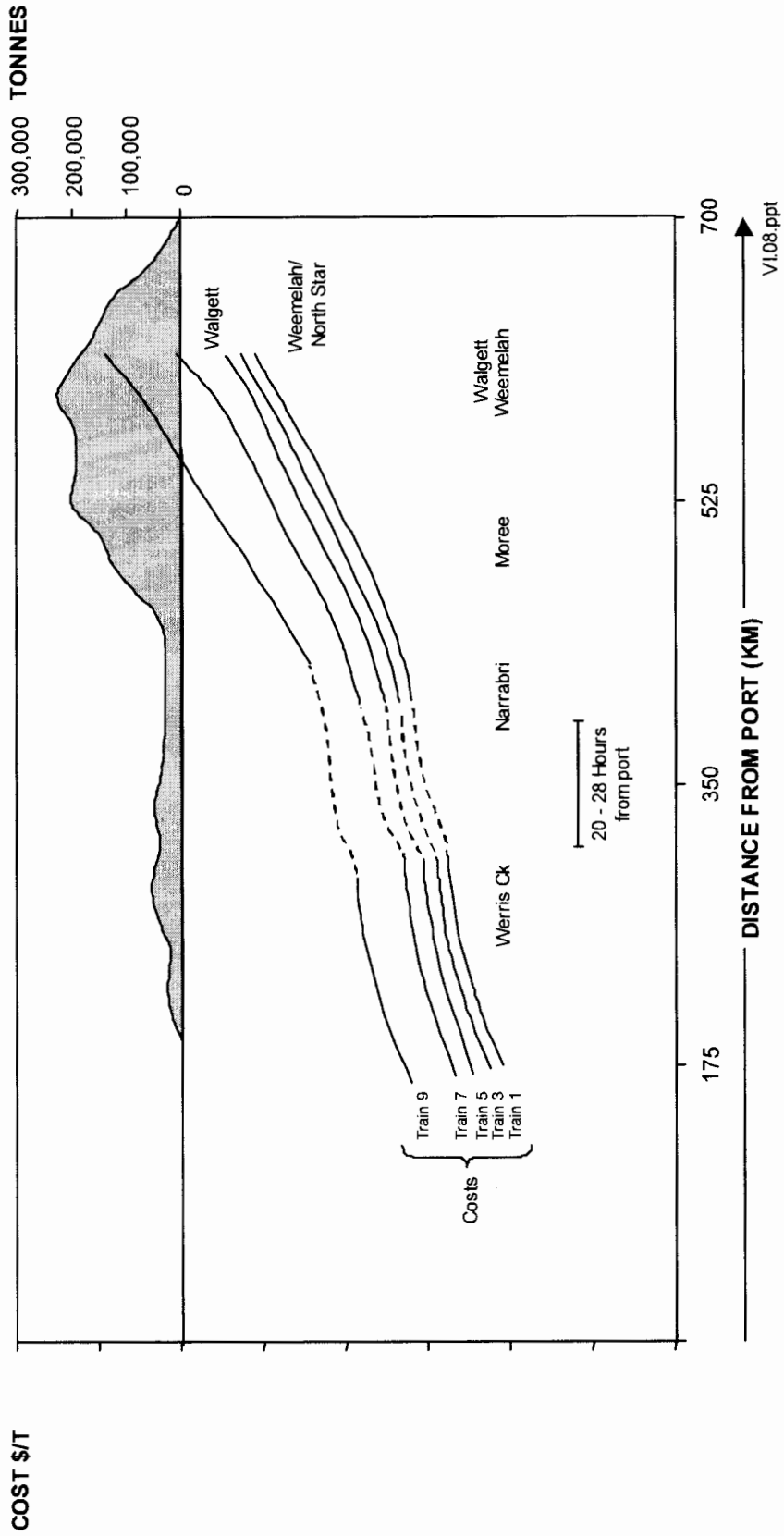


BRANCHLINE	MAINLINE
25	50
92%	100%
Yes	No
48 Class	Any
600	450

Grain Supply Chain...

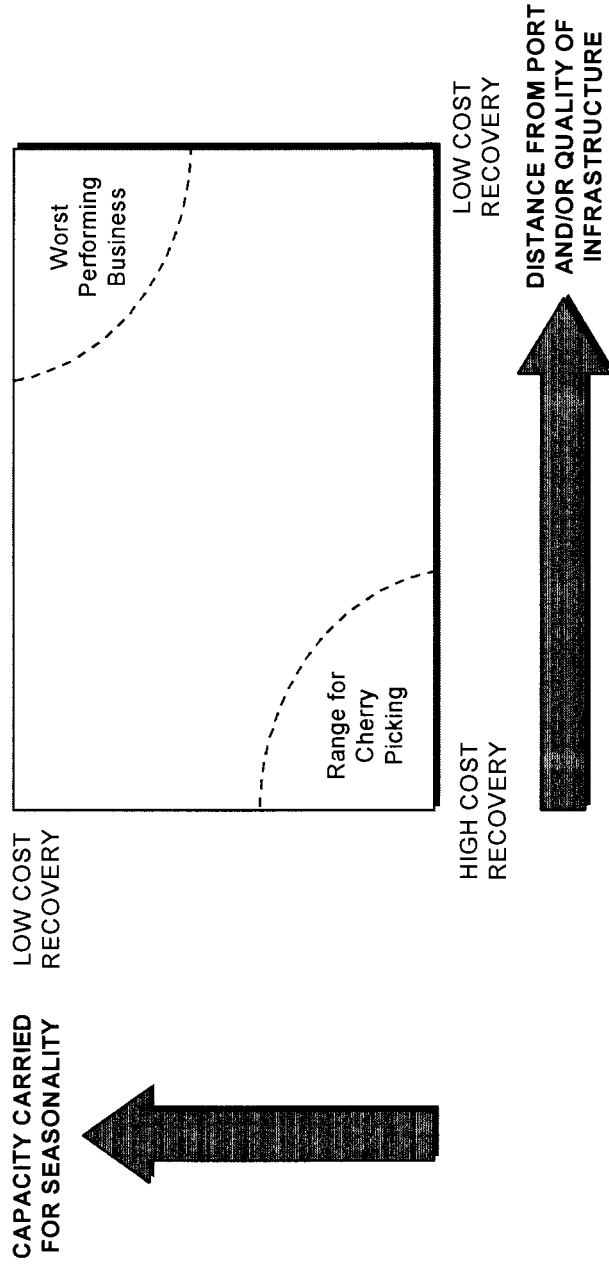
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**THE VOLUME VARIABILITY, BOTH INTRA AND INTER-SEASONAL, DRIVES EVER HIGHER COSTS WITH EACH ADDITIONAL TRAIN OFFERED TO THE MARKET**



**VARYING RETURNS ACROSS SITES, AND THE COST OF ACCOMMODATING VARIABILITY COMPARED TO A STEADY "BASE LOAD" TASK LEAVES PACIFIC NATIONAL VULNERABLE TO CHERRY PICKING**

- Contracts with Government restrict Pacific Nationals ability to address this commercially

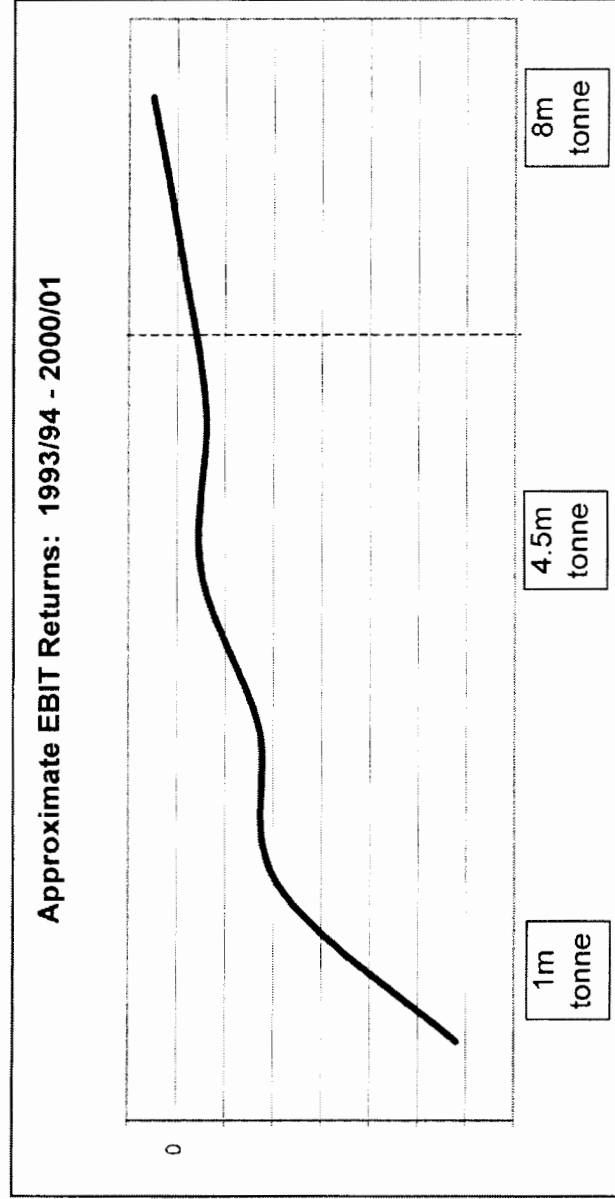


Current Performance...

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## **NSW GOVT CSO MASKED UNDERLYING POOR ECONOMICS IN ANYTHING OTHER THAN THE WORST SEASONS**

- Historical data suggests that the "break-even" harvest volume required under the FreightCorp CSO environment and associated cost structure was 6.5 – 7.0m tonnes
- This volume was only achieved 3 years in every ten.

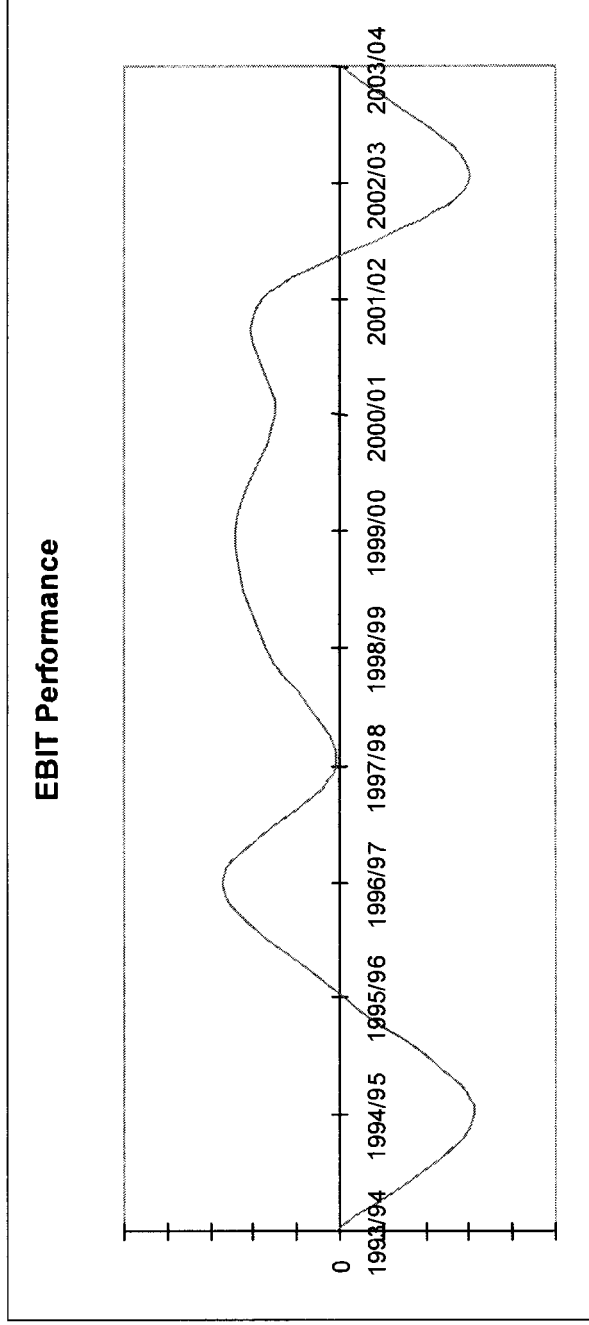


Current Performance....

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**THE WORK UNDERTAKEN POST-SALE HAS MOVED THE "BREAK-EVEN" VOLUME POINT DOWN MATERIALLY**

- At this particular cost and revenue base, a negligible small EBIT return would have been achieved over the eleven years 1993/94 to 2003/04
- This equates to a small average return per year



**III. PROPOSED JV AND FUTURE ISSUES**



**THERE ARE SEVERAL STRUCTURAL PROBLEMS WITHIN THE SUPPLY CHAIN WHICH CONTINUE TO CREATE INEFFICIENCIES**

- Five of the major impediments are highlighted, with the first two encompassing mis-aligned capital investment. Government inability to commit to branchline infrastructure also inhibits investment

<b>Inefficiency</b>	<b>Description</b>
Sub-optimal trade-off between rail efficiencies and storage capability	There is no opportunity to trade additional storage capability (e.g additional storage, fast outloaders etc) against improved rail efficiencies, or vice versa
Sub-optimal trade-off between storage operating hours/times and rail assets and resources	Rail operates 24hrs – but are often forced to operate between tight storage windows; 8hr load “up-country” and 8hr load “at port”.
Surplus labour between Pacific National and GrainCorp at all interfaces	Train crew are underutilised at loading points (15,000 hours p.a) and discharge points (10,000 hours p.a)
No consideration of cost of intra-seasonal variability	Additional rail resources required within the year – no confidence that optimal trade-off achieved
No co-ordinated short term planning of grain accumulation and delivery	Consistent planning and communication errors

Proposed JV And Future Issues...



**APART FROM PARTIAL BENEFIT IN THE FOURTH AND FIFTH POINTS, THERE IS NOTHING IN THE PROPOSED JOINT VENTURE WHICH IS CAPABLE OF ADDRESSING THESE KEY POINTS**

- Identified benefits result from the improved relationship between GrainCorp and AWB, rather than any contractual obligations under the JV itself

<b>Inefficiency</b>	<b>Joint Venture Impact</b>
Sub-optimal trade-off between rail and storage assets/resources	No capability of addressing over and beyond previous arrangements
Sub-optimal trade-off between storage operating hours/times and rail assets and resources	No capability of addressing over and beyond previous arrangements
Excess resources between Pacific National and GrainCorp at all interfaces	No capability of addressing
No consideration of cost of intra-seasonal variability	AWB and GrainCorp may address storage aspects, but not rail which has a higher exposure to intra-seasonal variability
No co-ordinated short term planning of grain accumulation and delivery	Improved planning between storage and marketing, but not the rail requirements

Proposed JV And Future Issues...

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**MOST OF THESE EFFICIENCY BENEFITS CAN ONLY BE CAPTURED WITH ALL PARTIES TOGETHER, PARTICULARLY THE BULK HANDLER AND THE RAIL OPERATOR**

- Inclusion of Pacific National into export grain logistics chain
  - of greater value if rates and service offerings developed end to end by all participants in the chain
- Alignment of the timing for bulk handling and rail contract discussions
- Alignment of participants and contracts (Government, rail operator, bulk handler, marketers) to a set time period for determination of optimal investment and operating decisions
- Opportunity for coordinated investment in the supply chain to create real efficiencies and increased sustainability

Proposed JV And Future Issues...

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**AS IT STANDS, THERE ARE NO EXISTING LEVERS AVAILABLE FOR PACIFIC NATIONAL TO JUSTIFY RE-INVESTING IN THE BUSINESS, AND HENCE DISINCENTIVE TO CONTINUE IN THE BUSINESS BEYOND 2007**

- Existing price and service caps do not allow the pricing of the business to follow the cost curves
  - every opportunity for competitors to cherry pick, including members of the new Export Grain Logistics joint venture
- Likelihood of continued deterioration of track infrastructure
- Risk is mis-placed in the supply chain; in particular, intra-seasonal risk and loading risk (of wagons)

Proposed JV And Future Issues...

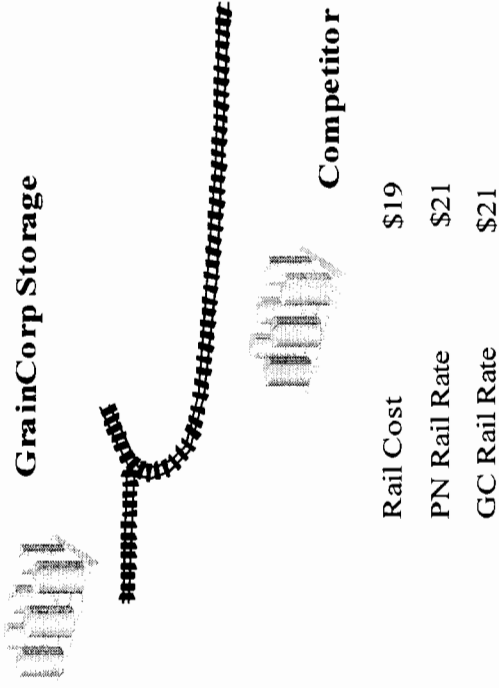


## IT IS UNLIKELY THAT THE NEWLY FORMED EXPORT GRAIN LOGISTICS JOINT VENTURE CAN REDRESS SOME OF THESE ISSUES

- Indeed, the operation of a GrainCorp train, with submissions for pricing of services already received by Export Grain Logistics, gives Pacific National concerns about the venture
- The opportunity for GrainCorp to provide less than cost recovery rates for rail to receive grain at their silos, and then more than recover this through the incremental return made on the silo receipt, threatens to further reduce rail returns

Rail Cost	\$20
PN Rail Rate	\$22
GC Rail Rate	\$19

Low rail rate encourages grain to be delivered to GrainCorp – incremental revenue \$10 per tonne and incremental cost \$3 – more than making up rail rate losses



Proposed JV And Future Issues...

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**IF THE JV CONTINUES IN ITS CURRENT FORM, SIGNIFICANT SAFEGUARDS INCLUDING FULL TRANSPARENCY OF HOW THE TASK IS ALLOCATED ACROSS OPERATORS (GRAINCORP TRAINS IN PARTICULAR) IS ESSENTIAL**

- The volumes and locations of sourcing for the GrainCorp train must be transparent both in the bidding process and on a day to day operational basis
- Particular attention would need to be paid when GrainCorp is servicing its own sites
- Clear illustration is required of the sections of the supply chain in which Export Grain Logistics expects to liberate value, particularly given that there is no opportunity for the JV to control anything in its own right other than the rail contract