

Mr. David Hatfield  
Director – Adjudication  
Australian Consumer & Competition Commission

21<sup>st</sup> February 2005

Dear Mr. Hatfield

**RE: EGL JV - ACCC authorisation - Brooks Grain & Elders Limited  
submission**

**1. Purpose**

This is a joint submission by Brooks Grain and Elders Limited ("The Parties") intended to inform the ACCC about the likely net detriment of the Export Grain Logistics Joint Venture ("EGLJV") developed by AWB Limited and Graincorp Limited and their associated entities ("The Applicants"). This submission responds to issues raised in the Draft Determination of 16<sup>th</sup> December 2004, and at the Pre-decision Conference of 14<sup>th</sup> February 2005. This submission aims to highlight the inadequacies of the current JV proposal in terms of its impact on third parties, its limited potential to achieve net benefits, and the lack of any mechanism imposed on the JV parties to ensure the alleged public benefits are delivered.

**2. Introduction**

**The Parties are opposed to the structural approach of the EGLJV as a means of pursuing supply chain efficiency advances and believe that authorisation of the EGLJV is not in the public interest. Should it continue in any form, extensive reforms and adoption of regulatory frameworks are required to at least partially reduce the extent of potential detriment associated with the EGLJV.**

The Parties believe that while potential for supply chain efficiencies exists from a more inclusive approach to supply chain management, the EGLJV may:

- Be over estimating the potential for benefits;
- Be an unnecessary and inappropriate structural approach to pursuing benefits. Experience in other parts of Australia with grain, and in non grain bulk commodity industries, demonstrate that benefits can be achieved and even be improved upon without taking the structural path of the EGLJV;
- Result in partisan pursuit of cost savings, or assignment of grain to particular receival sites, transport alternatives and/or ports to the benefit of The Applicants as service providers and infrastructure owners, while also simply producing risk and cost shift to third party operators;

- Result in the two monopoly export marketers gaining effective control of the transport capacity from country storages to port & major metro domestic markets through their dominant capability to book the use of that capacity. In the eastern States this capacity is the crucial supply chain bottleneck, so any cornering of this capacity by the EGLJV would directly benefit The Applicants non-monopoly businesses, by securing access to that capacity for supply of grain to domestic consumers or export (for non monopoly grains). This has the potential to highly marginalise other domestic traders. There is precedent experience from Western Australia which demonstrates this is a real risk;
- See some accretion of the efficiency gains to the profit of The Applicants commercial operations. The Parties believe that the "Chinese Walls" operated within The Applicants existing businesses are demonstrably not robust, and that therefore such slippage is highly likely; and,
- Produce significant public detriment in the market for storage and handling of grain, and in the market for trading of grain for domestic consumption.

In the end, the alleged beneficiaries of the EGLJV (i.e., growers via higher grain returns) may in fact be the victims; arising from less viable competition for their grain from third parties, who will be unable to compete with the "protection" afforded the two dominant JV partners (AWB Limited and Graincorp).

The Parties note that since preliminary authorisation, the EGLJV has done nothing more novel in coordinating supply chain activities than has occurred prior to the EGLJV, and that there is no evidence of real improvement to date. It is also noted that when asked at the PDC, The Applicants could not provide quantified evidence of efficiency gains achieved under the interim authorisation. The Parties have seen no attempts by the EGLJV to engage with third party owners of storage and handling assets (who compete with Graincorp and AWB receival sites), to identify opportunities for improvement.

The Parties believe that the primary focus of the EGLJV based on cost savings, is a flawed means to maximising grower returns. The eastern seaboard states struggle with transport capacity to get grain to port in the early season period when on average export prices are highest and holding costs are least. The public benefit would arguably better advanced if The Applicants focused on working collaboratively with all major supply chain participants to address bottlenecks and increasing early season capacity (which may even mean it is prudent to incur higher costs),

Use of a "public asset" (i.e., the use of single desk volumes, qualities, and market geographical spreads) via two private entities to drive a net public benefit, requires a measurable and transparent process to ensure those benefits are delivered, and to the intended beneficiaries. The EGLJV arrangements as presented and the interim authorisation contain no mechanisms to measure the benefit, nor a mechanism to review or hear complaints during the course of the authorization period.

The Parties also believe that the EGLJV notion of being "only concerned with export grain" is a flawed concept. It denies the reality of the interdependence of domestic and export grain inventory management, and to argue otherwise is at best naïve, and at worst, contrived for the Applicants' ulterior motives. Indeed, it is this integrated nature of grain inventory management (through swaps across quality, grains, locations, time, transport modes) which creates value for those in the supply chain, including growers, which would be put at risk if the EGLJV was to operated in the clinical export-only manner which the JV promotes.

### **3. Profile of Brooks Grain and Elders Limited**

**Brooks Grain** was established in 1958 by Ray and Bev Brooks, in the NSW Murray River town of Barooga. Brooks Grain has grown to be one of Australia's largest independent grain businesses and now services all major grain growing regions of Australia through its network of agents and offices.

The business today has diversified into four main areas of grain trading, grain storage, transport and direct farm investment.

Brooks Grain is trading over a million tonnes a year across all states of Australia. In 2003 the company formed an international business and trade alliance with Glencore International AG – one of the world's largest commodity traders and privately-owned natural resource companies. Glencore International AG processes and markets millions of tonnes of commodities globally, including wheat, corn, barley, oilseeds, meals, edible oils and rice. This relationship has provided Brooks Grain key insights into the importance of globally efficient logistics from farm gate to end user, with a resultant significant investment in its own storage and transport capability.

Domestically Brooks Grain operates private grain storage facilities for 200,000 tonnes of grain in 10 sites based mainly along the Murray River in NSW. The company also leases storage directly from the main storage and handling companies as well as utilising storage owned and operated by private agents in each state. The Brooks Grain storage business is an accredited National Agricultural Commodities Marketing Association Approved Bulk Handler, one of only five in Australia. Brooks Grain has met stringent selection criteria, incorporating insurance, financial viability, quality of outturn, storage and rates, etc to achieve this accreditation.

The company has its own fleet of prime movers and semi trailers with up to 100 sub-contracted carriers as well as rail freight agreements with the main operators. In the export market, the company has access to contracted shipping lines used to freight Glencore International AG commodities worldwide.

Brooks Grain is therefore well placed to see and understand the farm gate to end user logistics path, together with the essential requirement of cost efficiency and open access to providers of those services to farmers and customers.

**Elders Limited** is a long established Australian agribusiness. It operates across the value chain from farmer to consumer, in an extensive range of agricultural industries. Elders, together with AWB Landmark, represent the two dominant "faces" to farmers across regional Australia.

Elders grain trading interests extend to each state in all grains. In addition, they have their own internal grain requirements for cattle feedlots, along with major export interests in many agricultural products. Elders have not invested (to date) in storage and transport assets, and prefer to rely on an open, competitive service provided by third parties. They are uniquely placed therefore, to assess the potential impact of any restrictions or impediments to cost efficiency in the supply chain. They have no vested interest in assets to protect, other than as a buyer of those logistics services.

#### **4. Potential for cost reductions**

As presented and then discussed at the PDC, the justification of the EGLJV appears to be foremost on cost reduction, rather than examining how to maximise returns. The Applicants accept that more collaborative operation of the supply chain has the potential to create efficiency and thus reduce costs. We understand that there is potential for parties with the scale of task of The Applicants, to hire trains on a term hire (or take & pay) basis from companies such as Pacific National for delivery to seaboard locations for export and domestic use. If grain movements are carefully programmed and co-ordinated between The Applicants and Pacific National, term hired trains may have the potential to work out to be somewhat cheaper than engaging trains on the normal spot tariff rate. To the extent that savings are possible, it seems logical to also try to achieve savings for delivery to domestic customers.

The Parties are concerned that the perceived cost savings may be illusory. For example, Graincorp noted that they see a potential for \$15 million reduction in Pacific National costs, which would equate to around \$2 - 3/tonne in the Victoria - NSW export freight task. However to achieve such savings, there may need to be a smoothing of export sales patterns to take out the seasonal and more short term volatility in export movements that are currently major drivers of rail freight costs: this would mean on average taking longer to export each season's crop.

Australia is a contra seasonal supplier compared to most grain exporting nations. Accordingly over the long term Australia enjoys its highest export prices in a 6-month period beginning from harvest. Selling in the second half of the year delivers lower returns and higher storage and financing costs.

In the above case, a smoother flow of grain exports over the year may be able to produce rail cost savings of \$2 - 3/tonne, but would result in a lengthening of the average holding time for grain. This would see growers incur far more significant storage costs (apx \$1/month), funding costs for growers (apx \$0.75/tonne/month), and lower sales prices for grain held over to the second half of the season (\$0 to \$25/tonne depending on the year and commodity).

In NSW and Victoria, the primary bottleneck that prevents exporters from selling more of the crop in the first half of the year is transport capacity to port, i.e. rail capacity. It may indeed be rational to look at capacity upgrades, increased 24 hour operations and so forth at higher capital and operating cost, to achieve better sales prices, lower storage and financing costs, and overall higher net returns for growers.

The Parties note the success that the Hunter Valley Coal Chain ("HVCC") has achieved, and believes this offers some useful insights to the challenge of increasing export capacity as a means of maximising returns for export grain. The HVCC has focused on working collaboratively with all supply chain participants, to elevate the effective export capacity of existing assets through a combination of improved coordination, operational changes and selective asset upgrades. This has increased export capacity and has allowed increased exports to the net public benefit. And all of it has been achieved without the structural reliance on a Joint Venture company.

To date the discussion about the EGLJV has been about supply chain costs for grain destined for export. The Parties note that domestic consumption of grain in the eastern States is growing rapidly and has the potential to reach 10 million tonnes by 2007, which would often represent over 50% of production. With this prospect in play, it seems incongruous to focus only on pursuing supply chain efficiency advances for export pathway grain, or to only allow the benefits of such gains to apply to export pathway grain.

The Parties are sceptical that any such benefits can be quarantined to export-only grain, and that the Applicants stand to gain very significant competitive advantage (to the exclusion of all other third parties) in both the domestic market (the dominant East coast market), and for all non-regulated export grains (which after October 2005 on the East coast will be all grains except wheat).

The Parties believe that a fundamental rethink is needed by The Applicants of the objectives behind the EGLJV before moving forward. The challenge should be foremost about increasing supply chain capacity: for legacy assets that require a process that encompasses all major service providers and infrastructure owners and service & infrastructure users.

## **5. Potential for detriment**

The Parties believe that substantial public detriment can arise from the EGLJV arrangement. While The Parties believe that other frameworks would be superior means to delivery more efficient grain supply chain activities, we note that The Applicants are currently fixed on their pursuit of the authorisation of the EGLJV.

If the EGLJV is the path The Applicants are determined to take, The Parties believe that applying reforms and reporting obligations ("Reforms") to the EGLJV are necessary to reduce the public detriment.

The detriment revolves around:

- The JV improving information transparency for Graincorp and AWB as owners of key infrastructure, without achieving any improvement for third party asset owners. This will lead to The Applicants being able to make superior investment decisions and operational improvements from a position of information supremacy compared to third parties. We applaud this effort to improve the quality of investment decisions and capital usage in the industry; however, this improvement is quarantined to The Applicants to the exclusion of all other investors in and users of grains logistics infrastructure. Transparency improves for those two dominant parties, but not for parties external to the EGLJV. This will have the impact over time of concentrating grains infrastructure further into the hands of The Applicants, with a lessening of competition for grain alternatives for growers – who are the supposed primary beneficiaries of the public benefit argued by The Applicants; (As an example of how competing alternatives for growers can improve grower returns, the ACCC should refer to the introduction of competition in the provision of harvest finance to growers in 2001. Previously, such finance was solely an AWB Limited service; under open access with competing bank alternatives, AWB's interest rates dropped overnight by 1-2%, saving grain growers millions of dollars per annum)
- Potential for abuse by The Applicants in diverting export pathway grain, which will benefit from the future lower export orientated supply chain costs, into the domestic market. This "abuse" need not be intentional, but a logical outcome of the way grain is acquired and traded. Grain is acquired for a combination of delivery to export Pools and for delivery to domestic customers. The final destination is derived from the most profitable cost path, so that grain undergoes many potential ownership changes from its point of acquisition from growers. This is to be encouraged, however the concept of being able to quarantine export and domestic movements in the system is fundamentally flawed; and,
- The potential for access of third party traders to supply chain assets to be marginalised, in terms of price and/or access to rail capacity or export berth time (for non monopoly grains);
- EGLJV pursuit of cost improvements in export regulated grains coming at a corresponding cost for non-export regulated grains, and/or the access available to use transport assets for backloading of fertiliser and other associated transport tasks. If poorly conceived and executed, it is possible that the EGLJV activities could just produce an allocation shift of common user rail assets foremost to regulated grain, pushing non regulated grain to marginal access to rail and increased dependence on higher cost road transport; and,

- The absence of any structural remedies (i.e. regulatory and appeal frameworks) in the applicants proposal to address concerns about the operation of the EGLJV, as it applies (a) to measurement and capture of any public benefit and (b) as it may impact on third parties.

## **6. Markets**

The Parties see the potential for detriment from the EGLJV in the following markets:

1. The market for storage and handling of grain for domestic consumption and export; and,
2. The market for acquisition and trading destined for domestic consumption, and the accompanying/complementary market for grower services that goes with grain acquisition (e.g. freight services, finance and risk management services, etc....and the latter are currently dominant income streams for both JV parties, especially AWB Limited).

The ACCC Draft Determination also identified that the market for acquiring rail freight may be impacted by the EGLJV. While this is true and the EGLJV may negotiate those rates down, it is the IMPACT that the creation of differential rail freight rates (export versus domestic) will have on the market for acquisition and trading of grain (Market No. 2 above) which is critical. It is that very capacity to achieve lower freight rates by the EGLJV which alters fundamentally the competitive position of every other grain purchaser at the silo.

### **Market 1 - storage and handling of grain for domestic consumption and export**

#### Background description

*Most Australian grain commodities trade on an export parity basis, as production far exceeds domestic use. Country silos compete for storage of grain from farm, be it destined for export or domestic use. Given the export price is a given, it is the total of all port, freight, and notional cost deductions applied by export monopoly operators from silo to port that determines the competitiveness of each country storage site. For their monopoly grains, AWB and Graincorp therefore have a determinate impact on the competitive position of each country receival site, whether owned by The Applicants or a third party.*

*Currently the range of costs between FOB and silo that are so crucial to local competition at the silo level, are disclosed as one total by AWB and Graincorp for monopoly grains. Third parties find it difficult to identify what cost elements actually impact on the competitiveness of their assets. Without transparency of individual costs, it is difficult to address and lower cost drivers: this is why Graincorp are so keen to participate in the EGLJV, as transparency will help them become more competitive in the market for storage and handling of wheat.*

*The operation of the EGLJV is therefore critical. As presented by The Applicants the EGLJV will:*

- *Deliver the applicants transparency and co-ordination between their respective activities. This should provide cost savings to Graincorp and/or AWB country receival sites in a manner not accorded 3<sup>rd</sup> party infrastructure owners;*

- *Provide no commitment to furnish the same level of cost information disclosure and co-ordination to operators of third party receival sites*
- *Deliver benefits foremost to the applicants' country receival sites.*

### Impact on the market

The motives for Graincorp involvement in the JV include improving transparency between Graincorp and AWB. This will give Graincorp better certainty about the cost deductions to port applied at its sites by AWB, and will improve access to information relevant to investment in additional storage assets.

The information deficiencies that motivate Graincorp entry into the EGLJV, are experienced by all non-AWB owners of grain storage infrastructure and services, and will endure for those third parties. The EGLJV has made no attempt to provide a holistic solution, indeed it can be said that it will improve the competitive and operational advantages already enjoyed by The Applicants as the dominant merchants and storers of grain.

It is by no means clear from the ACCC Draft Determination, which refers to The Applicants undertaking to make Schedule 2 of the JV Agreement public, what Schedule 2 might contain, other than to describe the type of information to be shared between the JV parties. It is incumbent on the ACCC and the JV parties to provide a sample of what Schedule 2 does contain, before interested third parties can at all be satisfied that appropriate public disclosure will occur. (For example, actual export path costs, details of take or pay contracts, volume rebates, etc...without this, the transparency will be a sham.)

Even just for a moment accepting the contention that the proposed ring fencing of information might be effective (which we will later contest), the potential for public detriment arises in several ways, to affect owners and/or users of 3<sup>rd</sup> party grain infrastructure assets:

- To discourage ongoing investment in storage, handling and transport assets by third parties, including new entrants into the market. These parties will not enjoy the information advantages accorded to The Applicants;
- Erosions of competitiveness of third party storage operators, who will not be able to advance productivity in the same manner as The Applicants, due to the ongoing state of inadequate information disclosure and operational coordination; and,
- Through arbitrary application of the benefits of the EGLJV and existing shared costs. With the EGLJV considering multiple arrangements for sourcing freight to port, there will by nature be arbitrary judgements made by the EGLJV in arriving at 'standard' cost deductions (to reflect some averaging of spot rates, term hire rates, and take or pay contract rates). Where the EGLJV has superior information about costs and co-ordination from The Applicants sites to port compared third party sites, it can be expected that pricing to The Applicants sites will reflect less uncertainty & less risk and thus be relatively lower.

### Potential solutions

While The Parties believe authorising the EGLJV is undesirable, should The Applicants remain transfixed on that path then the following Reforms should as a minimum be adopted to reduce detriments in the market for storage and handling of grain:

1. Requiring the applicants to measure and report annually on the public benefit derived by the EGLJV. This would:

- Provide third parties (and the public) with some measure against which they can assess whether:
    - (1) what purported JV gains have been achieved;
    - (2) benefits have been captured by the public and not the EGLJV or The Applicants; and,
    - (3) like gains have been achieved from 3<sup>rd</sup> party owned receival sites;
  - Provide important data for assessment at any future re-certification of the JV arrangement;
2. Requiring the JV to disclose all cost deductions between the FOB position and the estimated silo return;
  3. Providing transparency to all stakeholders about the cost drivers and EGLJV contract arrangements that determine the standard cost deductions to port; and,
  4. Establishment of a dispute process for third party infrastructure owners. This could involve binding determination by an independent arbitrator/regulator. The sheer presence of an independent dispute determination process would provide some motive for the applicants to ensure detriments to third party asset owners are lessened or eliminated.

## **Market 2 - acquisition and trading of grain destined for domestic consumption**

### *Background description*

*The market for acquisition and trading grain destined for supply to the domestic market involves the purchase of grain, its temporary storage, and later delivery to customers. Grain may be purchased from farmers prior to and at harvest, from traders post harvest on an in-store basis, and may be swapped (even with export monopoly Pools) on an in-store basis for grain of a different type or location.*

*The key to a liquid market revolves around all participants having equality of access to storage and transport services.*

*The existence of two supply chain cost structures (one for export, another for domestic), has the potential to undermine the domestic trading markets if the applicants can in any way apply the export path cost structure for supply to the domestic market*

*Grain moves to domestic users by a combination of rail and road freight. Many points of domestic consumption are in capital cities, adjacent to export ports. Grain is received at Graincorp, AWB and 3<sup>rd</sup> part sites on a common user basis. Under terms of access to those sites, grain may be subject to movement to port at the operational convenience of the storage owners. Graincorp advises in paragraph 7.190 of the Draft Determination that swaps can occur for a range of reasons, viz... "...unavailability due to weather problems, grain infestation or fumigation, quality problems, inaccessible grain, mechanical failure, rail delays and last grain in storage being outloaded, etc...". In addition to these operational reasons, there are also location and quality arbitrage reasons for grain to be swapped out of nominal export ownership to a domestic path. These facts give rise to the fact that title ownership transfers/transactions occur on a regular and commercially desirable basis. The applicants own transaction records would show, and ACCC should request evidence, that this type of transaction has risen significantly in the past 3-5 years, and reflects the very competitive East*



coast market for positioning grain for the rapidly expanding intensive livestock industries (forecast to be in excess of 10 million tones by 2007 (Grains Industry Strategic Plan: Single Vision, 2004).

*Under the EGLJV, the rail freight cost to port (for export) will be lower than the rail cost to a flour mill in a city adjacent to the port, or a flour mill at the port. There is nothing wrong with this per se, and indeed would point to the EGLJV creating public benefits.*

*The difficulty arises in ensuring that the benefits of the lower cost structure to port for exports is quarantined to export destined grain, and is not used to advantage The Applicants trading into the domestic market. We contend that it is not possible to segment export and domestic owned grain...indeed it is a nonsense to claim the concept, as if applied it would lead to a significant loss of public benefit. Efficient grain inventory management requires a flexible system to access least-cost paths to both domestic and export customers, not an EGLJV "contrived" system which benefits the Applicants at the expense on non-EGLJV parties, with no mechanism to measure the claimed public (grower) benefit.*

*Similarly, The EGLJV may be creating efficiencies by moving third party owned grain: as presented those benefits do not flow to those 3<sup>rd</sup> party owners of grain.*

#### Impact on the market

As a result of structural arrangements associated with the way The Applicants record ownership, clear grain to port for convenience and swap grain ownership between owners and locations, it will be possible for The Applicants to apply, even inadvertently, the lower export path costs for delivery to domestic users. In doing so, The Applicants would take an arbitrage profit between the two (export and domestic) cost structures between country silo and port. The Applicants will also, by virtue of their lower export path costs, be more competitive at local silos in purchasing grain. This adds to their competitive advantage when they "bundle" other services in prices and options to growers, for example finance and risk management products (which today constitute a significant part of profit streams of The Applicants). Whilst we acknowledge that The Applicants will compete for grain at silos, it will be these two operators alone, who will be able to provide the options by virtue of their JV arrangements with access to lower cost paths. Third party operators will be squeezed out, without knowledge of those lower costs, nor with access to stock ownership data held within the EGLJV.

This arises because:

- AWB records grain ownership at a group level, rather than as AWBI and AWBAU. Accordingly Graincorp and the EGLJV (and other storage companies) will see AWB ownership and it will be impossible for them to always accurately know what cost structure (domestic or export) should apply;
- The EGLJV will clear silos along a branch line of all stock for convenience, without knowledge of its intended market. This may involve AWBI stock and AWBAU stock (under a single identity), Graincorp stock and third party stock. Typically Graincorp would charge grain owners for the cost of freight to port. The difficulty arises in knowing which freight deduction to charge AWB, as EGL will not know whether it is held under AWBI or AWBAU ownership; and,
- Even if issue 2 is overcome, it is possible that grain brought to export port on behalf of AWBI for export, could later be swapped with AWBAU and that AWBAU would indirectly get the benefit of lower export path freight costs.

The perceived risk that EGLJV arrangements could see domestic consumption grain moved to port on export path costs, en route to fulfilling domestic demand will create uncertainty

about demand for transport services to points of domestic consumption. This may lead to reduced supply of transport equipment over the longer term, and thus increased disparity between export and domestic path costs.

### Potential solutions

While The Parties believe authorising the EGLJV is undesirable, should The Applicants remain transfixed on that path then the following Reforms should as a minimum be adopted to reduce detriments in the market for acquisition and trading of grain:

1. Disclosing the domestic path costs negotiated by EGLJV for movement of AWBAU and Graincorp trading grain to domestic markets. This would provide a more fully informed market and ensure that The Applicants trading businesses do not benefit from leverage accorded by export monopoly grain volumes under the control of the EGLJV;
2. Disclosure to the market of export path costs, along with details of rail take-or-pay, minimum volume contracts, etc. If The Applicants claim that no advantage is being delivered to their trading operations, then disclosure of these details will create a better informed market for greater transparency to third parties to compete for domestic grain.
3. Providing access to all grain buyers to pass responsibility for their grain movements to the EGLJV. Parties choosing to do so would then be on competitively neutral terms to AWBAU and Graincorp domestic trading activities, and would pay a Common Rate . This would also need a protocol for common user access to ensure third party traders have equal access to the allocation of scarce transport capacity to domestic consumers and ports (for deregulated grains), and to export berth slots;
4. EGLJV ensuring that export path costs are only charged to stocks with the AWBI & Graincorp export monopoly identity, and which actually stay as AWBI/Graincorp export monopoly ownership through to FOB. This may be achieved by charging a common rate for all domestic & export grain when grains moves through the supply channel; with a fee rebate for export after completion of export loading;
5. Having AWBI as the counterparty to the EGL JV. AWBI is the nominated holder of the export monopoly under the *Wheat Marketing Act*. Currently AWB Limited is appointed by AWBI to provide supply chain services (although the role for AWB Limited seems redundant upon the formation of the EGL JV.) With AWBI poised to potentially have a majority of independent Directors' (subject to shareholder approval at the next AGM, 10 March 2005), having AWBI as the JV party seems entirely reasonable: this would provide further evidence that the EGLJV operation is designed for the exclusive benefit of export destined grain. It would also provide additional structural evidence that to the extent AWB Limited has an operational involvement in the EGL JV, it is on a commercial terms that is subject to the scrutiny of the independent AWBI. It also allows the remedy of exclusion of AWB Limited from EGLJV arrangements should AWBI have reason to consider that ring fencing or other EGLJV aspects are compromised by AWB Limited and or AWBAU. Since the "public asset" of wheat export monopoly volumes is a core component of the proposed EGLJV, it is appropriate that the custodian of that asset (AWBI as the nominated export license holder under the WMA) is the party to the JV, and not an AWB Limited wholly owned subsidiary (AWB Services), which is a for-profit venture with direct relationships to other AWB Limited commercial entities which have solo rights to supply services to AWBI...for example chartering, marketing services, etc);
6. Requiring ownership of AWB grain to be recorded in AWB and handling company information systems under either the AWBI or AWBAU identity from the moment of initial receipt and harvest, with tracking to remain at this level for the duration of its ownership by the respective AWB business activity. This could happen on a like basis for Graincorp export monopoly business units too. The separation of ownership records should ensure

that the applicants cannot apply export path costs to grain destined for the domestic market;

7. Adopting formal processes for conducting and reporting stock swaps between AWBI (and the Graincorp export monopoly equivalent) and other parties (including AWBAU) comprising:
  - Reporting of all stock swap quantities and net swap prices;
  - Stock swaps to be conducted on the basis of domestic path supply chain cost deductions in the first instance, or otherwise swaps should be subject to open tender.

## **7. EGLJV performance since preliminary authorisation**

The Parties note that since preliminary authorisation, the EGLJV has done nothing more novel in coordinating supply chain activities than has occurred prior to the EGLJV, and that there is no evidence of real improvement to date.

At the PDC, The Applicants noted steps like prepositioning grain at the Werris Creek sub terminal to accelerate the passage of grain to port, and consideration of moving rail wagons from Victoria to NSW. Exactly these activities have occurred in the past without the EGLJV framework. For example:

- In the record grain harvest in South Australia in 2002, narrow gauge rail wagons were relocated from W.A. to the Eyre Peninsula of South Australia, while to a lesser extent rail wagons from N.S.W. were engaged in eastern S.A. and Victoria. The initiative for these steps in S.A. came foremost from the rail operator and the bulk handling company, who were respectively trying to get better use of rail assets and clearance of grain to port prior to the next harvest. It can be argued that success in S.A. has the potential to outstrip the EGLJV, as endeavours in that State appear to draw all major supply chain stakeholders into a highly inclusive process, and there are no fears that benefits will get caught up in some form of operating JV company;
- The justification for sub terminal development, which predated the EGLJV formation, was prepositioning grain to get more efficient movement of grain along branch lines, then more rapid turn around to port from sub terminals. It is spurious for The Applicants to attribute the benefits of the sub terminal activities to the creation of the EGLJV, as they already existed!

At the PDC, AWB noted that it has not been able to pass benefits of EGLJV activities through to growers, as freight rates (in NSW) are currently locked in to 2006/07 as part of the package that comprised the sales of NSW State Rail assets to Pacific National.

It is the understanding of The Parties that AWB played a leading role in the development of the NSW Rail sales package; and, that it included both a contracted *increase* in the spot tariff rail rate and also access to hire trains on a potentially cheaper term basis. That sales package included the obligation on the new owner to spend \$118 million on two new sub terminals in NSW and the appointment of AWB as operator of those terminals. It is also noted that in developing that package with the State prior to the sale of the NSW rail assets, AWB did so to the specific exclusion of Graincorp. Arguably the two new sub terminals represented a replication of like assets that in part already existed as Graincorp assets. It is unfair therefore for AWB now to be critical of price increases that came from the sale process. If The Applicants are serious about achieving cost reductions, then they need to work with Pacific National and others to examine in detail the cost drivers of existing operations and to make effective use of term hired trains. We need an environment that gives parties the confidence to make long term investment decisions that are required to achieve process change and asset improvement. Focusing on costs alone and shopping for the best short-term deals, is not the best approach to encouraging national long-term infrastructure improvement and development investments.

While the PDC suggests The Applicants may have had some initial dialogue with Pacific National, The Parties have seen no attempts by the EGLJV to engage with third party owners of storage and handling assets (who compete with Graincorp and AWB receival sites), to identify opportunities for improvement.

## **8. Competitive neutrality and Chinese Walls**

The Parties are concerned that:

- That the EGLJV will not act in a competitively neutral way when allocating transport operators and ports to grain which must be moved to export; and,
- The Chinese Walls within The Applicants' businesses are not effective, and that this will be even more critical with the concentration of power that arises with the EGLJV.

### **Competitive neutrality**

Grain receival sites, export grain terminals, and rail rolling stock have several key features including:

- High capital cost;
- High fixed costs; and,
- Limited or no salvage value in the absence of ongoing utilisation.

The return on those assets is therefore highly dependent on the share of the export task that is given to those assets. Where this is most critical is where:

- Competing assets have equivalent costs. For example, grain from parts of Southern NSW can pass to the ports of Melbourne or Pt Kembla at around the same cost; and,
- Where there are notional costs deducted by the export monopoly operators (e.g. Port Cost Differentials) or there are arbitrary cost determinations (for example EGLJV calculation of an average freight cost from silo to port, where there is a mix of take or pay and spot freight arrangements engaged by the EGLJV).

The Applicants own country receival sites, port terminals and possess rail rolling stock assets that compete with third party owners/operators. The Parties have concerns about the fact that EGLJV will be able to choose service providers on behalf of their related export monopoly businesses, to favour their own infrastructure investments. Should this arise, The Applicants assets will benefit from reduced throughput risk and thus lower costs. Viewed holistically it may not reduce system costs, just produce risk shifts away from The Applicants. The same risks exist when the EGLJV is setting freight deductions to port from The Applicants sites compared to third party sites. While this is already a risk with Graincorp controlled NSW single desk operations and the passage of wheat through the limited number of AWB owned country sites and partially owned port terminal, the impact of such partial action will dramatically escalate once The Applicants work in tandem.

Examples of such fears are founded, with the following examples:

- Costs to export FOB for barley from Southern Riverina receival sites are comparable for grain taken to Port Kembla or the Port of Melbourne. When the NSW single desk for barley was operated by Grainco (an investor in the Port of Melbourne grain terminal), all that grain passed through the Melbourne terminal. Subsequent to the acquisition of

Grainco by Graincorp, that grain has been routed to the Graincorp owned Port Kembla Terminal;

- At the PDC, in response to Australian Bulk Alliance expressed concern about preferential assignment of grain to assets owned by The Applicants, Mr. Johns of Graincorp noted 'AWB has an incentive to use the Melbourne port which will benefit ABA as a joint operator of that port' (excerpt from the PDC minutes). While that may appease the ABA, it strongly suggests to The Parties that The Applicants will not operate the EGLJV in a competitive neutral way and that The Applicants will use their control of export monopoly grains to benefit their commercial infrastructure operations to the detriment of third party operators;
- AWB Limited, in its remuneration model with the export Pool, gets payment bonuses for achieving supply chain cost reductions. This may partly explain why the justification for the EGLJV and its focus is foremost on cost reduction. Conversely, AWB Limited does not get penalised under this remuneration model for externalities of its actions, such as cost shifts to non regulated export grains, domestic consumers, third party infrastructure owners, or if it increases funding costs for growers.

Furthermore, as presented the EGLJV Chinese Walls provisions provide only constraints on the disclosure of certain proscribed information. They in no way provide a framework for operation in a competitive neutral manner with respect to the allocation of moving grain to export, so as to provide a fair allocation of those tasks and comparable assignment of crop volatility risk between all infrastructure and service providers.

### **Chinese Walls**

The EGLJV arrangements have proscribed Chinese Walls arrangements.

The Applicants in their existing business operations also claim to operate such arrangements between their storage operations records and their for profit domestic trading operations. The Applicants believe that there is not a culture of compliance within The Applicant companies, and that the arrangements are not effective. The following examples support this view:

- Brooks Grain and Elders Grain commonly warehouse grain at Graincorp facilities. Almost immediately after entry into warehousing, Brooks Grain has received direct approaches by Graincorp trading operations to purchase that grain: the approaches have demonstrated detailed knowledge of the location, grain types and qualities in question that strongly suggests direct transparency to the benefit of the Graincorp trading operations; and,
- AWB maintenance of stock records within bulk handling records at a group level, which opens the potential for AWB trading operations to see the combined export Pool and trading operations stock position, especially when looking at where grain can be drawn from to meet domestic customer needs or for identification of profitable stock swap opportunities. Whilst it may seem fine for the Applicants to claim (as per PDC minutes) that stock swaps are open and accessible to any third party (and indeed they are), it is the "view of stock" (quality, location, variety, volumes, etc) which creates and enhances the ability to identify and maximize those opportunities.

The Parties believe that the provisions of the Chinese Walls arrangements of the EGLJV are inadequate. These provisions contain no effective penalties for non-compliance, nor procedures for routinely ensuring compliance. Given evidence of a culture of non-compliance and the strong commercial incentives in play, The Parties have little confidence that the arrangements will be effective.

## **9. Summary**

In summary, the Parties consider the EGLJV should not proceed as:

- the claimed public benefits are at best highly doubtful;
- the public detriment (to third party operators) is evident and will flow through to grower detriment;
- there are no measures proposed to measure public benefit; and,
- there are no dispute resolutions nor appeal mechanisms to deal with non-compliance or lack of delivery by the Applicants

In any event, if the EGLJV were to proceed (which we strongly oppose), there are a number of minimum reforms (as outlined herein) which must be imposed on the Applicants, before the EGLJV should be further entertained.

The Parties appreciate the opportunity to provide this submission, and are willing to meet with the ACCC at any time to discuss the matters raised herein.

Yours sincerely

Chris Brooks  
Managing Director, Brooks Grain

Mark Thiele  
General Manager, Elders Limited