TRADE PRACTICES ACT 1974

Australian Competition and Consumer Commission

Pre-decison conference

Minutes

Applications for authorisation (A30233, A30234 and A30235)

lodged by

GrainCorp Operations Ltd, AWB Ltd and Export Grain Logistics Pty Ltd

in relation to proposed Joint Venture arrangements for export grain freight and logistics in the eastern states of Australia.

14 February 2005
The Grace Hotel, Sydney

The information and submissions contained in this minute are not intended to be a verbatim record of the pre-decision conference but a summary of the matters raised. A copy of this document will be placed on the ACCC's public register.

Attendees:

Australian Competition & Consumer Commission	**Dr Stephen King (Chair)** Commissioner **Mr Scott Gregson** Acting General Manager - Adjudication **Mr David Hatfield** Director – Adjudication **Mr Paul Hutchison** Director - Mergers
Austport Project Advisory	**Mr Robert Taylor**
AWB	**Mr John Crosbie** General Manager, Supply Chain Operations
GrainCorp	**Mr Neil Johns** Business Development Manager **Mr Dave Poddar** Partner, Mallesons Stephen Jaques **Ms Jacki Cremer** Solicitor, Mallesons Stephen Jaques
Pacific National	**Mr Stephen O'Donnell** CEO **Mr Garry Malloy** General Manager – Rural & Bulk Division **Ms Sue Fairbairn** Senior Legal Counsel **Mr Bruce Lloyd** Partner, Clayton Utz **Ms Simone Warwick** Solicitor, Clayton Utz

Australian Bulk Alliance	**Mr John Warda** ABA Board Director and General Manager, Storage and Handling, ABB Grain **Mr Rob Taverner** Supply Chain and Assets Manager, ABB Grain
Elders International Australia Ltd	**Mr Malcolm McMahon** Trading Manager - grain
NSW Farmers Association	**Mr Nick Bryant** Senior Analyst **Mr Dougal Gordon** Senior Policy Manager
Brooks Grain	**Mr Chris Brooks** Managing Director

Conference commenced: 10:30am

Introduction

ACCC Commissioner Dr Stephen King welcomed attendees, made some introductory remarks outlining the purpose of the conference and declared the pre-decision conference open.

Opening statement

Commissioner King invited the party that called the conference, Mr Robert Taylor of Austport Project Advisory to make an opening statement.

Mr Taylor made the following statements:

Austport is proposing to develop a new and independent multi-user bulk handling facility at the Port of Newcastle. The proposed Joint Venture would have significant detrimental impacts on the development of such a facility.

Mr Taylor identified a number of concerns, including:

- Skewing of rail rates
- Concerns regarding effective ring fencing of information
- Skewing of assigned costs by transfer pricing which would distort the rail market
- Distortion of the risk/reward tradeoff in the supply chain
- Distortion of the allocation of wealth to growers.

Austport believes the impact of the joint venture on ports has not been well dealt with in the public material to date and it may be the most significant issue. Mr Taylor considers it is not clear how grain will be allocated to the existing terminals.

The impact of the joint venture operating under interim authorisation has been negative on Austport's proposals to develop a competing port facility. He expressed the view that potential partners gave up pursuing the proposal without even going through the details. The general perception was that interim authorisation meant final authorisation was a done deal.

Mr Taylor submitted that the ACCC should determine if the applicants have explored alternatives to the current joint venture proposals.

Mr Taylor posed a series of questions:

- Have the applicants disclosed all relevant information?
- What information has not been provided and why?
- What benefits to the applicants have not been explicitly disclosed?

Austport believes there are benefits that have not been disclosed. There are also very significant anti-competitive detriments. Further, the interim authorisation has allowed significant detriments to occur which can't be undone.

The Draft Determination is silent on how the JV will work in practice. Will the arrangements just default to existing port facilities (which are owned by GrainCorp)?

Austport believes the joint venture would affect the whole industry at all levels. There has been a shift over time in the Australian economy to increasing concentration in industries, which is not good from a competition perspective.

With respect to Austport's proposed new bulk handling facility at Newcastle, if you remove grain from the transaction, you lose significant economies of scale and it would threaten the viability of the new facility.

There are no assurances in the current arrangements that the right balance of risk and reward will be achieved to drive the best investment.

Mr Taylor argued that many of the benefits proposed by the applicants are questionable. In these circumstances you should question the motivation of the applicants.

He expressed the view that the application and the single desk are entwined. This needs to be examined more carefully by the ACCC. If the single desk is removed any authorisation should immediately fall away also.

Commissioner King invited the applicants to make an opening statement. The applicants declined the offer to make an opening statement, preferring to hear the other party's statements first and then respond to them all at the end.

Commissioner King invited Pacific National to make an opening statement.

Mr Stephen O'Donnell provided written copies of an outline of his presentation, including some graphs and charts for people to refer to during his presentation. *(A copy of Pacific National's presentation can be found on the ACCC website)*

Mr O'Donnell made the following statements on behalf of Pacific National (PN):

The current joint venture structure is focussed on rail freight and does not extend to arrangements with storage and handling, which is critical to optimising the supply chain. EGL must have contracts in place with the other segments of the supply chain to be able to achieve the claimed efficiencies. PN is not aware of any such contracts. These arrangements must be transparent to ensure the right incentives are in place for industry participants.

Without improved ring fencing arrangements, PN will not provide EGL with sufficient information for it to be able to achieve the claimed efficiencies.

Transparency in the allocation of rail freight charges across the network is critical to avoid distortion of charges at silos – particularly to benefit GrainCorp and AWB at the expense of other storage and handling providers.

There is significant variation in harvest volumes, such that there is decreasing expected utilisation rates for rail equipment in Victoria beyond a million tonnes of grain.

This makes the tendering process for grain rail freight very important. If GrainCorp gets first preference (for the GrainCorp owned train), it has a high probability of winning tasks. This means that PN faces a lower probability of winning tasks, which means it would need to share its fixed costs over less expected tasks. This would result in PN having to bid at a higher level.

PN is concerned that GrainCorp may invest in more trains over time. These arrangements could favour GrainCorp and AWB's facilities and enable them to establish a rail freight business.

Much of the PN locomotives fleet requires recapitalisation. Lack of clarity on the processes used by EGL will lead to uncertainty and hence lack of investment. Business needs certainty and a sustainable base to continue operating.

PN cannot have a normal commercial relationship with EGL. The relevant parameters need to be clearly set out up front. The tender process must be clearly defined as well as how the rail freight task will be managed and allocated over the period.

There must be an annual audit of the tendering and task allocation processes.

At the end of 2007, PN's community service obligations with the NSW Government expire. There is sufficient uncertainty going forward from that point as to constitute a material change of circumstances. Any authorisation granted should be reviewed at that time.

This joint venture will lead to reduced supply costs. Unlike the Hunter Valley Coal Chain Logistics Joint Venture, this joint venture does not include representatives of each level of the supply chain. If, however, the ACCC decides to grant authorisation, it must put in place measures to address PN's concerns.

Mr Taylor of Austport commented that increased storage at port would enable increased rail utilisation.

Commissioner King invited representatives of the Australian Bulk Alliance to make an opening statement.

Mr Warda made the following statements on behalf of The Australian Bulk Alliance and ABB Grain:

ABB has a cost advantage in storage and handling over GrainCorp, but this gets masked by the rail freight component. Any further efficiency gains ABB can make (such as increases in operating hours) must then be negotiated with EGL, since it is impossible to separate storage and handling from freight. Given EGL's shareholders are competitors of ABB, this reduces ABB's incentive to innovate and makes ring fencing of information by EGL critical.

The key issues for ABB are:

- Treatment of confidential information – not satisfactorily addressed in current arrangements
- Potential for discrimination when seeking access to scarce rolling stock – concern that EGL may favour its shareholders
- Transparency with respect to allocation of rail freight charges – it is not clear that the Estimated Silo Return contains what was actually negotiated
- Stock allocation to ships and movements from silos other than those owned by AWB or GrainCorp

ABB wants to see some evidence of the claimed public benefit and to understand how it is derived.

Commissioner King noted that the types of potential discrimination described could potentially occur in the absence of the joint venture and asked how that potential would be increased under the JV arrangements.

Mr Warda responded that with the JV in place, GrainCorp will know from EGL what ABB's storage and handling costs and its port costs are. This would enable it to marginally price under ABB and take business off ABB based on that information advantage. With the JV, AWB will have an incentive to favour GrainCorp sites that it did not previously have.

Mr Brooks offered to provide another example of potential concerns.

Commissioner King invited Mr Brooks to provide the example and to make any other opening statements he wished.

Mr Brooks made the following statements on behalf of Brooks Grain:

As an example of the way ownership changes can alter incentives and hence affect outcomes, barley from the Southern Riverina region is 'freight indifferent' between Melbourne and Port Kembla. In the past, all barley from the region went to Melbourne (since GrainCo was a part owner of the Melbourne Port Terminal). Since GrainCorp acquired GrainCo, all Southern Riverina barley now goes to Port Kembla (which GrainCorp owns).

The introduction of competition between grain buyers has led to increased returns to growers. It is significant that in the domestic market, the largest volumes are not made up of the three largest export players. Deregulation will let competition emerge to the benefit of the growers.

The obligation AWB has to maximise returns to growers is an obligation of AWB International. The application, however, has been submitted by AWB Limited, which may not be under the same obligation with more of a focus on returns to shareholders.

There is a 30% difference between the standard freight rates other industry participants face and that negotiated by AWB. This translates to roughly a $7/t saving, which exceeds the typical $3-5/t margin most industry participants are operating on. The savings available to AWB should be available to all.

Stock swaps are an important issue that have not really been discussed in submissions. This may be because industry participants will continue to need to deal with AWB and GrainCorp and do not want to jeopardise their commercial relationships.

The applicants can buy cheap grain in remote areas and then win grain feed contracts at higher prices. There are also blending opportunities available to the applicants that are not available to other grain traders.

The $7/t rail freight deduction achieved through the JV will lead directly to a parallel increase in price to domestic buyers for them to be able to attract grain away from export markets.

Brooks experience is that it is very difficult for parties other than AWB and GrainCorp to export grain. It is difficult to get a ship nominated on the stem, to get access to rail freight, to get necessary access to the port.

If the ACCC decides to grant authorisation, it is important that there be ongoing monitoring of rail freight efficiencies. These should be transparent and ideally available to all. Transparency with regard to stocks is also important. Without it, the JV will have access to market information early in the harvest about various growers grain volumes and quality. This would give the applicants a significant commercial advantage in grain trading.

GrainCorp know which grower owns what grain of what quality in which silo before anyone else. That information currently flows through to GrainCorp marketers who contact growers directly. This is in contrast to the situation in South Australia, where everyone knows who has what grain where. This greater transparency results in competition between buyers and hence better returns for growers.

Commissioner King invited representatives of the NSW Farmers Association to make an opening statement.

Mr Gordon and **Mr Bryant** made the following statements on behalf of the NSW Farmers Association:

The NSW Farmers Association has in principle supported the JV arrangements on the basis that the benefits will flow through to growers as claimed by the applicants. No information has been received yet from the applicants to enable the Association to form a view on the impact of the JV as operating under the interim authorisation.

The Association has tried to monitor the impacts of the JV during the current harvest and has some concerns. For example, at the GrainCorp Temora subterminal, storage and handling, freight and port costs contained in the Estimated Silo Return have increased by 17%, rather than decreasing.

The Association understands that GrainCorp charges a fee for delivery to a GrainCorp port for grain from a non-GrainCorp silo and that this fee was paid by AWB (amongst others). It is not clear whether this fee is still being paid by AWB, but there would appear to no longer be a justification for it or for passing it on to growers, given the JV arrangements.

The ACCC should compare ESR's for 03/04 with those in 04/05 to see what efficiencies the JV has been able to achieve – and to determine whether the example of Temora is more widespread.

There are mixed reports of the JV's operation – the Association hears reports that it is working well, but also hear rail freight providers complaining that co-ordination is not good and trains are being parked or delayed. Inefficient rail movements increase the cost to growers.

The Association is concerned about the potential for GrainCorp to cherry pick the more profitable rail freight tasks. Rail providers should be involved in the JV to ensure some (lower volume) growers don't get marginalised.

Commissioner King invited the representative of Elders International Australia to make an opening statement.

Mr McMahon made the following statements on behalf of Elders:

Elders expects to provide a submission to the ACCC by the end of the week opposing the grant of authorisation. The major concern regarding the JV is the potential use/misuse of third party commercial information.

The JV is a good commercial opportunity for the applicants, but is not a good opportunity for the industry. The arrangements are not transparent and it may not be possible to make them transparent enough to address the concerns.

The JV will kill off any investment by other grain storage and handling providers. The Grainco facility in Melbourne could not have proceeded without AWB committing to take or pay contracts. In future, AWB will not have any incentive to enter into joint ventures with other industry participants, it will favour its own (JV) facilities.

Elders believes AWB would be able to use its export grain volumes to achieve significant rail freight discounts and that these would flow through to its domestic volumes as well.

Rolling stock can be very scarce at peak times, especially if you are not one of the big 2 or 3 players. This JV will further entrench the applicants ability to access scarce rolling stock at the smaller player's expense.

In Western Australia, Elders had to go to CBH to sublet already committed rail stock. CBH had negotiated a significant discount to the standard rate (NACMA), but Elders had to pay the NACMA to CBH to use the stock.

Stock swaps have been an important aspect of grain trade. The freight benefits achieved by the JV will mean that no-one else can compete on swaps.

When grain is delivered to a storage facility at port, the applicants cannot know where its ultimate destination is – ie for export or to a domestic acquirer (such as Barrett Burston Malting at Geelong). Given this uncertainty, it is not clear how 'domestic' grain can be treated differently to 'export' grain when determining rail freight charges.

The JV will have a significant impact on all grains and other products. For example, fertilizer can be back hauled from port back to farms in trains that take grain the other way. As a result, AWB were able to offer a rebate through Landmark that Elders had to match (so as not to lose market share) but could not recoup in the same way AWB could (through JV freight savings).

Elders queries whether the benefits achieved by the JV will be passed on. The evidence suggests not all will be passed back. The JV will stifle growth in infrastructure development and will decimate competition that exists today.

If the ACCC decides to grant authorisation, it must make sure that all participants share the same freight rates, including the discount.

Statements in response

Commissioner King invited representatives of the applicants to provide a response to any of the issues raised.

Mr Crosbie (AWB) stated:

The applicants will respond to the issues raised by Austport in writing at a later date. Nevertheless, the JV doesn't impact on ports at all. The JV has no relationship with ports. It is the owners of grain that deal direct with port owners. The JV is just a servant of the grain owners.

AWB spoke to a number of rail freight providers, Queensland Rail, Pacific National and Freight Australia, who all identified potential efficiency savings of between 10-15%. The ability of the JV to obtain much of these benefits depends on the willingness of rail providers to participate.

Since it commenced at the start of this harvest, the JV has made savings – although these have not always been passed on. For example, in NSW the current freight contract sets out the rates and is still in place.

The sub terminal at Werris Creek is a good example of the benefits the JV can bring. With the flooding and resultant down time at the Port of Melbourne recently, the JV negotiated the opening up of Werris Creek and moved grain from up country closer to port. This enabled increased export capability when the port became operational again and delivered significant rail efficiencies.

The JV has also been able to avoid some congestion and associated costs in moving grain to Port Kembla.

The JV is negotiating with PN to optimise the use of rail assets in NSW, which it hopes will be reflected in future rates. The JV is also negotiating with PN to reallocate rail resources between NSW and Victoria, given the large harvest volumes in the north and reduced volumes in the south.

The JV has been able to negotiate with GrainCorp to deliver more flexible port operations – which GrainCorp has previously been unwilling to provide due to the increased cost. The JV is focussing on more efficient wagon loading practices and is working with PN on training and new specifications.

It is still early days in terms of the delivery of benefits. The JV needs to be allowed more time and needs a commitment by PN and QR to be willing to capture the benefits.

With respect to the likely environment beyond 2006/7, PN bought a contract that expires at that time and it will have to address the issues that arise when that contract expires regardless of the JV's existence or not.

The freight rate at Temora increased according to the formula in the existing contract and is not reflective of the JV arrangements.

Similarly in Queensland, there is a current contract in place which means the potential efficiency gains are not yet reflected in the freight rates – but there has been better coordination of the freight task.

In Victoria the JV has negotiated new rates – which are higher than before, but the ACCC should speak with PN about that.

Mr Johns (GrainCorp) made the following statements:

Many benefits have been achieved by the JV, but they have been captured by PN. There is no ability to compete with PN in Victoria. Rate reductions in NSW are also limited by the existing contract. There is an ability to pass benefits through to growers – particularly in the longer term.

With respect to the concerns expressed by the ABA, it is the owner of the grain that dictates the flow of grain. AWB has that responsibility. It is AWB that sets the storage and handling contracts, the JV acts as a slave to AWB in that role.

AWB has an incentive to use the Melbourne port which will benefit ABA as a joint operator of that port.

PN's concern regarding the entry of others into rail freight should be regarded as a competitive benefit to other market participants.

GrainCorp has reduced the fees for Grainflow grain moving to GrainCorp ports, with a resultant benefit to growers.

Pacific National have agreed that there is significant potential benefits to be achieved, around $15m. The question is can we achieve them, and who gets them?

General comments

Commissioner King opened the conference to general discussion. A number of persons present provided comments including:

Mr O'Donnell (PN) agreed that there are potential benefits to be achieved, but questioned whether the JV was the best vehicle to achieve them. PN consider AWB could have taken the lead to try and achieve these benefits earlier.

PN is very concerned that it is being forced to negotiate with a competitor, which makes ring fencing a critical issue.

Mr Brooks (Brooks Grain) stated that he doesn't see the need for the JV as other incentives may be driving some of the claimed efficiencies.

Mr Warda (ABA) noted that in South Australia, tripartite contracts between storage and handlers, rail freight providers and port operators have achieved significant efficiencies. It does not require a JV to achieve the necessary commercial drivers.

Commissioner King asked Mr Warda whether ABA considers that the grain freight task in NSW and Victoria is not as efficient as it could be.

Mr Warda responded that ABA considers there are savings there to be achieved, but doesn't see the need for the JV to achieve them. The JV is one way to achieve the efficiencies, but not the only way, and it raises significant concerns.

Mr Gordon (NSW Farmers Association) sought more information on the distinction between AWB Limited and AWB International with respect to the obligation to pass back savings to growers. Further, the statement at 7.62 of the Draft Determination that benefits will be shared back with growers appears to be inconsistent with the statements made at this conference that benefits can't be shared back due to existing contracts with service providers.

Mr Crosbie responded that AWB Ltd is a servant to AWB International and as such the obligations with respect to growers flows through.

The proposal to examine ESR's as a measure of the success of the JV would be inappropriate. AWB suggests the wheat benchmark formulation used by the Wheat Export Authority is a better measure.

Mr McMahon (Elders) noted that there is significant domestic demand for grain (10Mt) but it was not clear how or when it is determined whether grain is export bound or to be sold domestically. This is important since different freight rates are to be applied depending on whether grain is to be exported or sold domestically. Elders is concerned that the export-based volume discounts will be used to advantage the applicant's domestic operations as well.

Mr Taylor (Austport) raised the following questions:

- Did AWB invest in storage and handling facilities for sound market reasons, or was it trying to shore up its market position?
- Has AWB examined options for third party provision of port services?
- Should we add a single desk for rail negotiation to the single desk for wheat marketing?

The current proposal will not deliver long term benefits. What is needed is new and efficient port facilities.

Mr O'Donnell stated that the variable harvest volumes effectively meant there were two segments to the grain freight task – a baseload component and a highly variable component. Two freight rates could be developed for these segments, reflecting the low cost nature of the baseload segment, compared to the highly variable segment. Alternatively, the costs could be averaged. PN queried the approach the JV would take.

Mr Crosbie responded that freight rates are currently being negotiated with PN and they will be posted as ESRs at silos.

Mr O'Donnell expressed the concern that AWB and GrainCorp silos could be grouped into a baseload category and hence be awarded significantly lower freight rates which would attract grain to those silos and disadvantage all other storage and handling facilities.

Mr Brooks shared this concern.

Mr Taverner (ABA) queried whether the benefits listed at 7.38 of the Draft Determination can really be achieved – particularly the poor utilisation of rail assets due to uneven demand from month to month. Variability in grain volumes has always been difficult to manage and it is not clear how the JV would address this issue.

The ACCC needs to examine data to determine the broader impact of the JV across various jurisdictions.

Commissioner King invited the applicants and others present to provide the ACCC with data on the impact of the operation of the JV under the interim authorisation.

Conference close

Commissioner King closed the conference by noting that the ACCC would provide a further opportunity for parties to make written submissions in respect of its draft determination and requested further submissions reach the ACCC by 21 February 2005.

Commissioner King explained that the ACCC would provide participants with a record of the conference, which would also be placed on the ACCC's public register.

Conference closed: 1.35pm