

**COOPERATIVE BULK HANDLING LIMITED EXCLUSIVE DEALING
NOTIFICATION N93439 – INTERESTED PARTY CONSULTATION**

**SUBMISSION TO THE AUSTRALIAN COMPETITION AND CONSUMER
COMMISSION BY AWB LIMITED**

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1. Introduction

- 1.1 This submission is made on behalf of AWB Limited ("AWB") and its related entities in response to the Australian Competition and Consumer Commission's ("ACCC") review of the notification provided by Cooperative Bulk Handling Limited ("CBH") referred to as the "Grain Express notification", which essentially provides that CBH will offer to supply storage and handling services on condition that growers or marketers of grain acquire:
- (a) supply chain coordination services from CBH; and
 - (b) transport services from CBH whilst their grain remains in CBH's custody.
- 1.2 On 23 July 2008 AWB provided a written submission to the ACCC as part of the ACCC's public consultation process about the Grain Express notification first lodged in June 2008. AWB relies upon, but to avoid repetition does not repeat here, the matters raised in its earlier submission opposing the Grain Express notification. AWB makes the further submissions below as to why the ACCC should revoke the Grain Express notification and, where it is able to do so or has a comment to make, AWB responds to the specific questions raised in the ACCC's letter dated 18 June 2010.
- 1.3 AWB has consistently held the view that the imposition of the Grain Express model in Western Australia would lead to a significant erosion in competition and value for market participants in Western Australia. After almost two seasons of operation, AWB firmly retains this view.
- 1.4 As this submission identifies, there are several commercial activities within the 'wheat-belt of Western Australia' that have been negatively affected by the introduction of Grain Express. These include the commercial rail and road sectors and the container packing market.
- 1.5 Furthermore CBH has not increased the efficiency of the bulk storage and handling system but, instead, has used Grain Express to exercise monopoly power to:
- (a) increase fees and charges to its customers for bundled services, under the guise of

implementing efficiencies; and

(b) significantly increase its revenues at the expense of growers, domestic consumers and marketers.

- 1.6 CBH argues that their storage and handling business and marketers' competitiveness will be significantly eroded if the Grain Express 'command' style approach is not maintained. AWB's position is that through the introduction of Grain Express, CBH has avoided the need to improve the efficiency and operation of its four port facilities, which if that was to occur, would substantially improve the capacity of the Western Australian export sector and alleviate the need to create rigid, expensive 'up-country' operating processes and policies that transfer higher costs and all operational risks to their customers.
- 1.7 Paragraph 2.37 of this submission discusses the events that led to the most significant inefficiency to have occurred during the operation of Grain Express and demonstrates that poor port planning and operation were the cause of a significant episode of value destruction within the industry in early 2009. CBH sought to blame its sole rail provider for the underperformance of the CBH system. In fact, the inefficiency was created by CBH incorrectly forecasting the grain quality required by the marketers at CBH's ports. As a result there was insufficient available capacity at port to accumulate the grain required by marketers to properly perform their sales contracts. CBH's command style of capacity planning and the asset utilisation planning that underpins Grain Express was the cause of these losses.
- 1.8 It is relevant to note that when CBH realised the error of their approach, they unilaterally applied an overly expensive 'surge' charge that required immediate agreement from marketers, some of whom faced the prospect of breaching existing sales contracts and foregoing existing and pre-paid shipping slot bookings if they did not agree to the surge charge (see paragraph 5.4). AWB believes that a significant component of the unspent 'surge' charge was passed on to growers (members of the cooperative) rather than back to the exporters who directly carried the risk and over-charging to meet their contractual obligations to international customers.
- 1.9 This submission highlights that Grain Express is an expensive and inefficient solution imposed upon the industry at the expense of a more targeted capital expenditure program at the respective Western Australia grain ports that could: (a) improve flexibility of operation for all exporters; (b) improve capacity planning for CBH; (c) allow for a more competitive inland transport market; (d) support more competition in

the container packing sector; (e) give domestic processors more choice on the origin of their grain quality requirements; and (f) allow growers to be rewarded for grain quality in ways that Grain Express currently prohibit.

- 1.10 Recognising the inefficiencies that have been created as well as the anti-competitive benefits that have accrued to CBH as a result of Grain Express, requires an appreciation of the several components that facilitate the grain market from the point of production. These components and the damage caused by Grain Express are set out below.
- 1.11 Grain acquisition strategies predominantly target growers. Bids for grain are quoted on the basis of price, quality and time. Grain Express has effectively abolished the ability of marketers to discern and then maintain a specific quality profile offered by a grower at a local or up-country site market. This has removed a marketer's ability to discern and pay for specific quality characteristics. This has a two-fold effect. First, it has contributed to a decreased ability for Australian exporters (with the possible exception of CBH's marketing arm) to guarantee specific quality attributes to international buyers. This means a loss in the ability to supply to niche markets. Secondly, it has effectively eliminated the ability for Western Australian growers to earn quality premiums for their grain. As a marketer cannot obtain and retain control over that particular parcel of grain, there is no benefit to the marketer if it was to pay a premium to the grower for that higher quality of grain.
- 1.12 Under Grain Express, the inability to offer quality differentiation payments (similar to the 'Golden Rewards' offered under the Single Desk System on a farmer 'load by load' basis) is severely reduced to the point that the risk to the marketer outweighs the reward of offering quality incentives at a local level. Grain Express effectively commingles grain within a wide regional catchment and CBH only guarantees the out-turn of a notional receival standard quality and in some instances a lower state based receival standard. Any marketer offering a 'Golden Reward' style incentive in Western Australia is very likely to be incurring significant losses in the operation of these programs.
- 1.13 AWB strongly advocates the revocation of the Grain Express notification to create a more vibrant, competitive series of local and regional markets in Western Australia and it believes that the most effective solution to improving the long term efficiency of Western Australia's grain supply chain and the competitiveness of the grain marketing sector is for CBH to focus its efforts on improving its export capacity

planning and port operations.

- 1.14 On 8 July 2010, CBH sent an email to growers stating that, in the event the ACCC revokes the Grain Express notification, freight costs will increase, storage and handling costs will increase, greater weighted averaging will be highly unlikely, there will be less efficiency at CBH sites, less capacity available at ports and limited access to marketers. CBH concluded the email by stating, *"if you want to ensure Grain Express remains in place and protects the benefits of YOUR CBH system, then please share your support of Grain Express with the ACCC by contacting ..."*.
- 1.15 The above email is disturbing, for a number of reasons, which include:
- (a) As discussed below, the introduction of Grain Express has not increased efficiency or capacity at ports; and
 - (b) Charges have increased under the Grain Express system and there is no reason to believe charges will not continue to do so in the future if the Grain Express notification is not revoked. The services for which CBH has increased its prices include but are not limited to export loading, domestic outturn and container packing.
- 1.16 The ACCC should be wary of support for Grain Express which might be marshalled from this thinly veiled scare campaign conducted by CBH.

2. General

Impact of Grain Express on competition at all levels of the grain supply chain in Western Australia

Upcountry storage and handling

- 2.1 Since the commencement of Grain Express, Western Australian growers have invested more heavily in on-farm storage. AWB argues these growers are seeking to establish an alternative pathway to market as a direct result of the increased charges CBH has imposed on users of its system, (many of which are passed back to growers). AWB has been approached by several grower groups seeking alternative ways to move their grain to their market. However, as the growers do not have an alternative to Grain Express that is commercially viable, the increase in on-farm storage has not resulted in an increase in up-country competition. It merely results in a delay in that grain entering the Grain Express system. While AWB supports competition, CBH has a massive advantage through incumbency and scale which is uneconomic to replicate and compounded by the advantage conferred on CBH by the

Grain Express notification. As set out in detail below, CBH is using its scale and the additional benefit of Grain Express to its advantage and to the detriment of growers and marketers. Grain Express in its current form is proving to be anti-competitive in the manner in which it has stifled transport and container packing competition. Competitive alternatives in both these service sectors would assist new entrants to develop alternative pathways to export markets.

- 2.2 As noted in paragraph 2.1 above, AWB has not observed a significant increase in competition in the up-country storage and handling sector, despite CBH having significantly increased its fees since 2008 (see paragraph 2.40 below).
- 2.3 Grain Express does not create an incentive to have on-farm storage for the purpose of transporting the grain outside the Grain Express system, as there is no real alternative to Grain Express when moving the grain to port.

Grain transportation – general

- 2.4 AWB has observed a reduction in competition in grain transportation since Grain Express. CBH charges marketers who arrange transport outside Grain Express a “Non-Grower Receival by Commodity” fee of \$10.00 p/t for grain delivered into a CBH port from a non-CBH upcountry load site plus an additional fee known as the “Additional Non-Grower Receival Fee” of \$1.10 p/t. CBH says the “Additional Non-Grower Receival Fee” is to cover sampling and the manual process of CBH accepting the grain, yet CBH provides the same service to growers for no additional charge. CBH's charge structure under Grain Express makes it cost prohibitive for marketers to outturn grain from the up-country silos, where it is delivered and sold by the growers, for transportation to CBH's port terminal facilities and penalises marketers who wish to arrange their own transport. The Grain Express notification therefore enables CBH to charge higher prices, regardless of the cost of the rail service, because marketers have little, if any, option but to use Grain Express. It also means suppliers of transport services have little or no market to service outside Grain Express.
- 2.5 The ACCC considers the ability of growers and, to a lesser extent, procurers of grain to arrange transport outside Grain Express will provide sufficient competitive tension for CBH to maintain low prices. This is unrealistic and has not transpired. CBH has increased its prices since Grain Express was introduced and there is no real ability for growers or marketers to arrange transport outside Grain Express. The additional charges CBH imposes on marketers who choose to arrange transport outside Grain Express means it is not feasible for marketers to use alternatives to Grain Express. In

order for the opportunity to arrange transport outside Grain Express to provide sufficient competitive tension for CBH to maintain low prices, marketers have to be free to choose their own provider without incurring additional costs.

- 2.6 The area in which CBH previously faced significant competitive tension was the container export market. Independent container packers grew in size in Western Australia between the 2006/2007 and 2008/2009 seasons. In the 2008/2009 season, CBH increased its container packing charges from \$23.25 to \$27.50 per m/t (i.e. \$4.25 per m/t). At the same time, its domestic outloading fee only increased from \$2.90 to \$3.20 per m/t (i.e. \$0.30 per m/t). This meant that CBH's container packing services were not as competitive as alternative suppliers. However, in 2009/2010, CBH increased its domestic outturn fee from \$3.20 to \$8.50 per m/t (i.e. \$5.30 per m/t). As CBH does not apply that outturn charge to marketers who use CBH's container packing services, alternative container packers could not compete with CBH on price and it was not economically viable for marketers to use independent container packers. This resulted in some well established East Coast service providers such as Professional Grain Service Pty Ltd (ABB as then it was), Adams Packing Pty Ltd and AWH Pty Ltd ceasing to operate in Western Australia.
- 2.7 It should be noted that where grain is exported in containers, it is the domestic outturn point where CBH relinquishes its control over the grain as the containers are not exported from ports operated by CBH.
- 2.8 Previously, marketers were able to outturn grain that they had procured and stored in the CBH network for packing into containers by independent packing companies. As a result there was additional capacity in the storage and handling system, greater control over grain that was to be used to supply niche markets and downward pressure on costs charged by these service providers because of the number of competitors servicing the market. Grain Express removed the above competitive tension by practically removing the viability of an alternative supply chain.
- 2.9 As a result of the above, whilst alternative container packers closed their operations and moved to the Eastern states, the service fees at CBH's container packing facility have increased from \$19.50 in 2006/2007 to \$30.00 in 2009/2010. That is an increase of 54 %.
- 2.10 Without the restrictions imposed by Grain Express, marketers would accumulate grain on a lowest cost and transparent freight model, similar to that which exists on the East Coast.

- 2.11 The East Coast supply chain allows for:
- (a) the movement of grain from specific sites to port, using the services of various container packers, road or rail carriers; and
 - (b) seasonality of demand for services, meaning that carriers can freely move from one East Coast state to another to supply services required by marketers in moving the grain from up-country to port.
- 2.12 For example, during May and June of the 2009/2010 season, AWB moved a train from Victoria to South Australia to fulfil the transport requirements of another marketer. This could not have occurred under Grain Express.
- 2.13 Without the restrictions of Grain Express freight, capacity from the East Coast could move in and out of the West as demand required.
- 2.14 It is impossible to comment on whether there are differences in quality (including price) between road haulage services provided under Grain Express compared with services outside Grain Express because there is no transparency in the pricing or performance of services under Grain Express.

Grain transportation - road carriage

- 2.15 Grain Express prevents marketers from choosing the most cost effective mode of transport. Road carriage is a feasible transport option within a 300km radius of port. Road carriage is more cost effective than rail in areas like in Geraldton and Esperance where approximately 60% of transport occurs by road. However, marketers are unable to capture the cost efficiencies of road transport in these locations if CBH's services are used.
- 2.16 By limiting or removing the marketers' transport choice and ability to influence its cost structure, marketers do not have the ability to pass on potential cost savings and efficiencies to buyers and growers.
- 2.17 In an open, free supply chain market, a road or rail carrier could move transport assets across from the East Coast to the West Coast to increase capacity. It is common practice for repositioning to occur in the East Coast states.
- 2.18 CBH's proposal to sign four to five year contracts with road transport providers will prevent other entrants from seeking to provide road transport services. East Coast transport carriers (road or rail) would not consider moving surplus capacity across to Western Australia if the work is contracted out for a long period of time.

- 2.19 Since Grain Express, there have been no new competitors or investment in road carriage and, thus, marketers have no flexibility as to which carrier to use.

Port terminal services

- 2.20 There is no competition for port terminal services in Western Australia because CBH controls all grain export ports in Western Australia.
- 2.21 Since the introduction of Grain Express, there has not been an increase in capacity at the ports.

The public detriments arising from Grain Express

- 2.22 Making 'a least cost supply chain' (as this might appear to be on the surface) the driver or determinant of the way in which bulk handling and related services are provided substantially lessens competition in established markets and stifles competition in other emerging markets, to the detriment of the users of Grain Express.
- 2.23 By forcing growers to use the bundled services, growers pay for the whole of those bundled services, not just the services they require. The effect is a potential increase in cost to growers, which impacts on a marketers' position when purchasing stock to fulfil export contracts.
- 2.24 Grain Express also disadvantages marketers. Marketers pay CBH additional freight charges but, unlike growers, were not entitled to the freight rebate paid in 2008/09 on account of the surplus funds remaining from freight revenue after payment of expenses. CBH is yet to confirm whether it will pay a freight rebate for 2009/2010.
- 2.25 Grain Express passes the risk of poor quality stock to the marketers, who do not have the control (ownership) or access to information (regarding quality) to be able to manage their commercial risk or the fulfilment of their contractual obligations.
- 2.26 Under Grain Express, marketers have no control over their grain or the standard of grain they will receive at outturn. This reduces marketers' ability to service niche markets and achieve better prices, ultimately to the detriment of growers and the public for the reasons set out below.
- 2.27 CBH has a contractual obligation to outturn grain to its own minimal receival standard. CBH is not obliged to outturn grain to a higher receival standard, despite the fact that a higher standard of grain might enter the Grain Express system. The system allows CBH to blend wheat to achieve only minimum quality specifications, to the detriment of Australia's reputation and export marketing opportunities. It also means that if marketers identified grain from a grower that it knew would comply

with standards required by an overseas buyer that are higher than receival standards offered under Grain Express:

- (a) marketers could not buy that grain in the knowledge that it will be the grain outturned by CBH (and therefore would not know if they would be able to perform a sales contract); and
- (b) Grain Express has removed the ability for marketers to reward growers, in the form of price premiums, for producing wheat with particular quality attributes.

2.28 Grain is not a homogenous product. Under Grain Express, marketers are only entitled to receive grain at 15 Destination sites. This limits marketers' ability to monitor the quality and characteristics of stock and capture regional differences in grain specifications. It also prevents growers from receiving premium prices for grain that has particular quality attributes. This combined with the high fees charged by CBH to outturn from a CBH site, means that it can be cost prohibitive to service any niche markets.

2.29 Historically, Australian wheat has had a reputation of exceeding minimum specification. Since Grain Express, AWB has had to notify Japanese customers that grain from Western Australia would not meet Japanese minimum specifications. This has the potential to compromise Australia's reputation in the Japanese market, limit export opportunities and reduce the price which Japanese customers might be prepared to pay for premium wheat.

2.30 CBH says it is committed to accommodating niche grain entitlements upon request, although at a higher price that (it says) reflects the extra cost of providing the service and CBH will not guarantee that it can deliver grain to service niche markets.

2.31 It is cost prohibitive and practically impossible for marketers to service niche markets through CBH for the following reasons:

- (a) To service niche markets through CBH, marketers first need to accumulate or stack earmark grain in order to meet quality specifications, for which CBH charges:
 - (i) \$0.70 p/t for the first month
 - (ii) \$0.70 p/t for the second month; and
 - (iii) \$2.10 p/to for the third and each subsequent month.

- (b) If the grain is not earmarked (and there is only one chance to do this), CBH can move the grain on behalf of any other shipper.
 - (c) CBH has offered to earmark stock up to 25% of a grade by that marketer's zone entitlement. However, the marketer with the largest proportion of stock in the zone has first priority to accept this service. As CBH's trading arm is the largest holder of grain in Western Australia, it enjoys the right of first request.
 - (d) Marketers bear all the risk involved because CBH will use only "reasonable endeavours" to meet an agreed quality management plan.
- 2.32 Upon request, CBH has provided site specific ownership data to AWB. AWB intended to use that information to tailor grain parcels for specific customers. However, this was not feasible given the amount of grain that could be reserved due to CBH's reservation/earmarking rules.
- 2.33 AWB has not tried to reserve specific stock due to the terms and conditions of CBH's storage and handling agreement that pass on any added risk to the marketer, should anything happen to the stored grain. The combination of CBH's earmarking/reservation rules and the terms of CBH's storage and handling agreements means that AWB incurs additional costs and execution risks, without CBH committing to providing any additional service.
- 2.34 The Grain Express system is highly anti-competitive as it represents a lost opportunity to service niche markets, imposes charges that do not reflect actual cost and it creates the opportunity and incentive for CBH to provide its marketing arm with information about the quality of its stock and to blend stock or "mine" for high quality stock. This occurred recently when marketers (other than CBH's marketing arm) were advising Japanese buyers of noodle wheat that they did not have the wheat which complied with their specifications. At the same time, AWB was informed that CBH's marketing arm advised the Japanese buyers that they would be able to supply wheat which met the required specifications. CBH's marketing arm would not have been in a position to give this advice unless they were privy to information which was not available to other marketers and/or CBH "mined" for high quality stock to meet the required specifications.

The efficiency of Grain Express, including timeliness of the system in delivering grain to port and the appropriateness of the fees charged

- 2.35 AWB has not observed an increase in efficiency or timeliness of the system under

Grain Express. The problems experienced at the Western Australia ports in the 2008/2009 season provide a good example of Grain Express's inadequacies. Despite controlling the flow of grain to port, CBH was unable to transport sufficient grain through its system to port for loading onto waiting vessels. As such, marketers experienced severe delays in loading grain onto their vessels. It was only the historically low freight rates and associated low demurrage rates that reduced the financial cost to the industry.

- 2.36 Had it been possible (physically and economically) for marketers to transport their own grain to port outside the Grain Express system, the delays in loading the waiting vessels would have been greatly reduced.
- 2.37 Under Grain Express, the protocol requires marketers to have ownership of and nominate notional stocks at port no less than 22 days prior to the carrying vessel's estimated time of arrival. That date cannot be later than the last day of the shipment period. Grain Express should move this stock into a shipping position. The market, marketers, and the protocols in place should drive Grain Express to accumulate the grain in accordance with the market's requirements. However, movement to port is controlled by CBH's forecasting. CBH chooses the grain that it will move to port. CBH usually moves grain from one area at time. CBH's forecasting can and has been incorrect, meaning that marketers cannot properly perform the sales contracts. Under the terms of its storage and handling agreements, CBH does not bear any responsibility for its decisions.
- 2.38 Grain Express is inefficient and out of touch with real market demand, as can be seen from what occurred in the 2008/2009 season. In the early part of 2009, AWB consistently had issue with CBH not making its grain entitlements available at port when required, despite AWB complying with CBH's notification requirements. A specific example involved the sale of wheat to Iran. Iran experienced a drought in 2008 which lead to a significant importation program in 2009. In planning and physically moving tonnes to port, CBH moved milling grade wheat to port before the market gave the signal to accumulate certain grades for the Iranian program. The predominant grades required for the Iran program were non-major milling grades. The grain specifications required to fulfil the sales contracts were lower than that which was being held by CBH at port and that which was being moved to port under Grain Express. Australian marketers could not supply the minimum standard grain required to comply with the Iranian contracts and provided grain that exceeded contract specifications. This specific example had the following negative

ramifications:

- (a) Marketers paid additional surge cost to acquire transport to move grain to port to mitigate vessels demurrage;
- (b) Marketers paid additional surge cost to acquire transport to move specific grades of grain to port to attempt to maximise contract value;
- (c) Marketers obtained a lower price than should have been achieved for the same quality of grain;
- (d) The quantity of that higher standard of wheat left in Australia for sale and export was less than should otherwise have been the case; and
- (e) Australia was left with a larger quantity of lower standard of wheat for sale from Australia than should otherwise have been the case.

2.39 Prices for Grain Express increased significantly in 2008/09 (see the **attached table** marked "Attachment 1" and the examples set out below). CBH claims that the price increases in 2008/09 were caused by it having to pay more to ARG for its rail services. AWB does not believe the price increases were justified but it is unable to elaborate because there is no transparency as to how the charges were determined.

2.40 The following price increases were made by CBH from the 2008/09 to the 2009/10 season:

- (a) **CBH's Outturn & Re-delivery Fee** increased from \$3.20p/t in 2008/2009 to \$8.50p/t in 2009/2010.
- (b) **CBH's Carryover Fees** increased from \$3.00 p/t 1 Oct 08/09 to \$3.50 p/t 09/10; from \$2.10 p/t, 1 Nov 08/09 to \$2.50 p/t 09/10; from \$2.00 p/t 1 Dec 08/09 to \$2.50 p/t 09/10; and from \$1.90 p/t 1 Jan-2 Sept 08/09 to \$2.00 p/t 09/10.
- (c) **CBH's Domestic Outturn Fee** increased from \$3.20p/t in 2008/2009 to \$8.50p/t in 2009/2010.
- (d) **CBH's Domestic Outturn to Rail Fee** increased from \$5.70p/t in 2008/2009 to \$11.00p/t in 2009/2010.
- (e) **CBH's Export Fee** increased from \$8.00 p/t in 2008/2009 to \$14.10 p/t in 2009/2010.
- (f) **CBH's Upfront Marketer Fee** is a new fee of \$3.00 p/t.

Whether any improvements were made to Grain Express for the 2009/10 season compared to the 2008/09 season – and the impact of any improvements upon the efficiency of the system

2.41 AWB has not noticed any improvements to Grain Express for the 2009/2010 season compared to the 2008/2009 season.

3. Up-country storage and handling

Approximately what size is an average grain export shipment and could a grain marketer fill an average-sized export shipment entirely from on-farm stored grain in Western Australia?

3.1 AWB's average shipment is 35,000 m/t. In AWB's opinion, it is unlikely that an average-sized shipment could be filled entirely from on-farm stored grain.

What would be required to build sufficient up-country off-farm storage to be able to by-pass CBH's up-country storage and handling facilities (and, therefore, Grain Express)?

3.2 To build sufficient off-farm storage to by-pass CBH's up-country facilities would require the following:

- (a) Land to build the storage facilities;
- (b) Silos;
- (c) Unloading and receival facilities;
- (d) Weighing facilities;
- (e) Ability to safely store;
- (f) Ability to safely fumigate;
- (g) Moisture management system;
- (h) Sampling and testing facilities;
- (i) Segregation facilities;
- (j) Facilities to clean and dry grain;
- (k) Accumulating and assembling point;
- (l) Outturning facilities;
- (m) Access to road and/or rail.

4. By-passing Grain Express (other than up-country storage)

Excluding up-country storage, what other aspects of the supply chain may be necessary to effectively by-pass Grain Express – for example, is access to the rail network required and if

so are there any impediments to gaining such access?

- 4.1 To effectively by-pass Grain Express, marketers must have access to road and rail transport. At present, there is no real alternative to Grain Express for moving grain to port. The current impediments to access include the high cost of outturning grain from CBH's system and the ever decreasing access to road and rail carriers.

For grain delivered directly to a port outside of Grain Express, are there any extra charges at port? In your opinion, are these charges reasonable?

- 4.2 See paragraph 2.4 above.

If you have not delivered grain direct to port but would like to do so, please provide your reasons for not doing so

- 4.3 AWB has not delivered grain direct to port as it is cost prohibitive for it to do so outside the Grain Express system. This is due to the excessive outturn fee and the limited alternative transport that is now available.

5. Transport

What was your experience with the transport segment of Grain Express for the 2009/10 season as compared to the 2008/09 season? In particular, were you satisfied that grain was moved efficiently to port or other sites when requested?

- 5.1 For the reasons set out above, Grain Express is not an efficient system for transporting grain to port because of the excessive fees, additional charges and lack of control marketers have over the standard of grain received through the system.

Did CBH require marketers or producers (or both), using Grain Express, to pay any transport surge fees in the 2009/10 season? If so, what explanation was given for these fees?

- 5.2 In 2009/2010, the grower pays the freight cost to port with no surge cost.
- 5.3 The marketers pay for the surge through buying surge capacity (once the normal operating capacity is consumed surge capacity can be booked). There is no transparency in regards to the actual costs required to accumulate or whether the grain was accumulated without the need for additional costs. There is also no rebate to marketers in 2009/10.
- 5.4 CBH required AWB to pay a surge fee in the 2009/10 season.¹ AWB received an email from CBH on 17 February 2009 in which CBH advised AWB that it was implementing a "surge" fee. AWB was given until the close of business on 18

¹ CBH paid a rebate for surge costs in 2008/09..

February 2009 to accept the imposition of the new fee. The surge fee was forced on AWB in circumstances where it had no alternative but to accept the charges or risk delays or penalties (the cost of demurrage).

5.5 CBH claimed that the fee was necessary to increase the rate of accumulation of grain at port zones. CBH did not explain why the fee was charged or the basis on which the fee was calculated.

5.6 The surge payments caused the accumulation program to be front ended, versus an accumulation program. CBH's yearly forecasts should be based on historical export patterns on a month by month basis. This would mean that additional capacity in CBH's rail contracts under Grain Express would occur at some point during the season. Depending on their contracts with ARG and road carriers, CBH may not have been required to pay for this unutilised capacity. However, a lack of transparency means that whether this has taken place is not known.

5.7 Grain Express intrinsically links growers and marketers, thus marketers have a requirement for full visibility of CBH rail contracts when growers receive rebates and marketers pay surge based on CBH planning.

5.8 AWB does not know if Grain Pool was charged a similar surge fee.

In relation to the transport surge fees CBH charged marketers in the 2008/09 season, please provide details of the dollar and percentage amount of the surge fees that CBH returned

5.9 In 2008/09, AWB paid surge fees of \$2,167,551 and received a rebate of \$659,110.

Are there geographic regions in Western Australia where it is more efficient to transport grain from silo (or producer) to port by road compared to rail? What is the difference in the cost of transporting grain by road compared to rail in the various geographic regions?

5.10 Road carriage is a feasible, efficient transport option within a 300km radius of port and is more cost effective than rail in areas like in Geraldton and Esperance where approximately 60% of transport occurs by road. AWB cannot provide further information due to lack of transparency.

How difficult is it to source transport in Western Australia, other than through Grain Express? Is there currently sufficient spare capacity available, for example, rolling stock and/or trucks, for a marketer to arrange its own transport to port?

5.11 In theory, it is possible to source transport in Western Australia (i.e. trucks). However, it is not economically or practically feasible for marketers to use alternative transport because of the limited number of Destination sites from which the grain can

be outturned, the high cost of outturn (\$8.50 per m/t) and the high cost of re-delivery to the CBH system at port (\$11.10 per m/t).

- 5.12 Paragraphs 2.11 to 2.18 above also suggest that, but for Grain Express, there would be potential to source alternative transport. However, Grain Express removes the incentive and opportunity for other rail service providers to make the necessary investment and the ability of marketers to source other viable alternatives.
- 5.13 AWB believes the Western Australian grain market would be able to tap into capacity that exists in other industries (such as the Fertiliser, Mineral Sands etc) and spare capacity in the East Coast states if the restrictions of Grain Express were not in place.

6. Demurrage

Do you think Grain Express contributed to demurrage costs faced by marketers in either the 2008/09 or 2009/10 seasons? If so, why? How did the Grain Express contribution to demurrage costs, if any, differ between the 2008/09 and 2009/10 seasons?

- 6.1 Grain Express results in marketers having no control over or visibility of the planning process, and therefore no ability to directly influence their own vessel's accumulation. Yet under CBH's storage and handling agreements, all the risks of execution are borne by marketers including, but not limited to demurrage costs.
- 6.2 Grain Express increased AWB's exposure to demurrage costs during 2008/2009 season for the following reasons:
- (a) Grain Express was not able to move grain to port efficiently and within the time frame nominated by marketers and agreed to by CBH;
 - (b) CBH's charges made it cost prohibitive to outturn grain from CBH silos and transport the grain using non-Grain Express transport; and
 - (c) CBH refused the offers made by marketers to assist in the transportation of grain to the ports;
- 6.3 CBH sought to pre-empt the market quality requirement, by taking on the responsibility of choosing the grade of grain to move to port. Despite AWB notifying CBH of its expected requirements (in terms of volume, quality and so on, as required under the Grain Express protocols), AWB was not able to access the grades of wheat requested and was limited to the stock already at port. CBH determines the grades to be accumulated, without regard to the requests for services made by and paid for by the marketers. Therefore, vessels have to wait for their cargo and marketers are exposed to substantial claims for demurrage.

- 6.4 It should be emphasised that it was not a lack of port capacity that caused the delays in loading the vessels. Rather, it was the inability of Grain Express to deliver a service that CBH agreed, and was paid, to provide. CBH's answer to reducing the demands on the Grain Express system was, first, to impose a surge fee with one working day's notice (see paragraph 5.4). If AWB did not accept the surge fee then CBH would not commit to when an AWB vessel would be loaded.
- 6.5 Then, CBH imposed the Auction system in 2009/10 which is biased towards CBH's marketing arm. Marketers' entitlement to a rebate (once the total auction results are known) is measured against the total tonnage shipped during the relevant period, without reference to the premium paid at auction. As CBH's marketing arm is the largest shipper of grain from Western Australia, it stands to benefit the most from the Auction system.
- 6.6 In part the Auction system has reduced the demurrage problems of 2008/09. However, AWB still has concerns that quality optimisation is in the hands of CBH, which can result in the quality of the grain being used to perform export contracts exceeding specifications or marketers risking further demurrage. AWB's position is that Grain Express cannot operate efficiently without the terminal taking full responsibility for demurrage as per standard global practice.
- 6.7 CBH requires marketers to have ownership of a notional grain entitlement at port. In the current system CBH does not participate in vessel demurrage. It should be a natural extension of an efficient notional stocks system for the risks and associated costs (and benefits) of an integrated export system to be borne by both the marketers and CBH.

7. Shipping capacity allocation auction system ("Auction system")

Did CBH's Auction system rules impact on your decision to use Grain Express in the 2009/10 season? Please provide details. For example, did the requirement under the Auction rules that marketers must nominate either the Grain Express supply chain or a Direct to Port Access supply chain, within five business days from the completion of each auction, influence your decisions?

- 7.1 The necessity for liquidity in the secondary market requires marketers to nominate the Grain Express supply option. In order to trade on the secondary market, a marketer has to trade like with like. To the best of AWB's knowledge, there are no 'Direct to Port' option Trade slots available for trade on the secondary market. This means marketers are forced to nominate the Grain Express supply option. To do otherwise

means limited or nonexistent participants in the secondary market to buy a Direct to Port Access shipment slot.

What is your view of the way in which the Auction system operated during the 2009/10 season?

- 7.2 The Auction system has not been a success, save that it has managed to reduce the demurrage problems that occurred in 2008/09.
- 7.3 The Auction system has failed for the following reasons:
- (a) Excessive premiums paid by the market for slots, based on the fear that CBH would control the stem;
 - (b) The cost and risk imposed by the half month shipping periods imposed under the Auction system; and
 - (c) Ambiguous rules that are applied subjectively and without clarity.
- 7.4 Excessive premiums have been paid for slots which were not justified as it transpired that there was more supply of shipping capacity than there was demand. The first two annual auctions lasted nearly two days each with premiums \$14.00 over par, or 28 rounds. Subsequent auctions lasted no more than two rounds or \$1.00 above par with the last three auctions trading at par. Shipping slots were not a scarce resource. Premiums were high because CBH booked a significant proportion of the stem and their cost of not executing or lost capacity (\$14.10) was different compared to other traders. CBH's lost capacity or the take or pay cost of not shipping was paid to the operations part of the business, an internal transaction with no actual cost to the business. Marketers viewed this as an advantage to hoard the stem and felt compelled to remain in the auction to secure supply and access to the stem. In short, marketers felt that CBH were running up the auction premium, with less consequence to themselves than to others.
- 7.5 The average Auction premium is \$7.77 per m/t in addition to a \$3.00 per m/t upfront marketers fee. However, the Auction premium has reached \$14.00 per m/t. CBH's charge for non performance of a shipping slot is \$14.10 per m/t. These three fees mean that on average, the marketer will pay \$24.87 per m/t for a service, whether or not is used. However, based on historical figures, the combined fees could total \$31.10 per m/t. These fees distort the Australian export market. There are examples of marketers entering into "fire sale" contracts to sell grain at lower than market rates. If the discount on the sales price is less than CBH's fees, the marketer's loss will be

less than had it not used the vessel slot.

- 7.6 Alternatively, a marketer could pay another marketer an amount less than the above CBH fees to take the vessel slot, in order to reduce their losses that would otherwise be incurred.
- 7.7 By way of example of paragraph 7.6 above, a marketer that could not perform on a vessel slot paid AWB \$9.00 per m/t to take on responsibility for that slot, rather than incur CBH's charges in full. That marketer still had to forego the upfront marketer's fee of \$3.00 per m/t and the Auction premium rebate.
- 7.8 The Auction system created half month shipping periods. This was a significant change to a market that previously could determine required laycans, i.e. Japan historically had shipment periods from 10th to the 10th of the next month, covering 3 periods under the new system. Now a marketer is required to buy one slot and manage their risk if a vessel presents outside this period. The cost and risk associated with a vessel presenting outside the 15 day shipment period is unknown. The risk cannot be managed with existing FOB sale contracts or charterparties. Buyers will not accept this risk nor the inflexible terms and new costs imposed by CBH. This means that the marketers must bear the risk associated with CBH's ever changing rules and fee increases.
- 7.9 Under CBH's port terminal rules, trading in the secondary market cannot occur less than 30 days prior to the first day of the shipment period. However, CBH has the discretion to and has on occasion waived this requirement. CBH's ability to change the rules at its discretion creates a lack of certainty for participants in the Auction system and negatively impacts liquidity in the secondary market.
- 7.10 The Auction system hides the failings of the way CBH operates Grain Express. Under Grain Express, CBH controls the flow of grain to the port and loading on board the vessels. It also controls which vessel nominations are accepted. If CBH was able to operate its system properly, the Auction system (together with the associated additional costs and complexities) would not be required.
- 7.11 CBH asked marketers for feedback and suggestions on the Tradeslot auction for the 2010/11 season. Most of the debate centred on flexibility to move shipment slots between periods, the cost of lost capacity and the rebate. CBH then published a Notice to vary the port terminal rules for 2010/11. For the most part, the changes address industry requirements. A significant issue AWB has with the proposed changes revolves around the risks that CBH incurs vis-a-vis other marketers. In particular,

CBH proposes that an Auction participant will receive the weighted average of the auction premium as a rebate, as per tonnage acquired by that marketer, regardless of whether the tonnage is shipped or not, or traded in the secondary market. In AWB's opinion this opens the Auction and the market up to distortion. CBH in particular has less risk associated with lost capacity as it becomes an internal transaction. There must be equal and equitable penalties for all parties, (including CBH), that do not perform on shipping slots. For example, CBH should incur the same cost to their business as other parties, in the event that they do execute a shipment slot, not just a ledger transaction between divisions. AWB views this change to the rebate as another mechanism that will reduce liquidity in the secondary market and create an unfair advantage to CBH.

In your view, did the Auction system impact on the secondary market? If yes, what changes to the Auction system do you consider are required to facilitate a more effective secondary market?

7.12 The secondary market for shipping slots has been greatly constrained by the Auction system for the following reasons:

- (a) The Auction system allocates a narrow period within which the vessel must arrive at port to ensure that the marketer is not exposed to further costs and/or loss of vessel slot;
- (b) When seeking to trade on the secondary market, the marketer can only trade like with like. That is, where a marketer has a shipping slot for grain that is to be delivered Direct to Port (outside the Grain Express system), it cannot sell that slot to a marketer wishing to purchase a vessel slot for grain that is in the Grain Express system and vice versa. To the best of AWB's knowledge, there are no "Direct to Port" option Trade slots available for trade on the secondary market.

7.13 Instead if an auction system is to be used, that system should create a tradable commodity in shipping slots. To do this, the following is required:

- (a) Unambiguous rules (which are not open to subjective interpretation or CBH's discretion) to participate in the auction and the services provided by CBH; and
- (b) Equal and equitable penalties for all parties including CBH, i.e. CBH needs to be exposed to the same business costs as other marketers, if they do not execute a shipment slot, not just a ledger transaction between divisions.

8. Conclusion

- 8.1 For the reasons set out above, AWB submits that the Grain Express notification has the purpose or effect of substantially lessening competition and the public benefits do not outweigh the anti-competitive detriments resulting from the substantial lessening of competition and, accordingly, the Grain Express notification should be revoked.

Date: 30 July 2010

A handwritten signature in black ink, appearing to read 'Mitch Morison', is written over a horizontal dotted line.

Mitch Morison
General manager, Commodities - AWB Limited

0708		
Fee		Comments
Transfer of ownership	\$33.10	Per line item - Paper request
	\$22.60	Per line item - On line
Storage		
Domestic outloading		
Dom Express	\$2.25	Where CBH arrange transport
Dom standard	\$2.90	Site specific, owner organises t/port
Domestic outturn to rail	\$5.20	
Export outloading		
Export Assist	\$7.20	CBH site selects and arranges transport
Export Select	\$7.70	CBH arranges transport, the customer nominates the site selections
Export Standard	\$8.75	Customer arranges transport and selects sites
Vessel Nomination		
> 22 days	\$0.00	
> 15 <22	\$1.00	
>0 <15	\$2.00	
Vessel Cancellation	\$1.05	If accumulation has commenced and vessel nominated
Shipping relocation	\$2.10	Fee may be charged if cargo for a nominated vessel is held and needs to be relocated.
Blending fee	\$1.05	
Container packing Fee	\$23.25	Includes blending
Transport Recovery Charges	\$1.00	Covers rail and road labor resourcing and recovery on investment
0809		
Fee		Comments
Transfer of ownership	\$0.30	Paper request
	\$0.15	On line
Domestic outturn fee	\$3.20	
Domestic outturn to rail	\$5.70	
Storage		
Additional non grower receival fee	\$1.10	
Outturn and redelivery fee	\$3.20	For cleaning or drying and redelivery
Non grower receival fee	\$10.50	Applied to loads delivered into CBH by non grower delivery
Grain Assessment	\$1.15	Sampling and testing at the receival site
Export outloading		
Export loading	\$8.00	
Vessel Nomination		
> 22 days	\$0.00	
> 15 <22	\$1.10	
>0 <15	\$2.20	
Vessel Cancellation	\$1.15	
Shipping relocation		
Kwinana	\$2.30	Fee may be charged if cargo for a nominated vessel is held and needs to be relocated.
Gerladton, Albany, Esperance	\$4.00	Fee may be charged if cargo for a nominated vessel is held and needs to be relocated.
Blending fee	\$1.15	
Container packing Fee	\$27.50	
Container Blending fee	\$1.15	
Transport recovery fee	\$1.10	Covers rail and road labor resourcing and recovery on investment
0910		
Fee		Comments
Transfer of ownership	\$0.30	Paper request
	\$0.15	On line
Domestic outturn fee	\$8.50	
Domestic outturn to rail	\$11.00	
Storage		
Non grower receival fee	\$10.00	Applied to loads delivered into CBH by non grower delivery
Additional non grower receival fee	\$1.10	Sampling and testing fee
Domestic outturn to rail	\$11.00	
Export outloading		
Upfront marketer fee	\$3.00	
Export outloading	\$14.10	
Shipping relocation		
Kwinana	\$2.30	Fee may be charged if cargo for a nominated vessel is held and needs to be relocated.
Gerladton, Albany, Esperance	\$4.00	Fee may be charged if cargo for a nominated vessel is held and needs to be relocated.
Container packing fee	\$30.00	
Blending fee	\$1.15	
Outturn and redelivery fee	\$8.50	For cleaning or drying and redelivery
Late Shipment	\$3.00	7th day after load period
	\$3.00	14th day after load period
Vessel Cancellation	\$17.10	Loss of outloading fee + premium

Season	0708		Season 0809		Season 0910		% Change	Comments
	Service	Price	Description	Price	Description	Price		
Transfer of ownership		\$3.10	Per line item - Paper request	\$0.30 pt	Paper request	\$0.30 pt	33% / 232% / 8750%	3 scenarios used, a transfer of 100mt, 1000mt and 40,000mt Assumptions: Transfers performed on line
		\$22.60	Per line item - On line	\$0.15 pt	On line	\$0.15 pt		
Domestic Outloading		\$2.25 pt	Where CBH arrange transport	\$3.20 pt	Where the customer arrange transport	\$8.50 pt	-427%	The increase in this fee has eliminated the ability of a shipper to move procured grain from the CBH system to an independent service provider (Packer)
Dom Express		\$2.90 pt	Site specific, owner organises upport					
Dom standard								
Domestic outturn to rail		\$5.20 pt	Grain is weighed and outloaded to rail for outturn from the CBH system	\$5.20 pt	Grain is weighed and outloaded to rail for outturn from the CBH system	\$11.00 pt	+111%	The service remains the same yet the fee has increased 111%
Export Assist		\$7.20 pt	CBH site selects and arranges transport	\$8.00 pt	Export loading Fee	\$17.10 pt	+87%	The fee now includes the up-front marketer fee of \$3 pt plus the export loading fee that includes blending
Export Select		\$7.70 pt	CBH arranges transport, the customer nominates the site selections		(does not include the \$ 1.15 pt blending fee)			
Export Standard		\$8.75 pt	Customer arranges transport and selects sites (does not include the \$ 1.15 pt blending fee)					
Container packing Fee		\$23.25 pt	includes blending Container packing Fee Container Blending fee	\$27.50 pt \$1.15 pt	Container packing Fee Container Blending fee	\$30.00 pt \$1.15 pt	+34%	The cost of packing containers was \$19.50 pt in 0907. This reflects a 60% increase in the past 4 seasons.
Vessel Cancellation		\$1.05 pt		\$1.15 pt	The up-front marketer fee + the Export loading fee is non refundable	\$17.10 pt	+1500%	The risk of non performing has been transferred from CBH to the marketer at the same time other services (revenue) fee's have increased.
								General Comment CBH continue to claim costs have not increased, and in most cases they haven't to the grower. As you can see above the costs have increased substantially to the trade who return passes these costs back to the grower, and where he cannot WA grain becomes uncompetitive on the global market

0809 Surge

AWB Paid	\$2,167,551
Rebate	\$659,110
Total	\$1,508,441