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3 February 2011

Dr Jill Walker
Commissioner
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

Dear Dr Walker

CBH Grain Express Notification N13439

Thank you for attending and presiding over the pre-decision conference held in Perth on 20 January 2011. I appreciated the opportunity to communicate directly with you and your team in the presence of growers, marketers, State Government representatives, Local Government representatives, industry experts and other interested parties.

In this letter, I will respond to what I thought was the most relevant question asked in the meeting:

> ***"If Grain Express is as good as CBH says it is, why does CBH need to compel growers and marketers to acquire it?"***

The first point to make in answering the question is that CBH does not compel growers to acquire Grain Express. However CBH does apply terms and conditions to its unbundled warehousing service that, as the ACCC's draft notice has identified, may have the effect of discouraging marketers from using their own transport resources to move grain between CBH's upcountry storage facilities and ports. This distinction is important. Growers have at least three choices. They can:

- cart their grain all the way to port;
- warehouse and sell to a marketer, having the grain out-turned upcountry and the grower or marketer can use its own transport to port; or
- use Grain Express.

I understand that marketers believe Grain Express prevents from arranging transport between upcountry storage facilities and the ports, but it is not correct to say that growers are denied that choice.

So why then, does CBH require the notification? CBH requires the notification because without it, marketers are likely to challenge the terms and conditions of CBH's bundled and unbundled offers. They will do this because in some circumstances, marketers would like to acquire grain in CBH's system, outturn it onto their own transport and re-introduce it to the CBH system at port. They want CBH's terms and conditions to allow them to do that without significant additional cost to them. Essentially, this means a shift from marketers acquiring grain entitlement[1] at port (Grain Express) to marketers acquiring grain entitlement at country sites.

To appreciate the significance of this issue, one needs to understand the difference between "site based entitlement" and "port based entitlement" and also to appreciate the impact of each structure on supply chain control and efficiency. If a marketer acquires an entitlement to outturn grain from a country storage site, that marketer is then in a position to instruct CBH about when, where and how to move that particular quantity of grain to port. However, if a marketer acquires an entitlement to the grain only at port, the marketer has no such control or involvement in the movement of grain between country storage and port because the grower has already performed the port transport task through its cooperative, CBH. The idea behind the notified conduct is that **growers** choose between site based entitlement and "port based entitlement.

When growers choose Grain Express, they choose a port based entitlement system in which their cooperative is able to move grain between country storage and port in the most efficient manner possible, with the necessary transport resources acquired in bulk through a competitive tender process and arranged without profit to CBH.

We know what happens when marketers are able to structure the supply chain so that they acquire entitlement at site and control the movement of grain to port. We know this because that was the system that existed in Western Australia before Grain Express. It is the main system that exists in other States of Australia. In a site-based entitlement system, marketers move grain in a way that suits the individual needs of that marketer and without reference to the operation of the logistics system as a whole. In general, this means that:

- grain storages are opened more frequently;
- smaller parcels of grain are removed and transported on a more ad hoc basis[2];
- grain movements typically take place later in the season (because marketers move grain in order to load specific vessels rather than in anticipation of the entire harvest task as CBH is able to do);
- more upcountry sites fill and close;
- marketers tend to choose road resources over rail (incurring the externalities referred to by the transport experts in public meeting);
- marketers take a margin on the transport resources they re-supply.
- supply chain costs increase;
- those higher costs are passed onto growers by marketers.

I do not suggest that a revocation of the notification will result in a shift of the entire system to site based entitlement and marketer control of transport. Rather, the revocation of the notification is likely to cause marketers to assert a right to acquire some[3] grain upcountry, remove it from CBH's custody, transport it to port (most likely on road as is evident from Mr Brooke's comments) and then load it on a vessel at CBH's port terminal. As they did in the meeting, marketers will assert that, any of the terms and conditions of relevant CBH services that the marketer regards as unjustified are unlawful and predatory.

While it is tempting to think that the disagreements evident at the pre-decision conference were about "tying" conduct, in substance, they were really about the terms and conditions of the Grain Express bundle.

As a result, the likely result of the revocation is that there will be a significant degree of erosion of the efficiency of Grain Express. Grain Express will still exist, but it will operate at higher cost because there will be a proportion of the export grain task that will operate on a site based entitlement system with transport controlled by marketers. The analysis performed by Frontier Economics shows how this pushes costs onto other market participants. What is at stake is not the survival of Grain Express but a significant proportion of

[1] I use the term "entitlement" because the liquid nature of commingled grain means that property in specific grain is impossible, so a participant can, in practice, only acquire a right to be given a specified quantity and grade of grain.

[2] You may recall one attendee at the meeting saying that CBH's cost comparisons were unhelpful because load sizes in Eastern States are smaller. That is exactly our point.

[3] We cannot predict how much or how often

the efficiency benefits of Grain Express. Those benefits are valued by growers and they are conveyed not only in the form of lower storage handling and transport fees but also in an avoidance of externalities like local road usage problems and risk of increasing insect resistance to fumigants.

In summary, enabling marketers to control transport movements between up country and port:

- will not introduce much additional competitive tension in comparison to the present system, which focuses competition in a tender process and the choices available to growers; and
- will put at risk a substantial proportion of the public benefits arising from a system which delivers benefits from scale, scope and reduction of externalities.

CBH needs to construct its terms and conditions in the environment of certainty that the notification provides. Growers, who control CBH, are in favour of the notification. Government is in favour of the notification. Experts on freight logistics recognise the benefits of the notification. Quantitative evidence clearly shows that Grain Express, in its current form, operates more cheaply than its predecessor system in Western Australia and than any other supply chain in Australia. Opponents of the notification have good reasons for their opposition but those reasons are quite properly and understandably focussed on the kind of system that would most benefit their shareholders as opposed to WA grain growers.

Please look again at the issues raised in this letter and the accompanying attachments. If you have any questions or wish to discuss any issue please do not hesitate to contact us.

Yours sincerely

Dr Andrew Crane
Chief Executive Officer

Enc. Frontier note on issues raised in ACCC pre-decision conference

CBH notes on assorted other issues raised in the ACCC pre-decision conference

Response to issues raised in ACCC pre-decision conference

A NOTE PREPARED FOR CORRS CHAMBERS WESTGARTH

February 2011

Response to issues raised in ACCC pre-decision conference

We have been asked to respond to two particular matters raised during the ACCC pre-decision conference. These relate to the relevance of the $10.50 fee for receival, storage and handling whenever grain is delivered to a receival point at or near to port; and whether access to CBH's storage and handling facilities is necessary for competition in the market for grain transport.

The $10.50 receival fee at port under Grain Express does not prevent competition in the market for grain transport

During the ACCC pre-decision conference, one grower argued that the $10.50 receival fee at port under Grain Express prevents growers from organising their own transportation arrangements to by-pass transportation options offered under Grain Express. We disagree with this view, and instead believe the level of the fee demonstrates why transportation service providers should be able to compete on their merits with the options provided under Grain Express such that it does not lead to a substantial lessening of competition in the market for grain transport.

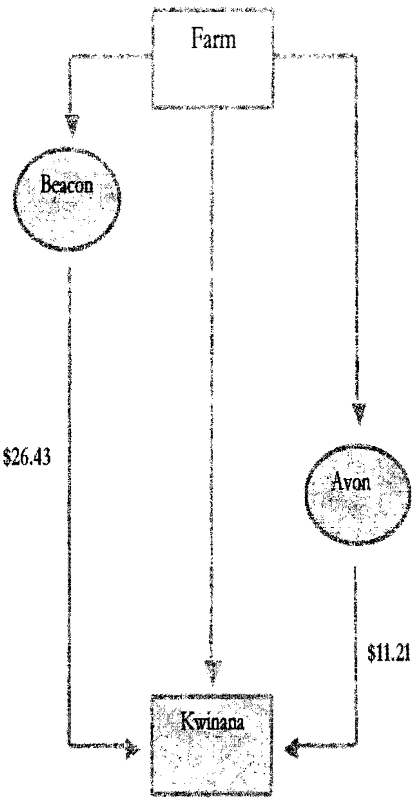
By way of background, the ACCC's Draft Notice finds that Grain Express substantially lessens competition in the market for grain transport in Western Australia. It appears to suggest that the tying arrangement locks-in use of CBH-organised transportation if growers and/or marketers wish to utilise CBH's storage and handling facilities. In turn, the ACCC appears to suggest this will lessen the competitive constraint that might otherwise exist in the market for grain transport, and removes the threat of alternative transport providers directly supplying services to growers.

We submit that this misunderstands the way in which Grain Express operates. As set out in our response to the Draft Notice[1], growers and/or marketers can still use Grain Express and organise their own transportation by choosing where in the CBH supply chain to deliver their grain.

To illustrate, suppose a grower has a farm near to Beacon, and wishes to export his grain through Kwinana. The grower then has a number of options for deciding how best to use Grain Express. These are illustrated in Figure 1 below.

1 See Frontier Economics, *Response to ACCC Draft Notice in respect of the Grain Express Notification*, at section 3.1.2.

Figure 1: Achieving competition in grain transport with Grain Express



OPTIONS

1. A grower could deliver his grain to Beacon, and have CBH organise transport for him to port. Using the Grain Express Freight Rates published on 18 October 2010, transportation from Beacon to Kwinana would be likely to cost $26.43 per tonne.
2. If the grower thought he could organise transport on more favourable terms than those offered by CBH, he could organise alternative transportation to deliver his grain to any other part of the CBH supply chain. For instance, he could deliver it directly to port at Kwinana, and therefore incur no transportation fee under Grain Express. This may be a better option for him if he believes he can organise transport more cheaply than the $26.43 per tonne rate offered under Grain Express.
3. Alternatively, a grower can deliver grain to an in-between point between Beacon and Kwinana (such as at Avon). The Grain Express Freight Rate between Avon and Kwinana is $11.21. Hence, if the grower thought he could transport grain between Beacon and Avon at a price cheaper than $15.22 per tonne (i.e. the difference between CBH's rates to port at Beacon and Avon), but he could not organise transport between Avon and Kwinana more efficiently than under Grain Express, then he could mix and match transport options to suit his particular circumstances.

It is clear therefore that Grain Express still enables competition in the market for grain transport in Western Australia in a number of meaningful ways. Transporters can still compete to move grain from up-country farms to port, or to move grain to any intermediate point along the supply chain. If competitive transport operators are more efficient at doing so, they are free to compete with the transport options offered under Grain Express.

As indicated above, one grower argued during the ACCC pre-decision conference that this form of by-pass was not feasible under Grain Express because a grower would have to pay a receival fee of $10.50 per tonne if he delivered grain directly to port. We submit that this fee does not limit competition in the market for grain transport because this fee is the same irrespective of where in the supply chain grain is delivered. In the example set out above, a grower will pay this fee irrespective of whether his grain is delivered at Beacon, Avon or Kwinana. Given the fee is the same at all these points, a grower can focus his decision regarding who should transport grain to port based simply on the efficiency of (and prices charged by) different transport operators, including those options offered by CBH under Grain Express. This is illustrated in Figure 2 below, which compares the costs to a grower or marketer of delivering grain at either Beacon or Kwinana. Provided the cost of a competitor's transport (in this case, T) is less than the cost of transport under Grain Express (i.e. the GE Transport cost of $26.43 per tonne), a grower will find it cheaper to deliver grain into the CBH supply chain direct to port, rather than at Kwinana. Importantly, alternative transport operators need only ensure they are more efficient in transporting than the option available under Grain Express if they are to win customers to them. They are therefore able to compete on their merits with the transportation options available under Grain Express.

Figure 2: Why the $10.50 receival fee promotes competition

Supply chain stage	Grain Express	Own Transport
Beacon receival	$10.50	n/a
GE Transport	$26.43	n/a
Competitor transport	n/a	T
Kwinana receival	n/a	$10.50
Total cost	$36.93	$10.50 + T

Put simply, Grain Express does not force growers or marketers to use CBH's transportation options if they want to use Grain Express. As the examples set out above illustrate, Grain Express does not totally prevent competition in the market for grain transport if growers want to use CBH's storage and handling facilities.

The only limitation Grain Express places on transportation options is *after* grain is entered into the CBH supply chain. For instance, a grower would not be able to enter grain up-country at a receival site (such as Beacon), but then take it out at another point (such as Avon) at no additional cost and organise for alternative transport before re-entering it at another point such as Kwinana. While this option is not foreclosed, a grower or marketer would have to pay a domestic out-turn fee of $8.50 per tonne. Charging a fee to take grain in and out of the system at various points in the supply chain is not, however, unreasonable if it imposes additional costs on CBH. It may also be efficient to charge a fee above the direct costs incurred by CBH of out-turning grain at a particular receival point if it also causes disruption to the operation of the supply chain as a whole and therefore imposes costs on others users of the supply chain in terms of reduced supply chain efficiency.

Hence, while Grain Express does seek to levy fees if a grower and/or marketer seeks to withdrawn grain from the CBH supply chain *after* it has been entered, it does not limit where in the supply chain it can be entered. The ability to enter grain at any point in the supply chain means growers and marketers can seek alternative transport options to move grain between their farm and port and still use the storage and handling facilities under Grain Express. In this way, it preserves competition in the market for grain transport in Western Australia in a number of meaningful ways.

Response to Glencore 20 January 2011 submission

We note that at point 16 of Glencore's 20 January 2011 submission to the ACCC, Glencore argues the Morawa-Geraldton example contained in section 3.1.2 of our January report is misleading. Glencore argues this is because the $0.95 per tonne fee is a transport charge to move grain from CBH's Geraldton port storage facility to the Geraldton port terminal. We disagree that this example is misleading and believe it actually serves to demonstrate how a grower or marketer can avoid much of the $17.06 per tonne fee for moving grain from Morawa to Geraldton if it is willing to find an alternative transport supplier that will enable it to deliver grain to a point closer to port. Clearly, a fee of $0.95 per tonne to move grain from the Geraldton port storage facility to the Geraldton port terminal is substantially less than the $17.06 per tonne fee for asking CBH to organise transport from Morawa to Geraldton. The $0.95 per tonne fee would also be payable by any grower who chose to deliver grain to CBH's Geraldton storage facility.

We also understand that there is no transport fee at all if a grower delivers grain directly to either the Kwinana or Albany storage facilities. Based on information set out in Table 4.1 of the ACCC's Draft Notice, these two ports handle approximately 69.56 per cent of average annual grain export volumes out of Western Australia.[2]

Access to CBH's storage and handling facilities is not necessary for competition in the market for grain transport

A number of comments made by parties during the pre-decision conference (and in particular those made by ARG) suggested that by-pass of Grain Express is not

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2 See ACCC, *Draft Notice in respect of a notification lodged by Cooperative Bulk Handling Ltd*, 6 December 2010 at Table 4.1 on p. 6. The combined average annual grain export volumes out of Western Australia is 11,500,000 tonnes, of which 8,000,000 tonnes (or 69.56 per cent) is exported out of Kwinana and Albany.

possible if there are alternative transportation options that are more efficient for moving grain to port.

In addition to the option available to growers of delivering grain at points closer to (or at) port discussed above, we believe there is nothing to prevent alternative transport operators developing their own storage and handling facilities to completely by-pass the CBH system if they wish to compete with Grain Express. As argued by Frontier Economics in its response to the ACCC Draft Notice, up-country storage and handling facilities are not natural monopoly facilities[3]. This has been recognised by the Productivity Commission, and is evidenced by the growth of alternative on-farm storage facilities in Western Australia. It is also shown by the development in recent years of competitive up-country bulk storage and handling facilities on the east coast of Australia.

If ARG believes it can transport grain to port more efficiently than the options offered under Grain Express, there is nothing to stop it investing in its own storage and handling facilities at strategic points in up-country Western Australia if it does not want to use CBH's up-country storage and handling facilities.

This would appear to be supported by comments made by Dr Fred Affleck on behalf of the Freight and Logistics Council of Western Australia, who commented during the ACCC pre-decision conference that[4]:

> ... there are some large on-farm storage set ups that it is possible to truck grain from and it is also possible for growers to establish silos on the grain network. This would enable them to truck the grain to those silos and then have it transported to port.

While it is true that CBH has some advantages over new entrants in the sense that it has already invested in storage and handling facilities of its own, this is the same for any firm wanting to enter a market. The issue to consider is whether investment in alternative storage and handling facilities is a barrier to entry for alternative providers of bundled storage, handling and transportation services.

We believe the growth in on-farm storage in Western Australia, and the development of alternative facilities in other parts of Australia, suggest this should not be the case. Indeed, a new entrant might have some advantages over CBH in providing storage and handling facilities. A new entrant would not need to invest in (and maintain) all of the 193 receival points CBH has invested in to compete to provide an alternative to Grain Express for some growers, and could instead focus on particular high demand points in up-country Western Australia and/or develop mega-centres of its own at particular strategic points. It may also be able to take advantage of advances in storage and handling techniques to offer more efficient storage and handling facilities than those previously built by CBH.

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3 See Frontier Economics, *op. cit.*, at section 3.1.1.

4 ACCC, *Pre-decision conference Minutes*, 20 January 2011, at p. 6.

In other words, while incumbency can have advantages, it can also create disadvantages as demand patterns change at up-country storage and handling points and newer efficiencies develop in storage and handling techniques and facilities.

Ultimately, access to storage and handling facilities is not necessary for competition in downstream transport markets. The costs of alternative investment are not prohibitive, and storage and handling facilities are not a natural monopoly.

Response to Glencore 20 January 2011 submission

We note that at point 15 of Glencore's 20 January 2011 submission to the ACCC, Glencore questions whether the figure of 2 million tonnes of on-farm storage facilities referred to in our January 2011 report is correct.

To be clear, references in our report to on-farm storage facilities relate to the capacity of on-farm storage facilities. In this regard, we have referenced information from the Department of Infrastructure, Regional Development and Local Government[5]. We consider this to be an independent source of information on this matter. It is noteworthy that this body has estimated there is *currently* 2 million tonnes of on-farm storage in Western Australia, and that this will *grow* to between 3 and 4 million tonnes in coming years.

[5] See Department of Infrastructure, Regional Development and Local Government, *Independent Review of the Grain Infrastructure Group's Freight Network Review: Review of Technical, Cost and Market Assumptions,* 2009, at p.25. This is referenced at footnote 13 of our January report.

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Issue: Allegation that CBH awarded the rail contract to itself

This claim was made by ARG in relation CBH's recent announcement that it was awarding the responsibility for above rail operations to Watco Companies Inc (**Watco**). It is an incorrect statement that implies that CBH is operating rail transport services itself. Since the commencement of Grain Express CBH has been provided above rail services by ARG. ARG also managed access to the below rail network on behalf of CBH.

CBH recently awarded Watco the opportunity to provide those above rail services to CBH to move all grain handled by CBH for export. In conjunction with this, CBH will now play a role in the below rail contract in order to gain greater visibility and control over this critical part of using rail transport to move grain.

In order to complete the transaction CBH will enter a rail freight agreement with Watco to provide the legal foundation of the relationship. This agreement will provide incentives for Watco to move more tonnes of grain and generally provide better services to CBH and the users of its system. CBH has not decided to enter the rail transport industry as alleged.

As part of bringing in a new operator to WA, CBH is purchasing some rail assets including locomotives and wagons. CBH is doing this to achieve a number of objectives including:

- Obtaining newer, safer and more productive rail equipment;
- Ensuring that the rail equipment can be depreciated over a longer period than a rail operator who was attempting to gain a return on the asset within a 10 year contract timeframe;
- Leveraging CBH's balance sheet to provide better freight rates; and
- Facilitating new methods of operating which better integrate with CBH's operations.

The fundamental difference between this arrangement and the current one with ARG in a legal sense is that control of the rail assets will revert to CBH at the end of the rail freight agreement thus reducing the barriers to entry to a new operator taking over the contract if Watco is not performing. CBH then pays a transparent amount for the equipment and below rail access instead of it being bundled into a single opaque rail freight charge.

If the notification continues, rail transport capacity will not be diminished. CBH will acquire an appropriate number of rail wagons to provide the requisite capacity. That may include the acquisition of some, but not all, of the ARG wagons that are still in good working order if an appropriate price can be reached.

However, in the absence of the notification, all parties appear to be in agreement that additional tonnes would move to port by road. This agreement is found in ARG's original submission to the ACCC in 2008, and the comments at the pre-decision conference by the Freight and Logistics Council[1], Local governments[2] and numerous growers.

Issue: Allegation that rail volume will not necessarily move to road

This issue was raised by a number of marketers who state that CBH is attempting to run a scare claim about rail.

One of the efficiencies of Grain Express is that there is a greater proportion of unit trains. With disparate ownership at site under the marketers proposed system, Marketers would have no option but to move uneconomic tonnages by road.

For example, a standard gauge train carries 3500 - 4000 tonnes of wheat and a narrow gauge train carries between 2200 and 2700 tonnes of wheat depending on configuration and axle

[1] See comment by Dr Fred Affleck at page 5 of the minutes.
[2] See comment by Mr Steve Martin at page 8 of the minutes.

load. Carrying smaller amounts will increase the unit cost per tonne to a point where it is more efficient to carry by road transport.

The other cause of a shift to road transport is the possibility of part train loads at a site? If the marketer only has half a train it is more likely to be moved by road as it would be inefficient to send half a train. In this situation, distributing the locomotive weight over less wagons results in higher effective below rail access cost per tonne of grain moved and the fixed costs of the locomotive are distributed over fewer tonnes thus increasing the unit cost per tonne of grain moved.

Attached are maps showing which sites marketers would have acquired tonnages had there been a site entitlement system in place. The maps show aggregate tonnages and do not take into account commodities and grade splits which may slow loading and unloading significantly (see break out box below). For the purposes of assessing what might be feasible to go by rail CBH has adopted a 2000t minimum task for rail.

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Preliminary estimates are that at least 15% of volume available to be transported on rail will be lost to road transport. CBH considers that the end result will be higher as some customers will not want the hassle of arranging rail transport on only a few occasions throughout the year and will therefore use road transport. In addition, the figure above does not take into account the amount of grain above 2000t that may not constitute a full trainload. If a train is 2000t and a marketer has 3000t at site, the above assumption is that all 3000t will be moved by rail. However, in reality the full train load of 2000t might go by rail and the remaining 1000t will go by road.

The remaining grain handled by rail will be much less efficient as there will be a much greater number of multiple grades and multiple commodity trains than currently. This will result in CBH's outloading and inloading rates dropping from current levels, reducing the ultimate throughput at its port terminals. Further it is likely that cost savings currently held under Grain Express will be lost and no longer available to CBH and its grower members.

In addition, CBH considers that the minutes of the Pre-decision Conference do not correctly represent the impact of Mr Jeff Myers of SRT Transport's statements[3]. CBH's recollection is that Mr Myer made the point that if more grain went to road the damage would be far greater than currently occurring as there would be both a move in (currently carried out in harvest when the majority of road transport occurs) **and a move out** [CBH emphasis] (which is not currently occurring at rail sites). Two road transport movements will increase the damage being done to the roads. This was further illustrated by Danielle Whitfield of WAFF[4] who raised the issue that the move out would likely be conducted with larger trucks which would exacerbate the damage.

[3] See page 8 of the minutes.
[4] See page 8 of the minutes.

Dealing with multiple commodities
Dealing with multiple commodities and grades may significantly impact on transport efficiency and port terminal operations. This was one of the reasons for the introduction of Grain Express, as it facilitated the possibility of unit trains.

Different commodities and grades cannot be mixed in either over rail loading cells or receival pits. For instance, when receiving a train with multiple commodities at port, after the first commodity has been unloaded, the pit and conveyor belts need to be run until they are empty (approximately 10 minutes) the train needs to be broken apart and the receival grid cleaned [blown down] and elevators checked (10 minutes) and the system set to unload into a different cells (5 to 10 minutes) before the next commodity can be loaded or received. This adds from 25 to 30 minutes to the unloading time for each change in commodity. Two or three commodity changes can increase the time to unload by 50% to 100% and consequently reduce the throughput of the facility.

When changing between grades of the same commodity, elevators and pits need to be run clear and checked but the grid does not need to be blown down and the train does not need to be split because the risk of contamination with a foreign grain does not exist. The system still needs to be set to unload into a different storage cell. Therefore each grade change adds about 20 to 25 minutes to the unloading time for each grade change.

Issue: Allegation that container packers going out of business

Container packers did not go out of business because CBH reorganised its fees. Container packers ceased to operate because their business model was not sustainable. If the sole reason that container packers failed had been due to CBH's storage and handling fees then they could have constructed their own storage. CBH does not have a monopoly on storage and handling facilities[5] and some of the operators that withdrew are themselves storage and handling providers.

CBH considers that the principal reasons that container packers failed is that the spread between the bulk freight market and the container freight market returned to normal levels in 2008/09 thus reducing demand for grain in containers and the bulk wheat export market was opened up from being a single desk in 2008/09. This meant that exporters who had exported significant tonnages in containers historically as the only method of exporting could now provide bulk grain to their customers cheaper than they could containerise it. This was a natural market adjustment and had nothing to do with the notification and any attempt to link it to the notification is ill-informed.

Issue: Stock swaps will not prevent transaction costs and coordination problems

Glencore's submission implies that stock swaps can solve all coordination issues and allow all efficiencies to be maintained. In essence a stock swap is where marketers agree to swap ownership at two different sites and pay a fee based on each parties assessment of the different location and potentially quality. Parties may pay a premium when their alternatives are limited and they will otherwise incur costly fees and charges.

CBH disagrees with Glencore's contention and considers that this simplistic examination of the coordination issues inherent with 26 wheat exporters together with barley and canola exporters does not take into account the transaction costs that may be imposed. Stock swaps are never without cost and difficulty.

[5] For more information see the note containing Frontier's comments on storage and handling not being a natural monopoly.

For instance, how will Glencore know which other marketer has stock at a given site? Does Glencore expect that CBH will be expected to coordinate the stock swap? Will Glencore propose to share the type and volume of stock that it has at different sites so others can see if they could swap with Glencore? On what basis do the marketers agree the value attributed to the difference in location and quality? Will CBH need to bargain with stock owners to move stock at peak harvest demand?

Unlike the situation that existed prior to the opening up of the export wheat market, there is no buyer of last resort who can be relied on to have significant tonnages available. If no stock swap is agreed then all the additional costs and expenses still have to be incurred in addition to the transaction costs associated with the attempted stock swap.

In CBH's experience, stock swaps whilst possible, are often contentious and can involve considerable costs.

Issue: CBH cannot avoid additional costs imposed by unbundling

Unlike its competitors and potential competitors in storage and handling, CBH is a receiver of last resort and is obliged to receive grain even if accepting that grain will drive up its costs. This means that CBH is obliged to make preparations to store the entire crop, and under Grain Express makes provision to move the entire crop.

This obligation is set out in the Bulk Handling Act 1969 (WA)[6] and means that CBH cannot change its behaviour to avoid having additional costs imposed on it. For this reason it is imperative that CBH manage those factors that constrain or impact on its ability to receive grain.

Issue: Allegation that freight rates rose 43% under Grain Express

Glencore's claim recorded at page 11 of the minutes is incorrect and contains a percentage increase over the 2006/7 to 2009/10 seasons not just the 2008/9 to 2009/10 seasons. Freight rates in Western Australia were rising prior to Grain Express and this was one of the factors that led to CBH deciding to lodge the notification. As shown by CBH in its graph attached to the minutes of the pre-decision conference[7] for a similar distance move the freight rates in Western Australia remain the cheapest in Australia.

Some of the factors which led to the increase include:

- The rail freight agreement which had been signed prior to the privatisation of Westrail was ending;
- AWB being distracted by impending deregulation and other matters at that time;
- the change in and separation of the ownership of the above and below rail freight providers; and
- a general increases in costs in the Western Australian economy associated with the commodities boom.

When comparing freight rates with those in the Eastern States, the increase in freight rates since 2006 unfortunately appears to be evidence of a normalisation of freight rates enabled

[6] See section 42 of the Act and regulation 13 of the Bulk Handling Act Regulations (1967) WA; mentioned in paragraph 2.16 of the CBH's 11 June 2008 submission.
[7] See page 22 of the minutes and the graph entitled Absolute Freight Rate Comparison.

by the prospect of fragmentation of the freight task and the market failure in apportioning all the costs of road transport[8].

CBH was not satisfied with this level of increase and accordingly took both the road freight task and the rail freight task to an open market to achieve the best possible rates and services on behalf of the Western Australian grain supply chain.

Issue: Allegation that the percentage of grain on rail has reduced over the past few years

Glencore's claim at page 11 that the rail freight task has diminished over the past few years is also incorrect. The percentage of grain on rail dipped in the first year of Grain Express as CBH brought in road transport to increase capacity to port to make up for limitations on rail. However, in 2009/10 CBH increased the percentage of grain movements by rail from 57% in 2008/09 to 64% in 2009/10 with a forecast of 66% in 2010/11. The percentage of grain moved by rail from rail sites increased from 78% in 2008/09 to 86% in 2009/10 and is forecast at between 88 and 91% in 2010/11.

Despite the statements of ARG and Glencore, the problem with rail was not due to a lack of assets, which will be exacerbated if ARG removes its assets post May 2012, it was due to the underperformance of those assets for a variety of reasons outlined in our response in May 2009, October 2009 and July 2010. CBH notes that the facts outlined in those responses have not been disproved.

Issue: Allegation that CBH's domestic outturn fee inhibits competition in storage and handling and port services

Mr Brooks claimed in the pre-decision conference that it is not economical to build up-country or port storage because of CBH's outturn fee. This is completely at odds with Mr Brooks assertion that the domestic outturn fee is too high. If the cost of outturning from CBH's up-country sites was too low this would inhibit up-country competition but if it is too high it would stimulate competition.

Storage and handling is not a natural monopoly and Glencore is free to build storage if it can run it cheaper than CBH and it can then contract with ARG to move that grain by rail to port. At port it can utilise an access undertaking to allow the grain to be exported. The reality is that CBH's outturn fee does not have any impact on the economics of upcountry storage that Mr Brooks asserts.

Issue: Glencore's erroneous submissions

The errors contained in Glencore's 20 January 2011 submission are dealt with below under the same numbering as set out in Glencore's letter.

1. Glencore is mistaken in its understanding that CBH is setting up a new rail service, as CBH is merely entering a new contract to provide grain freight on rail. It does not alter the circumstances under which the Commission previously approved the Notification.

[8] This market failure was highlighted by Mr Adam Sidebottom of WestNet Rail at page 10 of the minutes, Mr Fred Affleck of the Freight & Logistics Council at page 5 of the minutes, Mr John Georgiades of the Department of Transport at page 7 of the minutes, Mr Steve Martin of WALGA at page 8 of the minutes, Mr Trevor Badger at page 9 of the minutes and Ms Michelle McKenzie of WALGA at page 10 of the minutes.

The introduction of other operators will raise costs, lose economies of scale, reduce capacity and cause increased coordination difficulties. For these reasons CBH opposes the disruption that Glencore's proposal will introduce into the WA supply chain.

2. Glencore makes bold unsubstantiated claims about CBH's tying and predatory pricing with no evidence to back them up and makes misleading statements about CBH's motives.

Glencore's 12 January 2011 submission refers to Graincorp fees and charges which Glencore claim are cheaper than CBH's charges. However, an examination of the Graincorp fee schedules available at the Graincorp website show that Glencore has omitted a few fees and charges to achieve a lower aggregate figure.

In particular, Glencore has:

- omitted the $7.50 receival at port fee and the likely costs of port storage which should range between $1.10 a tonne and $3.30 a tonne depending on whether the accumulation takes 7 or 21 days; and
- inserted the wrong export fee by claiming it is $7.50 when in fact it is comprised of two fees, a vessel nomination fee of $5.00 per tonne and export outturn fee of $2.70 per tonne. Further, if Glencore wishes to compare the two it should also add in blending of $2.10 a tonne.

When the cost of the omitted fees are included, the true comparison is CBH's bundle of $27.10 a tonne versus a Graincorp Victoria cost of $38.37 a tonne. CBH notes that Graincorp Victoria rates are the lowest of the Graincorp rates. Revoking the notification that enables efficiencies necessary for the low bundle price will not be result in lower supply chain costs.

Glencore's motives are focussed around its profit and it would appear that it is willing to try to gain a dollar of profit regardless of whether it imposes ten dollars of cost on the remainder of the system. CBH is endeavouring to promote the development and sustainability of the industry in WA and this has been recognised by the Full Federal Court[9].

3. Glencore states that transport to port should be organised by marketers not by port terminal operators nor growers because in its view it is the only person affected by the grain freight operations. This statement by Glencore highlights its lack of understanding of the WA grain supply chain. CBH has highlighted in numerous submissions to the Commission its incentive to organise transport for multiple marketers and has done so for the last three harvests without making a profit margin on the coordination of transport[10].

4. Glencore's belief that Grain Express is only a freight issue reinforces its lack of understanding of the WA grain supply chain. The Grain Express notification is primarily a coordination issue and an attempt to save grain on rail.

5. Glencore's claim is that it can secure better rates than CBH is unsubstantiated. CBH notes that Glencore has not proved that it can offer those rates – it merely claims it can obtain better rates without providing any transparency or evidence on this issue. CBH considers that it is hypocritical of Glencore to call for transparency at the same time it is declining to provide it.

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[9] The Full Federal Court held in Commissioner for Taxation v Cooperative Bulk Handling Limited [2010] FCAFC 155 that "CBH was established for the purpose of promoting the development of Australian agricultural resources and was not carried on for the profit or gain of its individual members".

[10] supra at footnote 9.

7. Glencore is mistaken if it believes that a domestic outturn fee can be "done away with" and CBH notes that domestic outturn fees exist in all States in Australia. It is also misleading of Glencore to imply that Glencore and CBH Grain have different up-country and port charges. There is no difference in the charging structure levied by CBH on Glencore and CBH Grain. CBH has been reviewed by an independent auditing firm three times on this issue and no unsubstantiated difference has ever been found.

8. Glencore again misleadingly claim that CBH has moved into "train operation". This is incorrect, CBH has merely indicated that it will be contracting a new above rail services provider. Further detail is provided above in relation to paragraph 2.

9. CBH notes that CBH's submission dated 12 January 2011 (which Glencore has read but has seemingly ignored) points out the issues with the Draft Notice.

10. Glencore's reply highlights Glencore's motives to substitute transport on an ad hoc basis in the belief that all other costs and charges are not impacted. CBH has previously explained in its submissions, including the initial submission, why it is desirable to have a centralised coordination of transport and the detrimental loss of efficiencies and the introduction of additional costs to the system.

11. CBH submits that Glencore has missed the point that the ACCC was trying to make, namely that Grain Express allows CBH a discretion as to where it outturns up-country and that discretion makes warehousing unviable as a competitive alternative. With respect, the Commission did not make out that the discretion flowed from the notified conduct, as that discretion exists in other states where the notified conduct was carried out. Therefore any detriment that the Commission might allocate to this discretion cannot be accrued to the notification and therefore cannot found a reason for revocation.

12. If there is one coordinator of transport and one transport operator moving 6 million tonnes on rail this gives economies of scale. Two transport operators moving 3 million tonnes each do not have access to the same economies of scale. Economies of scale do not accrue to an operator if tonnages are split across many operators.

13. The position put by the Freight and Logistics Council is not that of CBH and therefore CBH will not comment on Glencore's response.

14. The benefits of the Grain Express notification have been explained clearly in CBH's submissions of May 2009, October 2009, July 2010, October 2010 and January 2011.

15. Glencore does not substantiate why it wishes to ignore the Department of Agriculture and Food in WA (DAFWA) estimate of the amount of on-farm storage. In CBH's view DAFWA has access to far more information than Glencore, is not financially motivated by the outcome of this matter and therefore its statement as to on-farm storage carries far more weight than Glencore's unsubstantiated dismissal of the statistic.

16. Glencore has failed to illustrate how the example by Frontier Economics is misleading. Glencore also erroneously claims that a $10 fee has been waived by CBH under threat from Glencore to set up storage in competition. These statements are incorrect and should not be accorded any weight.

17. In this paragraph, Glencore illustrates that its purpose is to free ride on the CBH system of coordination under Grain Express. CBH queries how Glencore can clear all its grain from a storage site at the same time as other entities if Glencore does not have a vessel at port that it is currently accumulating for?

    This implies that Glencore expects CBH will coordinate Glencore's transporter, whilst it loses the volume over which CBH's transporter divides its overheads. In addition, CBH will pay a fixed flagfall charge for rail assets until May 2012. Glencore appears to consider that CBH can break its contract with ARG without penalty, yet that is not the case.

On the issue of timing, CBH considered in July 2010 that if a final notice was received prior to December 2010 that it may be possible to minimise the detriment of a revocation. That is no longer the case and CBH now considers that it is not possible to revoke the conduct before the 2011/12 harvest.