

GRAIN EXPRESS

Submission by AWB Limited in response to a Notification of Exclusive Dealing by Co-operative Bulk Handling Limited

I. Introduction

- 1.1 On 11 June 2008, Co-operative Bulk Handling Limited ("CBH") lodged a Form G, Notification of Exclusive Dealing with the Australian Competition and Consumer Commission ("ACCC"). The Notification is made pursuant to section 93(1) of the *Trade Practices Act* 1974 (Cth) ("the Act").
- 1.2 CBH is an integrated marketer and bulk-handling company situated in Western Australia and is a monopoly provider of bulk handling services in the grain industry in Western Australia. In substance, CBH proposes to supply storage and handling services relating to dealing with grain in Western Australia, but on condition that growers or marketers:
 - (a) *acquire supply chain coordination services from CBH; and*
 - (b) *to the extent that grain remains in CBH's custody, that they only acquire transport services from CBH (through its nominated carrier).*
- 1.3 The proposed service delivery scheme is referred to as "**Grain Express**".
- 1.4 This submission is made on behalf of AWB Limited ("AWB") and its related bodies corporate. AWB is an interested and affected party by reason of its substantial grain trading and marketing business, which is Australia wide and in relation to which a substantial proportion is undertaken in Western Australia.

II. Executive Summary

- 2.1 AWB submits that CBH ought not be granted immunity from legal action under the Act by lodging the exclusive dealing notice of 11 June 2008.
- 2.2 In summary, AWB submits that if the conduct falls within the definition of full line forcing, as is submitted by CBH, that conduct has the purpose, effect or likely effect of substantially lessening competition, and ought not be granted immunity from the effects of the exclusive dealing provisions. AWB submits that making "a least cost supply chain" the driver or determinant of the way in which bulk handling and related services are to be provided will substantially lessen competition in those and other established markets and stifle it in other emerging markets, which will be to the material detriment of growers, customers and other participants and stakeholders in the West Australian grain

industry and to the Australian public. Grain Express is fundamentally a response to issues in a subsection of the supply chain, without consideration of the optimisation of value of the base product that is under management in the grain value chain.

III. Submissions

Characterisation of the Conduct: Full or third line forcing?

3.1 CBH has claimed that the notified conduct is full line forcing and not third line forcing. AWB takes the view that Grain Express does not constitute pure bundling (full line forcing). Product bundling is a marketing strategy that involves offering several products for sale as one combined product. Pure bundling occurs when a buyer can only purchase the entire bundle or nothing. If the end result is that AWB can only buy at specific points in the supply chain, the result is that AWB is forced to buy on a bundled basis in that the growers' grain has been commingled, transported and blended.

3.2 AWB takes the view that Grain Express is a form of third line forcing because it involves the supply of bulk handling services (in respect of which CBH is in a monopoly position) on condition that the purchaser buys goods or services from ARG as rail provider and from road carriers selected by CBH, or a refusal to supply because the purchaser will not agree to that condition. This requirement is evident in Section 2(b) of the "Form G Notification", which states that:

"CBH will offer to supply storage and handling services on the condition that Growers or Marketers acquire:

- (i) Supply chain coordination services from CBH; and*
- (ii) To the extent that grain remains in CBH's custody, that they acquire transport services from CBH (through its nominated carrier)."*

3.3 The third party forcing is also evident in Clause 12 of CBH's *Standard Terms and Conditions* set out at Annexure A of its Notification. This demonstrates that CBH requires either that marketers enter into contracts *in their own name* with CBH's nominated carrier: ARG; or incur transport costs in CBH's name.¹ Hence, the refusal in this case is not outright, but the imposition of a rail movement cost equivalent regardless of whether rail is used which, combined with a refusal to deal with alternative (road) transport providers has precisely that commercial effect. Moreover Grain Express is explicitly designed to achieve exactly that commercial effect.

¹ See *Castlemaine Tooheys Ltd v Williams & Hodgson Transport P/L* (1986) 162 CLR 395.

- 3.4 Even if the conduct is not taken to be a refusal to supply, the service is certainly on disadvantageous terms for those purchasers, who do not comply with the third line forcing of ARG services.²
- 3.5 In sum, this is not an arrangement of full line forcing, as CBH submits, but one of third line forcing whereby CBH offers to supply storage and handling services on condition that the growers/marketers acquire the services of another person, namely ARG and the services of road carriers selected by CBH. Furthermore, AWB submits that regardless of any effects on competition, there is sufficient evidence that any likely public benefit arising from such conduct will not outweigh the likely public detriment from such conduct (See section *IV* below); and therefore the notification lodged by CBH ought to be revoked.

Assessment of the Conduct

- 3.6 Since conduct other than third line forcing is assessed by first considering whether the conduct may substantially lessen competition before applying a public interest test, this submission addresses the notification as follows:
- (i) How the exclusive dealing will substantially lessen competition, including the markets involved;
 - (ii) How the public benefits are outweighed by anti-competitive detriments.

How the exclusive dealing will substantially lessen competition, including the markets involved

- 3.7 The CBH notification affects a range of markets for the supply and acquisition of goods and services. The CBH submission specifies (at 1.21) the following markets as being affected by competition effects:

- "(i) markets for the supply of country grain receipt, storage and handling services in Western Australia, or alternatively, in each of the four port zones in Western Australia;*
- (ii) markets for the supply of bulk grain road haulage services in Western Australia, or alternatively, in each of the four port zones in Western Australia;*
- (iii) markets for the supply of bulk grain rail haulage services in Western Australia, or alternatively, in each of the four port zones in Western Australia; and*
- (iv) grain trading markets, which may include:*
 - (A) a market in Western Australia for the acquisition and supply of wheat; and*

² See s47(7) of the Act.

(B) a market in Western Australia for the acquisition and supply of coarse grains."

- 3.8 AWB submits that the conduct described in the submission supporting the CBH Notification also affects competition in additional market(s)³ to those described by CBH.
- 3.9 In sum, AWB submits that in each market so affected, the existing market power of CBH is already strong enough that the restraints arising from the proposed exclusive dealing will reduce the ability of other suppliers and dealers to choose alternative sources of supply, particularly given the existing barriers to entry; and the long-term nature of the restraint once implemented.

Markets for the supply of bulk grain road haulage services in Western Australia, or alternatively, in each of the four port zones in Western Australia

Road Carriage

- 3.10 There will in future be limited choice of road carriage providers in Western Australia if the selection is limited to successful tenderer(s) to Grain Express. Some road carriage providers who are currently operating in bulk grain collection and distribution are likely to be shut out unless they are a successful tenderer to Grain Express. (See paragraph 8.18 of CBH's submission in support of notification).
- 3.11 This in turn will lead to a lessening of competition, particularly if the contractual arrangements with successful tenderers are of a long duration; and/or if prices become fixed along the lines of the CBH rates.
- 3.12 There is no guarantee that independent road freight carriers will be given equal priority at receival stations to those who are successful tenderers to Grain Express.
- 3.13 CBH submits that in the current supply chain, marketers exert substantial influence over the movement of grain from country to port. This assertion is not supported by any data to demonstrate such influence from marketers.⁴

³ A market is the area of close competition between firms or field of rivalry between them. Within the bounds of a market there is substitution—substitution between one product and another, and between one source of supply and another, in response to changing price.

⁴ AWB experience is that AWB has no contractual capability to influence CBH in the movement of grain from country sites even when AWB has entitlement to that grain. For the last 10 years AWB has been unsuccessful in seeking to introduce in Western Australia a system of authorising freight movements ("Stock Transport Orders") to port as operates in Eastern States. Similarly even as a party to joint rail contracts, AWB has been excluded from the committee that manages the weekly rail planning and scheduling process. More recently AWB has been allowed to attend to observe but not to contribute to decisions. A practice of surge movements by road is accepted – this occurs when limited contestable road movements are used to meet short term spikes in shipping demand. This limited practice of surge movements can hardly be described as substantial influence. Moreover it is unlikely that Grain Express will remove the need for such contestable road movements.

Markets for the supply of bulk grain rail haulage services in Western Australia, or alternatively, in each of the four port zones in Western Australia

- 3.14 CBH is not itself a carrier but has secured an exclusive access agreement with the rail freight provider, ARG, forcing customers to deal directly with CBH for access to the provision of freight services. CBH submits that the services are bundled and, as it is acting as the agent for ARG, there is no third line forcing. As submitted above, AWB is of the view that the exclusive access relationship between CBH and ARG results in an arrangement of third line forcing and is not in the public interest.
- 3.15 Grain Express also has the effect that growers are forced to use ARG services and pay for the freight and bundled services. If growers are forced to use the bundled services it follows that they are paying for the whole of those bundled services, not just the services that they require. The effect is a potential increase of cost to growers which will impact on the marketers' position when purchasing to fulfil export contracts.
- 3.16 Non-rail freight is restricted under Grain Express.

Standard gauge national rail services

- 3.17 Grain Express intends to leverage CBH's monopoly to secure arrangements that subsidise underperforming narrow gauge branch line rail infrastructure. The Grain Express arrangements defeat the efficiency opportunity of using the national standard gauge network due to the cross subsidising of narrow gauge lines. This conduct directly lessens competition.
- 3.18 Rail service providers have a unique opportunity in the newly deregulated wheat export market to negotiate the supply of grain moving services on a national basis by rail across the standard gauge network. However such a competitive market development will not occur on the standard gauge if Grain Express proceeds because Grain Express defeats the efficiency opportunity of using the national standard gauge network due to anti-competitive protection of narrow gauge upcountry networks. This occurs by cross subsidising the high cost of narrow gauge network from charges levied for use of the standard gauge network. This effectively shuts out national operators from the West Australian market. The structure of the market should not be driven by the objective of ensuring the survival of an inefficient rail system. However, contrary to this principle CBH under Grain Express:
1. makes a commitment to the entire rail network and will continue the cross subsidies; and
 2. by restricting access to ownership to end-points in the supply chain will prevent other traders from seeking to maximise opportunities for freight efficiency on the standard gauge lines.
- 3.19 Standard gauge service providers other than ARG should have the opportunity to enter this market. When either demand or opportunity arises, these

providers have the capacity to safely operate an additional 15 or 20 grain wagons on trains bound for ports at a lower rate. Access to the network could be negotiated for spare pulling capacity to be utilised in this way. This has not yet been done but is an area of opportunity and efficiency benefit that should not be precluded. Grain Express would preclude it by restricting entitlement to end-points and ceding the supply chain to CBH with their exclusive arrangement with ARG as rail provider.

- 3.20 As long as rail is efficient and competitive, the aggregation of demand does have benefits from a transport cost perspective. However, these benefits only apply where rail is the major transport mode such as in the major rail port zones of Albany and Kwinana⁵. There does not appear to be the same need to protect rail use in the other two port zones. The introduction of a system wide bundling arrangement to protect the West Australian rail network is not warranted.
- 3.21 Restrictive rail siding capacity and insufficient outloading speed mean that Grain Express will not overcome systemic inefficiencies or deliver the claimed benefits. CBH does not have a standard receival site configuration at all sites as the infrastructure was developed over many years. As a result, each of the up-country receival sites has a different loading capability (tonnes per hour) and rail siding length (number of wagons able to be positioned for loading when the train is not available to shunt the entire consist of wagons).
- 3.22 The key to an efficient train operation is the cycle time associated with the train leaving the destination port, travelling to one or more up country locations, loading of the wagons occurring, and the subsequent return journey and discharge at the port.
- 3.23 In Western Australia, and especially on the standard gauge rail line, sub 24 hour cycles are desirable for an efficient operation. If a train is to be loaded with approximately 2800 tonnes of grain this requires an acceptable outloading speed (tonnes per hour) to be able to load and have the train return to port within the desired timeframe.
- 3.24 Of the 200 CBH sites, only 28 have a rated outloading capacity greater than 400 tonnes per hour. The average tonnes-per-hour of the majority of the CBH sites is in the vicinity of 300 t/ph. This effectively means a load time for a train at one site of over 9 hours. This load time will not optimise train running and may not allow a 24 hour cycle. As a result, standard practice in Western Australia (and other parts of Australia) to ensure better train cycles is to use multi-load points.
- 3.25 In fact, the current Western Australia rail agreement includes a commitment by CBH to ensure that end points (nominally the last site on a line section that the train loads prior to returning to collect wagons dropped at other sites in transit) has the capability to load to at least a minimum tonnage per hour.

⁵ Kwinana, which receives approximately 50% of the harvest of WA, receives grain only by rail

- 3.26 Multi point loading means the train on its outward journey from port will drop wagons into the rail sidings of one or more sites prior to loading the remainder of the wagons at the end point.
- 3.27 The number of load points will be determined by the relative speed of the load points and also the rail siding lengths. Twenty five CBH receival sites cannot take more than 25 wagons at a time.
- 3.28 Grain Express will not cure this systemic issue.
- 3.29 AWB repeats the comments at paragraph 3.13. To the extent there is influence, it is driven only by the need to secure or preserve entitlement to particular stock for quality and marketing purposes. The importance of that objective is discussed at "Overseas Bulk Sales" in this submission.

Quality incentives to growers

- 3.30 Grain Express will remove any incentive for marketers to provide rewards to growers in the form of, for example, a price premium for producing wheat with particular quality attributes. While it may be inefficient in terms of the land-based bulk handling supply chain to deliver the same grain to the warrant holder at port as was delivered by the grower at the country receival point,⁶ the efficiencies of that supply chain must be viewed in terms of the global grain market and its demands. The haulage of grain ought not be "... controlled by persons whose interests are entirely aligned with Supply Chain efficiency"⁷ but by considerations of competition and the public interest. Such incentives are strategies designed to improve product marketability for domestic and overseas export markets. The incentive is removed to the disadvantage of growers because:
- a. no marketer can secure ownership⁸ of any particular stock; and,
 - b. there is no transparency of what stock is held in the system by reference to particular quality criteria.
- 3.31 Similar to other bulk agricultural products, value can be maximised by maintaining intrinsic local quality and blending to specification on each sales contract. It is acknowledged that additional costs are incurred to maximise the overall value of exported wheat. This is a positive cost/benefit outcome. Grain Express eliminates marketers' opportunity to acquire high quality grain for sale at premium prices. There will be a substantial lessening of competition in the premium production growing market. It is also contrary to the public interest because a reduction in the identified premium grain market would lead to a reduction in export market earnings. The effect is to penalize growers by

⁶ See para. 2.47 of the CBH Notification Submission.

⁷ See para. 2.86 of the CBH Notification Submission.

⁸ Issues of ownership also raise significant questions relating to the passing of title. These questions also go to usual trading terms and marketers' sales terms to their customers as well as legislative provisions relating to property and the passing of title. Grain Express confuses rather than clarifies these important commercial issues.

removing their opportunity to benefit in the “marked by production” of grain with such quality attributes. For example, the proposed use of a rolling profile and a weighted average profile⁹ suggests that it is likely that there will be pressure on segregations to the point that a grade may have quite a wide range of quality attributes.¹⁰ Most wheat may fall into an ASW grade with a protein range from 7.5% to 12.8%. AWB sales and commitments to customers are relatively specific in relation to protein. Sales will be made based on low protein at the bottom of the range, for example, 8% to 9.2% protein. Other sales may require a range of 11.5 to 12% protein. Providing the average of 10.1% is, in AWB’s submission, not acceptable and detrimental to Australia’s interests.

- 3.32 Deep sampling and zone based sampling will only be available by special request and at additional cost. These services are particularly important to the ongoing development of a premium grain growing market. Under Grain Express the facility of site specific samples is to be offered or withheld in CBH’s sole discretion, which may mean smaller marketers operating in and/or wishing to enter this premium market will be denied the opportunity of site specific samples altogether.

Secondary accumulation market

- .33 Currently, if 40 or so traders are buying grain up country, the sites at which acquisitions are made each have more or less efficient logistics¹¹. This gives rise to demand for swap or sale intra-site. There is also a secondary accumulation market as a result of the need to accumulate from specific sites to complete a full shipment. Such factors currently drive price at particular sites and the selective purchase of grain at different points in the supply chain.
- 3.34 Under Grain Express, marketers can only outturn grain at a limited number of destination sites or at port, compromising activity in this secondary market. Furthermore, Grain Express will block the rise of new grower marketing cooperatives that may otherwise seek to aggregate their tonnes to allow innovation and /or marketing advantage based on volume and margin.
- 3.35 If CBH were to run a fully transparent swap book, marketers could see and share information so as to maximise efficiency in the accumulation of cargo ready to load to shipment. There are, however, obstacles to the required information transparency currently. These include inability to weigh at all silos, the quality and sampling concerns referred to at 3.31 and 3.32 above and volume reconciliation issues. (For example, the allocation of a shrinkage factor to all grain held on account of others¹²; the effect is a customer has a

⁹ CBH submission paragraph 3.30, a weighted average quality based on destination site is the information that will be made available to marketers.

¹⁰ See para 3.31 of the CBH Notification Submission

¹¹ Approximately 70 sites have outloading rates of 400 tonnes per hour compared to others where the rate is 1,000 tonnes per hour.

¹² Shrinkage is a phenomenon of stored grain and is due to a range of physical changes including drying, breakage and dust.

pre-estimated “shrinkage factor” applied to its grain irrespective of whether there is any shrinkage or the extent of that shrinkage).

- 3.36 All of these obstacles could be addressed by silo network rationalisation, additional investment in equipment and the full automation of information held in the systems of the bulk handler. At para. 3.9 of its submissions, CBH refers to its delivery forms still being in paper form.
- 3.37 Such improvements would add to the opportunity for a secondary market which has the potential to emerge further in the deregulated wheat export market. The opportunities for the expansion of the secondary market include string sales, freight, blending, hedging, and various other forms of arbitrage.

Overseas bulk sales

- 3.38 Under Grain Express, only a virtual quality profile will be provided, which is indicative of what will be delivered at destination site and based on average results. The quality profile will be based on binning grade, and not ranges within such grades. This will have the effect of wheat being accumulated to “minimum specifications”.
- 3.39 Australian wheat traditionally has had the reputation of exceeding minimum specification¹³. This has assisted in accessing markets that would otherwise be closed to Australian wheat. It has also resulted in Australian wheat attracting premium prices from its buyers. Marketers are willing to and do pay for the stock they acquire including premium for quality, provided that can actually acquire it. There is no truth in the proposition that marketers “mine” commingled stacks to obtain a greater share of high quality grain than the marketer has paid for (CBH submission paragraph 3.29). The outcome of the Grain Express proposal would be to limit export marketing opportunities. While this might be a private benefit to CBH, not only is this a lessening of competition but it may result in a reduction of exports, which would be to the detriment of the Australian public.
- 3.40 The conduct is also profoundly anti-competitive, because CBH as bulk handler will have access to quality information that is more detailed and can be used to the financial and commercial benefit of CBH’s marketing function.¹⁴ CBH will be in a position to favour the contracts of its own marketing arm. In 2004 CBH formed an alliance with the Salim Group to form the joint venture company Pacific Agrifoods. Pacific Agrifoods then acquired a 66.7 per cent stake in Interflour from Interpacific Holding (which retained 33.3%). Interflour is one of the largest flour milling operations in Asia, with 5 mills in Malaysia and Indonesia, and a mill and grain terminal in Vietnam. In 2004 CBH also obtained a one third interest in the Indonesian company PT Berdikari Sari Utama Flour Mills, which owns Eastern Pearl Flour Mill in Indonesia, the world’s fourth largest flour mill. In May 2005, Pacific

¹³ See also the ASW details referred to in paragraph 3.31

¹⁴ See paragraph 4.18 and paragraph 4.19

Agrifoods increased its equity in Interflour to 100%, and CBH's investment in the Eastern Pearl mill was increased from 33.3% to 50%.

- 3.41 To withhold the same opportunity to derive financial and commercial benefit from marketers otherwise dependent on CBH is quite simply to prevent them from effectively acting as marketers on the same "playing field" as CBH. Examples of financial and commercial benefits potentially open to CBH through Grain Express include blending opportunities, "cherry picking" or "mining" of highest quality stock and potential access to the price sensitivity of detailed volume and quality information.
- 3.42 Finally, if stock held in silo is to be divorced from ownership of marketers, marketers are impeded in their ability to manage their own risks, being the risks they assumed in entering into sales contracts with their customers. The Grain Express model tied to proposed terms and conditions of storage and bulk handling services will pass the entire risk of quality rejection and related international counterparty risks to the marketer while at the same time denying that marketer access to the information (quality, profile etc) and control (ownership) that would enable the marketer to manage the fulfilment of its contracts and its risk in connection with those sales contracts, in respect of which CBH seeks to contractually limit its obligations.
- 3.43 As an example, at cl.26 of its standard terms and conditions, subject to very narrow exceptions, CBH seeks to exclude liability to damages caused by its gross negligence or wilful misconduct. In the unlikely event the exclusion can be circumvented then CBH seeks to have its liability potentially limited to \$100,000 per any single event. Pursuant to cl.26.4(iv) of its conditions, such limitation of liability extends to losses caused by CBH varying its receival standards. These exclusions, which solely benefit CBH, mean that the exporting marketer is required to take the risk of CBH's acts and omissions.¹⁵

Optimising grain value

- 3.44 CBH's submission at paragraphs 3.32 and 3.33 proposes to address the concerns of meeting niche marketing requirements by the ability to request internal stock reservation, however this is completely inadequate as a substitute for current market dynamics since:-

- CBH commits to do no more than "endeavour " to meet such requests.
- Such requests may be refused.

¹⁵ AWB had previously used CBH as its port agent. This relationship was changed due to CBH only focussing on the administration aspects of the role and not protecting value for AWB after CBH contaminated a number of cargoes to Japan with a banned chemical substance that was applied to a GPPL vessel (Carmoisine dye). This resulted in close to \$10m of cost to AWB and severely damaged the trading and marketing relationship with Japan a premium customer. If an agent besides CBH was at the port it was likely the issue would have been picked up prior to the first AWB vessel being loaded.

- A sole individual "logistics quality manager" will be unable to provide the service required by any reasonable stretch of the imagination.
- The appointee to the role of logistics quality manager is unlikely to be sufficiently skilled and qualified in the areas required to judge the nature and importance of such requests or as between competing requests.
- In any event the appointee is subject to guidelines and quality management plans that do not yet exist.

Ocean freight market

3.45 There is a risk that fewer vessel owners or charterers will be willing to carry Australian wheat exports or, alternatively, will increase freight rates, due to increasing delays at Australian wheat ports and the potential for greater uncertainties over loading arrangements. These types of issues have already occurred at certain coal terminals in Australia, particularly at Newcastle, where the length of delays has had the effect of substantially lessening competition in that freight market. Ships that carry wheat, as a function of their typical size and cargo carrying capacity, experience greater demand from a wider range of commercial users worldwide including shippers of "clean" cargos than bulk ships used in the coal trade. As a consequence the owners and operators of ships with wheat carrying capability have less incentive to trade into potentially congested ports where their ships may be delayed and precluded from taking advantage of spot market freight rates. In the deep sea ocean freight market vessels complete an approach voyage that is subject to weather and sea conditions, speed of steaming and other variables. In a deregulated market, different charter freight contractors will bring in vessels at times to suit themselves and not with regard to vacancy at loading berths, so that queues will tend to form at peak periods. On arrival, surveys of all vessels must be carried out (another timing issue, particularly when a vessel fails a survey and has to be cleaned and re-surveyed). Grain at port may not fulfil loading requirements for vessels in the order in which they arrive, tending to further delay. The geographical distance of Australia from hub ocean freight routes limits the opportunity to substitute vessels or dictate arrival time. These are all unavoidable features of ocean freight transport and are far more costly variables in the supply chain than land-based cost components. In this context, Grain Express will provide no benefit because the drivers behind the international freight markets are all outside CBII's control and no increase in efficiencies through Grain Express (assuming there will be any) will affect international freight markets.

3.46 By contrast, for the reasons discussed in para 4.6 to 4.10, substantial demurrage¹⁶ costs stand to be added to the cost to Australian exporters as a result of Grain Express, to the detriment of those exporters. CBH terms include a charge of a fee in respect of vessel notification ("VNF") if a full 30

¹⁶ Indicatively demurrage on a Panamax size vessel (being the size typically used in Australian grain exports) is presently around US\$80,000.00 per day.

days' notice of vessel arrival is not given. This fee is currently \$2.00 per m/t if less than 15 days notice is provided of a vessel's estimated date of arrival.¹⁷ Levying of VNF does not accord with the practicalities of ship chartering and such charges if imposed will routinely result in increased costs and reduced returns to growers. West Australian ports may be less competitive than other ports as a result. Other ports from which wheat is exported in competition with West Australian ports typically operate on 10 - 15 day nomination periods and manage cargo accumulations and vessel loadings in line with shippers' expectations.

IV. Why the notified conduct is detrimental to the public interest

The global wheat market

- 4.1 The supply chain between farm gate and port terminal in Western Australia is a component of a larger model. For example, any overseas purchaser of wheat has options as to which country of origin it will deal with; assuming it decides to purchase wheat of Australian origin, it may then consider from which port of Australia it will source that wheat. It will weigh up a range of considerations including quality, timing, delivery point, parameters and restrictions and price.
- 4.2 The farm gate to port operational logistic efficiency prevailing in Western Australia has its place and its challenges, but to prioritise this element through the implementation of Grain Express above any other element and value in the larger model of the global market for wheat in bulk is misguided.
- 4.3 It lacks, for example, a rational perspective or analysis on relative cost/benefits. A full analytical analysis is required on the benefits generated in the supply chain from the introduction of the radical model compared with any resultant value destruction. This is critical as Grain Express places at risk a range of market and public benefits extending across a broad spectrum from grower incentive and choice to the national balance of trade¹⁸.
- 4.4 The value eroded is a potentially disproportionate segment of the Australian national export market¹⁹. Clearly any such erosion is not to the public benefit. The Grain Express proposal fails, in that the adverse effect on the national account is disproportionate to the minimal private gain (potentially a matter of a few cents per tonne that CBH would derive from the Grain Express proposal).
- 4.5 The public benefit is served by ensuring that Australia has a competitive and responsive grain market for both domestic sale (to the benefit of Australian

¹⁷ CBH, internet site at <http://www.cbh.com.au/grainops>

¹⁸ The national wheat pool, until now managed by AWB (International) Ltd, is a significant contributor to the Australian economy capable of accounting for around 3% of the total value of Australia's exports although obviously the figure has varied from year to year.

¹⁹ Wheat is the major grain crop grown in Western Australia. Of the grain exporting states of Australia, Western Australia produces the largest average volume of wheat per annum.

consumers) and the export market (to the benefit of the balance of trade). The public benefit is not served by protecting inefficiencies, cross-subsidization and market distortion and eliminating competition as is the inevitable effect of Grain Express.

Ocean freight costs

- 4.6 In the supply chain, the port is one component (a “choke point”) in the longer, or whole, supply chain (a loading port is not the end of the supply chain as Grain Express tends to suggest; the supply chain finishes at destination).
- 4.7 Under Grain Express the risk remains of silo space at port being filled to relieve harvest storage pressures at country sites, or multi-grains and grades being loaded on rail to effect complete clearance of a receival site to enable CBH to secure a lower operational cost of freight movement.
- 4.8 The consequence will be to reduce the ability of CBH as the bulk handler to schedule vessel loading flexibly according to particular ship load quality specifications. Vessels may need to be called out of order, simply because of constraints as to which grain can be loaded at a particular time due to the erosion of flexibility at ports on account of inappropriate product being stored at that port. In this context “inappropriate product” is grain that is stored at that port that cannot be utilised for near term shipping from that port.
- 4.9 Marketers sell on terms that include a specified loading period and a “demurrage rate” that is payable if that loading period is exceeded. The effect of vessels being called out of order or a lack of vessel loading flexibility is the likelihood of vessel loading times being delayed leaving the marketer with a demurrage exposure, without recourse against CBH, as CBH has sought to contractually exclude such liability under cl.26 of its standard terms and conditions. Similarly, (as exists in other states in Australia) the trader does not have the capability to ‘surge’ the supply chain by providing incentive pricing to road carriers to add tonnage capability to the system. The trader will have to rely on CBH to add capacity. Given CBH has no financial incentive to drive for capacity this is unlikely to create an optimal outcome. CBH does not have incentives as:
 1. CBH does not currently have exposure to demurrage; and
 2. CBH has incentives associated with fixed cost payments to not move any tonnes from rail sites by road transport.
- 4.10 The short, medium and long term effect will be to increase the arrived cost of Australian wheat and damage the competitiveness of Australian wheat in its available markets by the imposition of increased risk and cost on exporters for the sole purpose of giving a protected benefit to Grain Express in the performance of a limited part of the supply chain. If marketers are compelled to provide 30 days’ notice of a vessel arriving, they are likely to apply a premium to the vessel’s owners or operators because the vessel is likely to be in transit to Asia, and able to command a higher price, rather than potentially

lying idle in Asia and being more receptive to negotiate on price. This long notice period will increase the cost of freight and reduce the returns to growers, because buyers faced with a choice of buying in Australia or another origin where freight is not so expensive would be prepared to pay a lesser FOB price for the Australian wheat. AWB has asked CBH to consider urgently the possibility of a system of marketers booking shipping slots for the new crop grain ex Western Australia. AWB's view is that this kind of pre-paying will deter "speculative" participants and encourage those with a real need to mitigate the risk of missing shipping. The concept of slot booking necessitates CBH assuming responsibility for costs to a marketer if CBH causes the marketer to miss the pre-booked slot. There has been no indication of CBH being willing to assume this kind of responsibility.

Freight Fund

- 4.11 There are many concerns about the proposed freight fund, why it is necessary and how it would work. Further details are also required on how the freight fund will be operated and which entity or entities will be trustee of the fund, how it is audited and how funds are to be allocated. Given that the fund will support track maintenance and infrastructure investment, there are no guarantees that it will not become an income subsidy stream for the benefit of infrastructure owners' operations (and/or associated engineering maintenance divisions) rather than for the renewal of maintenance and infrastructure investment
- 4.12 CBH and ARG are of the view that while Grain Express may be exclusive dealing, this is justified in the public interest to maintain up-country rail branch lines and to simplify the supply chain logistics management. This would only be the case if there is a clear case for the retention of those up-country rail branch lines. No cost/benefit analysis underpins the assumption that up-country rail branch lines on narrow gauge networks that are used for a few months per year justify the significant cost of their retention and upkeep. Such an analysis should be done. AWB is strongly of the view that an objective analysis would conclude that only substantial and sustained flow of subsidy will keep parts of the West Australian narrow gauge network in operation. It is AWB's view that a determination of the relevant public benefit would be incomplete without reference to a testing of the assumption underpinning CBH's submission and whether contestable road freight and/or a mixture of both modes would provide a notably better set of market and environmental outcomes.
- 4.13 Considering *all* grain leaves the farm gate by road in any event, the assumption requires proper justification as to the alleged public benefit involved and whether the actual benefit is in fact a private benefit to Grain Express and ARG through ensuring their respective operations to the detriment or exclusion of other potential infrastructure providers in the future.

Grain Pool Pty Ltd

- 4.14 CBH has sought accreditation under the *Wheat Export Marketing Act 2008 (Cth)* in respect of its subsidiary Grain Pool Pty Ltd ("GPPL"), the shareholding in GPPL having been transferred to CBH in accordance with Schedule 1 to the *Grain Marketing Act 2002 (WA)*.
- 4.15 Grain Express does not provide robust safeguards against the potential for conflict of interest in the context where the CBH group of businesses will become fully vertically integrated.
- 4.16 It is relevant to note that GPPL enjoys certain preferential treatment under the provisions of the *Grain Marketing Act 2002 (WA)*, including under section 27 of that legislation being granted the first main export licence under that Act and under section 45 of that Act certain asserted exemptions from the TPA, with reference to the Competition Code. Whilst some aspects of the *Grain Marketing Act* may require review in light of the *Wheat Export Marketing Act 2008 (Cth)*, what is clear is that if GPPL enjoys any preferential treatment, then public benefit demands that the position between CBH and GPPL be rigorously examined.
- 4.17 Past criticisms of CBH that are in the public domain in this regard may be placed on record in this context:-

The Grains Licensing Authority in WA stated that *'in a number of instances there does not appear to be justification for some of the policies, fees and charges that CBH has put in place'* and *'While it is understandable that costs would be lower for a subsidiary there is no transparency as to how the costs differ and if they are justifiable'*²⁰.

Independent reports from the WA Chamber of Commerce²¹ and Industry and the Allen Consulting Group²² have detailed the existing anti-competitive practices and abuses of market power already apparent.

- 4.18 CBH has attached as Appendix 2 to its submissions its "Ring-fencing Arrangements and Policy" ("Policy"). The Policy is grossly inadequate and clearly shows the distinct market advantage that will be provided to GPPL and any other companies associated with CBH if Grain Express is allowed to operate as proposed.
- 4.19 For ease of reference, the numbering below accords with that in the Policy.

²⁰ Page 5, *Annual Report to the Minister by Grains Licensing Authority of WA: Operation and effectiveness of the licensing scheme for export controls 2005-2006*, 15 September 2006, www.gla.wa.gov.au

²¹ *Annual Report to the Minister by Grains Licensing Authority of WA: Operation and effectiveness of the licensing scheme for export controls 2005-2006*, 15 September 2006, www.gla.wa.gov.au

²² "Competition and regulation in the export wheat supply chain - access to grain transportation, storage and export infrastructure" dated March 2008

1 Organization Structure

- 1.4: Both CBH Operations and GPPL General Managers report directly to the CBH CEO and Board. This is a clear risk in establishing an independent position.

2 Physical separation

- 2.1: Having GPPL on a separate floor does not itself protect confidential information that is held by CBH.
- 2.2: CBH has failed to provide details of GPPL actually being situated in an office that is separate from CBH. However, assuming that such a move did take place, that still does not ensure the protection of confidential information (see below).

3 Accounting separation

- 3.5: CBH does not intend to have separate auditing of accounts. However, absent a strong auditing requirement, there is no independent verification that transfers or cost shifting/subsidizing has not occurred.

These points represent serious deficiencies in the "ring-fence" proposed by the Policy.

4 Information flows

AWB has serious concerns with the entire section of the Policy.

- 4.2: Provides for more detailed processes and procedures to "promote and encourage compliance". The statement acknowledges that the current Policy is not complete. Further, it shows that CBH is not seeking to enforce a compliance, but merely "promote and encourage compliance".
- 4.3: Under the exclusion provisions, CBH is effectively able to provide GPPL with:
 - (a) name, address and contact details of the marketers (vii);
 - (b) information gathered by CBH in the course of providing its services (x).

The above provides CBH with a very wide exclusion provision that practically renders the Policy ineffective, particularly given the vague terms in which (x) is drafted and the probability CBH could contend that the majority of the information it derives falls within this sub-category.

- 4.5: Only prohibits use of confidential information for the purpose of substantially damaging a competitor or conferring upon its related

bodies corporate or unfair competitive advantage. This begs the question of what is meant by "substantially" and when a competitive advantage becomes "unfair".

4.6(ii): Is discriminatory, as it provides CBH with the discretion as to the parties that will be provided with such information. The information should either be provided to all parties that request access to such information or to none.

4.9: Promotes discrimination that will favour GPPL. Marketers will only receive information that is provided to GPPL in report form, whilst GPPL will receive direct database access. Failure to provide the same information at the same time and in the same form, will provide GPPL with a direct market advantage.

5. Decision Making

This segment clearly identifies flaws in the Policy. It alternatively refers to CBH and CBH Operations (the distinction being made in paragraph 1.2) and lacks transparency. How there can be certainty that the internal dealings will be on "an arms-length commercial basis"; and the assertion that CBH's terms and conditions will differ to "proportionately reflect objectively verifiable commercial factors" is not only a vague generalisation but also beyond verification. Further, at point 5.1(iii)(D)(5), CBH proposes an objective "to protect the port terminal provider (ie. CBH) against liability" – that is to entrench the shifting of cost/risk for CBH's own actions to their customers – see also paragraph 3.43, above.

6. Compliance

The Compliance provisions of the Policy are hollow. They are nothing more than a statement of good intent. The Policy – if it is put forward as a ring-fence – must include obligations, mechanisms, sanctions and discipline for breaches. There are none.

7. Complaints Handling

The Complaints Handling processes are no more than a façade. A complaint of a breach of the Policy is to be made to CBH for CBH to investigate. There is no impartiality; there is no independence and there are no rights or sanctions. The reference to a possible external auditor in point 7.4(ii) is meaningless. Any such independent audit will be driven by CBH (and not the aggrieved party) and at best the outcome of an external audit according to point 7.5(iv) will be recommendations to appropriately address the "the compliance failure". This process in the Policy is meant to give an impression of viable procedures; in reality it is a procedure to suppress complaints through internally managed control.

Contingency

- 4.20 In the event of a derailment or similar incident, under Grain Express the consequences for marketers and other stakeholders could be dire in terms of lost revenue, liability claims and loss of customer goodwill. Any proposals such as Grain Express should address this contingency and be predicated on the provider holding both relevant insurance coverage and accepting appropriate liabilities so as to protect the public benefit. Grain Express's terms and conditions exclude or severely limit the liability of the provider. This means that risk and liabilities are likely to be largely borne by users of Grain Express such as AWB, rather than those responsible for or with the ability to control the likelihood of the problem arising.

Freight performance incentives

- 4.21 Under Grain Express there is no mechanism of market choice to provide incentives to rail and road contractors to improve their performance and services, nor is there accountability given the extraordinarily favourable limitations of liability with which CBH's standard terms and conditions protect CBH. The likelihood of failures and poor performance stands to be increased (as it is not subject to any sanction) in such an environment, to the detriment of the public benefit.

Use of fumigants

- 4.22 Very rarely or never are fumigation cycles interrupted by opening of bins during the fumigation period for health and safety reasons.
- 4.23 The best way to avoid logistic inefficiency through fumigation constraints is to provide a fumigation schedule as transparent information available to all marketers. Marketers will then be able to cooperate to ensure efficient outcomes including by making use of the secondary accumulation market, to the public benefit.

Information

- 4.24 In addition to the comments relating to information flows (see para. 4.19 above under the heading "Information flows") AWB expresses concern at the accuracy and quality of data presently being received from CBH. AWB's concerns largely relate to information that is not correct. This is particularly the case in reconciling stock entitlements and stock adjustments. Further, the information that is provided is not provided on a timely basis. Recording of rail movements has been poor, creating commercial issues between AWB and customers. There is no reason to believe that under Grain Express serious deficiencies in data transmission will be rectified and it is not in the public interest for marketers to not have concise up to date information.

V. Conclusions

- 5.1 AWB submits that the ACCC should remove any immunity under the Act in respect to CBH's Notification concerning its Grain Express proposal. Grain Express is not properly characterised as full line forcing but if the ACCC takes a different view, the alleged public benefit that may result from the proposed conduct will not outweigh the detriment caused by the lessening of competition.
- 5.2 The West Australian supply chain, the subject of the Notification, is not a discrete chain but is one component of the global agricultural supply chain. The global supply chain is complex with demand being generated from numerous importing countries and impacted by changing global supply and production forecasts.
- 5.3 The solution to inefficiencies in the West Australian supply chain that is likely to have the greatest overall, widespread and long term benefits is a solution based on information transparency rather than information suppression and the monopolisation of the supply chain.
- 5.4 Grain is classified as a commodity that is tradable on the world market. The value resides in the nature of the product in its unprocessed form being available to the customer when demand exists at a price that is acceptable. Therefore optimisation within a grain commodity supply chain requires a focus on satisfying discrete points of customer demand. This demand takes many forms from either demand in the non-physical trading exchanges, or through direct sales to an end-user of the raw product.
- 5.5 Given the relatively small domestic market in Western Australia, optimisation will occur by satisfaction of discrete demand from international customers. Value will be maximised for most, if not all of the participants within the West Australian supply chain if the main objective is to maximise the value that can be extracted from the base grain. This is best achieved by satisfying discrete customer demand (grain quality and timing of sales and delivery) in the most efficient manner. It will not be achieved by narrowly focusing on the efficiency of the way in which bulk handling and related services are to be provided in a manner that will *'... optimise infrastructure utilisation and minimise supply chain cost'*.²³

23 July 2008



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Gordon Davis
Managing Director, AWB Limited

²³ Synergy Report, at 30.