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Australia Western Railroad Pty Ltd
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12 January 2011

Mr G Jones
Director – Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3000

Dear Mr Jones,

**SUBMISSION IN SUPPORT OF ACCC ASSESSMENT CONTAINED IN DRAFT
NOTICE DATED 6 DECEMBER 2010 IN RELATION TO NOTIFICATION N93439**

We refer to the Australian Competition & Consumer Commission's (**ACCC**) draft notice dated 6 December 2010 (**Notice**) proposing to revoke the immunity provided by exclusive dealing notification N93439 and we provide the following submissions in support of the same with respect to the market for the storage and supply of bulk grain rail haulage services in Western Australia.

Background

1. Cooperative Bulk Handling Limited (**CBH**) has a substantial degree of market power in the market for the supply of grain receival, storage and handling services in Western Australia.
2. As stated in the Notice, the notified conduct of CBH compels growers who acquire CBH's storage and handling facilities to also acquire transport services from CBH. This denies the growers the option of acquiring transport from suppliers other than CBH. Consequently, this tying arrangement forecloses opportunities for transport suppliers to compete with CBH to supply stand alone transport services. Growers are therefore denied the opportunity to acquire these services directly on terms that best reflect their specific individual transport needs and at prices that are subject to competitive constraint.
3. ARG is a subsidiary of QR Limited which in turn is wholly owned by QR National Limited (**ARG**). ARG is the current provider of bulk rail haulage of grain for CBH in Western Australia. On 13 December 2010 CBH announced that it:
 - a. had awarded a ten year grain rail contract commencing in May 2012 to Watco Companies (**Watco**), a United States transportation company; and
 - b. plans to invest up to \$175 million in rollingstock as part of its decision to award the grain rail contract to Watco.

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4. [REDACTED]
[REDACTED] These assets operate on both standard gauge and narrow gauge track. Whereas ARG's locomotives may be re-deployed to other tasks its wagons are dedicated to grain and are [REDACTED].

Effect on Competition on Rail

5. The Frontier Economics submission to the ACCC dated October 2010 makes the distinction that CBH acquires transportation services from road and rail operators and does not actually perform the transportation function itself. As a result of the CBH announcement on 13 December 2010 to award a 10 year contract to Watco this is no longer true for rail transport:
- a. CBH will be investing up to \$175 million in rolling stock (locomotive and wagons) and perhaps maintenance facilities. Before the rolling stock can be used on the rail network it must be accredited by WestNet Rail Pty Ltd (**WestNet**) and the Office of Rail Safety. CBH must also have an access agreement with WestNet;
 - b. CBH's investment in rollingstock, associated obligations arising out of its ownership of rollingstock and the way it is contracting with Watco, will make CBH a significant above rail operator in its own right from May 2012. From this date CBH will be a bulk provider rather than a bulk acquirer, of rail transport services in its own right; and
 - c. Even with modest expectations for return on capital, it is reasonable to conclude that CBH's foreshadowed substantial capital investment in rollingstock will demand healthy operating revenues so that CBH can recover its large capital investment to support its impending relatively high cost bulk rail transport operating model.
6. If CBH's notified conduct was to continue it would result in, or have the likely effect of resulting in, a substantial lessening of competition:
- a. CBH sets the freight rate at all of its 193 'up-country' receival, storage and handling sites, four port terminals and metro grain centre;
 - b. As the exclusive grain rail operator and logistic coordinator, CBH will have the opportunity to set its own freight rate, determine its own revenue and therefore define its own return on capital in the absence of any other above rail competition within the rail network. CBH will be in a position to leverage its substantial degree of market power to charge above market rates for its new assets and not be held to account by competition either in rail or road;
 - c. Any argument that suggests that inter-modal competition from road transport will drive accountability and prevent CBH from charging above market rail

rates is flawed. Under the notified conduct CBH controls both modes and can manage supply of either as it requires;

- d. The capacity of the road network is at times limited. Given the export volumes in Western Australia and the lack of domestic demand for grain, demand for export rail services is potentially price inelastic. With the control of supply, CBH will be in a position to extract above market rates with only a cursory consideration for other modal competition;
- e. Approximately 110 of the 193 CBH receival points are configured for rail transport. In most seasons, particularly large volume years, a grower's choice away from rail at these 110 sites would require a significant investment in farm storage. In most instances, the grower could be compelled to pay above market rail rates rather than incur the cost of duplicating the CBH bulk storage system in order to utilise road transport;
- f. It is important that the ACCC recognise that previously, as a buyer of rail and road services, CBH had the ability and incentive to facilitate inter modal competition. As the **provider** of rail services, but with retained control over road transport, CBH has no such incentive and will be in a position to suit its own commercial purpose at the expense of the market;
- g. Effectively, the notified conduct means that CBH will not have to price rail services to compete with alternate modes and CBH's substantial degree of market power in the market for the supply of grain receival, storage and handling services has now been extended to the market for bulk freight services; and
- h. If the notified conduct was revoked, ARG (and others) would be able to compete with CBH in the supply of bulk rail haulage of grain. When faced with the threat of alternative transport providers directly supplying services to growers, CBH would have an incentive to offer its transport service on terms and at prices that were at least as attractive as rival transport providers such as ARG. This competitive tension would constrain CBH's pricing behaviour.

Public Benefit

- 7. As stated in the Notice, CBH identified the following public benefits in its initial submission in support of the notified conduct:
 - a. More efficient grain delivery and handling at grain receival points;
 - b. Better coordination of storage and handling;
 - c. Improved efficiency of the transport task;
 - d. Enhanced port efficiency;

- e. Dynamic efficiency gains, which improve the prospect of efficient investment in infrastructure in the future; and
 - f. Better marketing decisions for growers and marketers.
8. It is recognised that the coordination of grain storage, handling and transportation has the potential to generate significant efficiencies in the operation of the Western Australian grain supply network, which may deliver significant cost savings and result in a more efficient supply chain network.
9. It is CBH's position that public benefits of the notified conduct are generated through the bundled supply of storage, handling and transport services. The benefits do not flow from the compulsory tying of these products. If the notified conduct was revoked then it stands to reason that public benefits should continue in the absence of the compulsory tying arrangement with any bundling arrangements done within the bounds of the TPA.
10. The Notice states that CBH controls around 90 per cent of grain receipt, storage and handling infrastructure in Western Australia and that 95 per cent of the Western Australian grain crop is exported through CBH's port facilities. Grain receipt, storage and handling infrastructure that is not controlled by CBH is made up of small locally based private operators and on-farm storage. In short, CBH has a monopoly in this area.
11. CBH has relied upon the protection afforded by the notified conduct and the cross subsidies available within its own monopoly supply chain to make commercially extravagant choices in rail freight investment as outlined above. These choices will result in CBH overcapitalising as it becomes a bulk rail freight provider from May 2012. Existing bulk rail freight providers already have the necessary rollingstock and infrastructure in place and accordingly will be able to provide more cost effective bulk rail freight services than CBH. If the notification is revoked by the ACCC and CBH continue to offer bundled services, ARG will closely monitor CBH's conduct to ensure any bundling arrangement by CBH are within the bounds of the TPA. ARG has concerns that CBH will leverage its substantial market power in the grain receipt, storage and handling market to squeeze prices in the supply of haulage services and recovering any losses sustained from that part of the bundle where it has market power. ARG encourages the ACCC to also closely monitor CBH's behaviour in that regard.
12. A key tenet of the notified conduct is the positive externality associated with grain on the rail network. ARG agrees that this is a positive outcome for communities. However, the consequence of CBH becoming an owner of rolling stock as outlined above combined with the continuation of the notified conduct will limit and inhibit the public benefit of grain on rail:
- a. CBH proposes to own and operate 22 Locomotives and 465 rail wagons;

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- b. If the notified conduct was allowed to continue ARG's [REDACTED] wagons would become stranded and cease to be available to the West Australian growers. [REDACTED]
[REDACTED];
- c. For the reasons outlined above, the inability of ARG to compete in the rail haulage of grain would mean the loss of these dedicated grain resources. This would inevitably result in less grain moving on rail for the simple reason that these ARG assets would otherwise be available for the task. This loss would be felt most in the large volume years where the CBH asset base cannot accommodate the movement task in full;
- d. ARG agrees with the ACCC consideration in the Notice that on balance, the notified tying arrangement substantially lessens competition in the market for grain transport in Western Australia and that the substantial anti-competitive detriments outweigh any public benefits resulting from the notified conduct.

Effect of Competition on Storage

- 13. The notified conduct would not substantially lessen competition if there were significant numbers of storages other than those of CBH.
- 14. The CBH charging structure applies quite punitively to marketers attempting to work out-side of the CBH supply chain. This means that when combined with the investment demands of a separate supply chain network, any alternative supply chain is prohibitive. Accordingly, if the notified conduct was to continue, ARG's rail assets **could not** rely upon an independent alternate supply chain investment as a means of competing with CBH on rail. However, if the notified conduct was revoked, and there was sufficient demand and volumes from growers or marketers to bypass the CBH supply chain, [REDACTED]
[REDACTED].

Timing of Revocation of Notification

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- 15. In the Notice the ACCC stated that the revocation of the notified conduct in mid harvest may have the potential to cause significant disruption to the industry. ARG does not believe its grain haulage services would be disrupted by revocation immediately or in mid harvest.
- 16. Currently ARG has the capacity to haul grain for growers and exporters who wish to utilise its services. Accordingly, ARG submits that any revocation of the notified conduct should be immediate after the 30 day period allowed for by the legislation, with an exemption for grain in CBH storage 'up-country' for which CBH has firm commitments and actual plans to haul the grain to port.

17. In the event that a grower has paid up front for transport to port, such payment should be credited to any transport that the grower may choose in the event that there is no firm commitment and actual plan to haul the grain to port at the time of the up front payment.

Conclusion

18. CBH and ARG should be able to fairly compete in the rail transport of grain. For the reasons set out above, ARG submits that the notified conduct 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 notification should be revoked.

Yours faithfully,



Simon Bradshaw
Acting Group General Manager Bulk West
ARG a QR Company