



ForestrySA

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Australian Competition & Consumer Commission
23 Marcus Clarke Street
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By email only: exemptions@accc.gov.au

Attn: Danielle Staltari, Director, Competition Exemptions

Dear Ms Staltari

Re: AA1000539 – Morgan Sawmill Jamestown – Submission

Background

Thank you for the opportunity to comment on the application for a collective bargaining authorisation made by Morgan Sawmill Jamestown (**MSJ**) on behalf of itself and other potential group members (together, **the Nominated Applicants**).

This submission from ForestrySA is focussed on the question of the substantive authorisation to be considered by the ACCC, with a submission previously made on 27 January 2021 in relation to the interim application.

The interim submission provided relevant background on ForestrySA, its role and position within the forestry industry in South Australia and its log marketing practices. In particular, ForestrySA now reiterates the substantial efforts made to prioritise support for the local regional wood processing sector. Notwithstanding this, ForestrySA has no mandate to enter supply arrangements that are not competitively priced in the context of an active and competitively operating market environment. ForestrySA's principal concern is not specifically regarding long term (10 years or similar) sales commitments, but rather the effect that the proposed conduct may have on competition between the Nominated Applicants, and therefore on price.

ForestrySA considers that a net benefit to the public is best achieved through potential customers, including the Nominated Applicants, continuing to operate in a market that is demonstrated to be competitive.

Introductory Comments

The Application favours the negotiation of a single log supply agreement to be entered between the Nominated Applicants and ForestrySA.

A bid (or submitted price) for a single agreement, may well be as competitive as the Nominated Applicants, collectively, may otherwise offer individually. However ForestrySA is concerned that,

were only a joint offer to be received from the Nominated Applicants, there is a real likelihood that such submission would offer a lower price in comparison to what individual Nominated Applicants are likely to present as their individual best offers. This is probable on the basis that a joint offer would eliminate the need for individual Nominated Applicants to attempt to outbid each other. It appears likely that the price offered in a joint offer would more closely align with a collective 'lowest possible cost' assessment by the Nominated Applicants, rather than an individual assessment by each Nominated Applicant as to what they would be prepared to pay to secure part or all of the parcel for a particular length of time.

Specifics - Application for authorisation

In respect of the substantive application, which is dated 18 December 2020 and attached to the cover letter, ForestrySA makes the following comments, by reference to the numbering used in that application.

Item 1 – Details of applicants

No comment

Item 2 – Details of others

In respect of this item in the Applicant's application, ForestrySA makes the following comments:

1. The sale of log by ForestrySA from the Mount Lofty Ranges estate and the purchase of log by the Nominated Applicants to support their timber processing businesses, is not a 'closed circuit'. For example:
 - a. At least some of the Nominated Applicants also purchase log from private forestry owners and leaseholders, although ForestrySA accepts that the log from the Mount Lofty Ranges estate currently provides a significant supply to its local customers, including the Nominated Applicants.
 - b. ForestrySA has other customers who have demonstrated capacity to compete in the market for purchasing log from the Mount Lofty Ranges estate, including timber processors from the Green Triangle region as well as exporters of raw log. This is addressed in more detail later in this letter.
2. ForestrySA refutes the suggestion that the 2020 parcel of approximately 75,000 tonnes was sold by way of a tender process written "in such a way as to exclude small local processors", and in particular strongly refutes any imputation that this was a deliberate act on the part of ForestrySA to prejudice any Nominated Applicants. In relation to the sale of this parcel, ForestrySA notes that this was an unusual offering outside of ForestrySA's sustainable annual cut volume for the following reasons:
 - a. The majority of this parcel comprised fire-affected log as a result of the Cudlee Creek bushfire in December 2019. To remain merchantable, fire-affected log must be processed within a much shorter timeframe than non-affected log. This was the principal reason for such a large parcel being taken to market by ForestrySA with a short timeframe for processing.
 - b. The parcel included an amount of lower grade log to be harvested as part of the recent reinvigoration of a concerted 'thinning' program to increase the value of the Mount Lofty Ranges estate's future yields.
 - c. Additional non fire-affected log was also offered as it was anticipated – correctly – that continuous operations in non fire-affected areas of the estate may be required to maintain contractor personnel and equipment in the region during the wetter

months of 2020 when the site in question was likely to be inaccessible due to steep terrain.

- d. The competitive process undertaken by ForestrySA for this parcel attracted 8 respondents including some of the Nominated Applicants, other South Australian processors and exporters. Four of the respondents were processing businesses with facilities outside of the Mount Lofty Ranges region.
- e. As is ForestrySA's normal practice, the process was open to respondents to bid for part of the parcel, and some in fact did do so, including MSJ. MSJ's price was simply not competitive.

Item 3 – The proposed conduct

3.1: Description of conduct

In respect of this sub-item, ForestrySA makes the following comments:

1. ForestrySA refers to its comments below under Item 3.3 – Rationale – in relation to the statements in the application about ForestrySA's view of the "number" of log supply agreements it would prefer to manage, as well as the proposal for the Group members to undertake the conduct with a view to how the group could work together to secure a "10 year" log supply agreement.
2. ForestrySA is of the view that the primary purpose of the conduct would be to secure lower log pricing through reducing competition between the Nominated Applicants (pricing is included in the contract terms nominated for collective negotiations.) Notwithstanding the competition implications presented by joint negotiations on price, ForestrySA may be open to the benefits to the Nominated Applicants if other terms (specifications, measurement methods etc) were to be discussed jointly.

3.2: CCA Act

No comment

3.3: Rationale

In respect of this sub-item, ForestrySA makes the following comments:

1. In relation to the assertion made and repeated in the submission that the ForestrySA is "seeking to have only one or two log supply agreements" ForestrySA confirms this is not accurate. Instead, in the context of giving evidence to a Parliamentary Committee on Matters Relating to the Timber Industry in the Limestone Coast, the Chief Executive of ForestrySA expressed a personal view that a consolidated processing sector would be likely to be more sustainable in the long term. This could be regarded as common industry opinion, given that the high relative overheads (primarily labour costs) of operating a small sawmill is the main reason for the recognised national industry consolidation. ForestrySA has not expressed, and does not have, a preference about the number of supply agreements it wishes to manage in relation to the Mount Lofty Ranges estate stock.
2. Similarly, ForestrySA refutes the assertion that it has "voiced that [it] find[s] long term agreements to be inconvenient". ForestrySA has been and remains open to entering into log supply agreements of up to 10 years and has conducted good faith negotiations with existing contractors in relation to such agreements. However, ForestrySA considers that to faithfully and properly discharge its functions in its Charter and legislation, any long term supply agreement that locks in significant amounts of future yield at a fixed price with CPI or similar indexation (which is what appears to be the goal of the Applicant) should reflect

a price benchmark which takes in account the potential opportunity costs described in this submission. More particularly, it should reflect pricing that other market competitors are evidently willing to pay.

3. ForestrySA refers to its submission above in relation to the peculiar circumstances attributable to the 75,000 tonnes parcel it sold following a competitive market process in early 2020.
4. ForestrySA has demonstrated through its conduct in recent years that its practice in relation to log sales is, in summary, to:
 - a. remain open to receive unsolicited offers and enquiries from any current or potential customers, including the Nominated Applicants;
 - b. undertake good faith direct negotiations with incumbent and new customers provided that ForestrySA is satisfied that price benchmarks will be met or surpassed by the party;
 - c. for available log parcels, undertake competitive, open market processes with significant rigour including by acting in accordance with documented process and evaluation plans, and engaging an independent probity advisor;
 - d. actively consider bids for not just whole, but also parts of, parcels offered through a competitive sale process; and
 - e. place more weight on the local status of a customer, over mere price, than a purely commercial entity would.
5. Consistent with this, given MSJ's incumbency status and the end date of its existing log supply agreement, ForestrySA has made significant effort to ensure that MSJ is given opportunity to present competitive offers to advance the prospects of a new agreement resulting from a direct negotiation. To date, no such offer has been received by ForestrySA.
6. ForestrySA also refers to its submission under Items 9-11 below.

3.4: Term

In respect of this sub-item, ForestrySA refers elsewhere in this submission in relation to the proposed 10-year log supply agreement, but otherwise makes no comment in relation to the term of the authorisation.

Item 4: Documents

No comment.

Item 5: Names of impacted persons etc

In respect of this item, ForestrySA makes the following comments:

1. ForestrySA does not consider that it is likely to benefit from the proposed conduct, for the reasons set out throughout this response.
2. As mentioned above, ForestrySA has no current intention of, and does not consider there to be any particular benefit in, reducing the number of log supply contracts it currently manages. ForestrySA considers there are benefits for it in supporting ongoing relationships with a number of customers who are capable of processing the full range of the varying grades of log produced by the Mount Lofty Ranges estate from time to time, including at times within short timeframes, owing to for example fire events or increased forest management activities.

3. As mentioned above, long-term log sales agreements are not necessarily of benefit to ForestrySA, taking into account the opportunity cost of market variations, and other dynamic features of the market (including the impact of weather events on the availability of certain grades of log, and on the ability to undertake felling and processing within particular timeframes). Nor does ForestrySA discourage long term agreements, with current agreements successfully being managed under terms ranging from several months up to 10 years in length.
4. ForestrySA disagrees with the assessment and calculation provided by MSJ in terms of potential administrative savings (based on 'meetings not required') and in any event does not consider the potential administrative savings in contract management resources to be a significant factor either way in the context of the application. In revenue terms to ForestrySA, the administrative savings highlighted by MSJ equate to a total log price variance of (plus or minus) 0.26%.
5. As mentioned above, ForestrySA has supplied and does supply log from the Mount Lofty Ranges estate to South Australian based processors other than the Nominated Applicants. While ForestrySA is tasked with encouraging and facilitating regionally based economic activities based on forestry and other industries, ForestrySA does not consider that this equates to ensuring the ongoing viability of any particular (or a particular subset of) local sawmilling operations. As discussed above, the regional location and operations of any potential customer are factors taken into account by ForestrySA as part of its log sales bid evaluations, but this factor is not, and need not be, determinative.
6. In this context, ForestrySA considers there is an overall industry and public benefit to retaining at least some exporter presence in South Australia. The export market has demonstrated a willingness to purchase almost any product for sale by ForestrySA, including very low grade and non-radiata pine, which domestic processing customers (both among the Nominated Applicants and elsewhere in South Australia) are unable or unwilling to process. Being able to sell these products allows ForestrySA to continue to invest in improved forest management practices including by removing very low grade or surplus logs which in turn increases the future value of the remaining yield. These practices provide further benefits in relation to fire protection obligations, significantly reducing fuel loads by minimising waste left on the forest floor.¹
7. The assertion that downstream customers of the Nominated Applicants would need to pay increased prices due to variations in freight costs alone is unfounded. ForestrySA finds no evidence that the scale, raw material input prices and general efficiencies of alternate timber suppliers as compared to the Nominated Applicants collectively (who are themselves geographically dispersed) would translate into price increases equivalent to the freight differences.
8. Further, if downstream customers were forced to buy from alternative processors who were successful in obtaining additional supply from ForestrySA's estate, it is logical that the additional or substitutional log supply was procured competitively (or at lower prices) than existing volumes to the processor, hence their interest in procuring it. This may

¹ See further the ForestrySA annual report 19/20, page 20: *"Following the finalisation of ForestrySA's own bulk log export sales program in mid-2018, significant improvement to commercial performance of log sales has been achieved by selling surplus parcels of log through competitive sales processes. This initiative has resulted in multiple exporters entering the local market and establishing log yards at Port Adelaide. This development has introduced new opportunities for ForestrySA's log sales program and promoted competition within the local marketplace. Over the course of the year, significant progress has also been made in overcoming long-standing historic impediments, including the sale of low quality log from plantation thinning and fire salvage operations. This will allow ForestrySA to become more responsive to fluctuations in log sales within the local market and achieve on-time thinning of the estate."*

translate to a lower downstream price to the customer if considered solely on the basis of input costs and consistent margins.

Item 6: Market information and concentration

In respect of this item, ForestrySA makes the following comments:

1. As mentioned above, ForestrySA is aware that the Nominated Applicants are often in competition with each other for available log supply of specific grades.
2. Of the regular, ongoing sustainable annual cut volume of 155,000 from the Mount Lofty Ranges estate on average, 145,000 tonnes (or 94%) is contracted to the Nominated Applicants.
3. ForestrySA is also aware that the Nominated Applicants purchase or receive log supply from forests other than the Mount Lofty Ranges estate managed by ForestrySA.
4. ForestrySA also wishes to emphasise that ForestrySA has over the last approximately 10 years managed to preserve and sustain the local customer base for log from the Mount Lofty Ranges estate. In fact, during that period, ForestrySA has supported the expansion of its local customer base to include the primary applicant in this matter, MSJ, following the Bundaleer and Bangor bushfires in 2013 and 2014, which effectively cut off MSJ's supply from those areas.
5. ForestrySA has customers outside of the Nominated Applicants, and regularly fields enquiries from such customers, several of whom have demonstrated capacity to compete in the market for purchasing log from the Mount Lofty Ranges estate, including timber processors from the Green Triangle as well as exporters of raw logs. ForestrySA considers that, in overall terms, and based on the open market tenders (Requests for Proposals) it has managed over the last approximately 3 years, the market for ForestrySA products is evidently and demonstrably competitive. It is worth noting that periodically, ForestrySA has had several competing bids for specific log parcels, including from Nominated Applicants, and has therefore seen the effects of direct competition for log supply. ForestrySA refutes the assertion that in respect of each individual processor within the Nominated Applicants, "there is minimal overlap."

Item 7: The industry and processes etc

In respect of this item, ForestrySA makes the following comments:

1. In relation to MSJ's statement that the ForestrySA log sales agreements held by Nominated Applicants "were historically offered on 10 + 10 year period", ForestrySA seeks to correct the record. None of the Nominated Applicants have been issued with a 10 + 10 year agreement by ForestrySA. ForestrySA has entered into a range of agreements, with one of these Nominated Applicants under a (current) 10 year agreement. Other terms are agreed upon, mainly with consideration to attractiveness of the terms and conditions, likely opportunity costs in future years, and supply risks posed by bushfire, pests and diseases and other resource management constraints. These terms typically vary from 2 to 5 years and can also be nominated as 'spot sales' meaning short-term, once-off opportunities for specific log parcels (as seen by ForestrySA's competitive process in 2020 for the 75,000 tonnes.)
2. South Australia, like other jurisdictions, has seen both privatisation of public forest assets and industry consolidation in recent years. This has been exacerbated by the failure of historic Managed Investment Scheme (MIS) plantation businesses and a subsequent retraction in overall plantation area. Significant (mainly capital) barriers to entry have

restricted overall plantation expansion, leaving the industry well aware of a looming supply shortfall for wood products generally. The Commonwealth Government has referenced an “increasing domestic and global demand for wood-fibre” and in commentary on the future supply forecasts, framed the resultant opportunity as a “forest fibre boom....”.²

3. Clearly, competitive tension for raw material within the industry across Australia has contributed to a trend away from long-term log supply agreements between forest managers and sawmills, as has increased demand (and therefore successful access to) export markets for forest managers. Vertical integration of some timber businesses (for example, large forest managers now also owning sawmills) has lessened the occurrence of fixed-term, fixed-price supply arrangements. As stated in the application, timber businesses may also source a particular product from one another rather than producing it from raw materials.
4. The market approach and sales processes adopted by ForestrySA (specifically, utilising a combination of medium to long term contracts with an established customer base, supplemented by ad-hoc sales of specific parcels via competitive processes) is in accordance with the industry generally. As discussed above, ForestrySA is well aware of its obligations as a Public Corporation and incorporates consideration of regional economic contribution into evaluation processes.

Item 8: Overlapping products/services etc

In respect of this item, ForestrySA makes the following comments:

1. ForestrySA refers to its comments above.
2. Most timber products are relatively liquid; that is, if supply from a particular region becomes expensive it can readily be replaced, at a price, by product sourced from elsewhere. This is evidenced by the proportion of the Nominated Applicants end product being sold interstate rather than in South Australia. Likewise, supply of finished timber goods to the retail market in Adelaide is supplemented by product of interstate origin when local product is less available (or priced too high) so substitution is plausible.

Item 9: Competition

In respect of this item, ForestrySA makes the following comments:

1. ForestrySA refers to its comments above.
2. In determining whether to advance direct negotiations with a timber processor or to take a parcel to an open market tender, ForestrySA uses price benchmarking which it has developed using pricing data derived from existing contracts, responses from competitive processes run by ForestrySA over the last three years, and unsolicited offers made by buyers comprising processors (including members of the Nominated Applicants and outside of the Nominated Applicants) and exporters from time to time.
3. ForestrySA reiterates that it has continued to directly negotiate in good faith with MSJ, however the offers made by MSJ to date have not been sufficiently competitive to warrant ForestrySA advancing those direct negotiations further. MSJ will of course be invited to submit a proposal as part of any upcoming open market tender for parcels of log.
4. As discussed above, while in the past some supply contracts were executed on a longer term basis, a review of marketing practices in recent years concluded that a high

² See <https://www.agriculture.gov.au/sites/default/files/sitecollectiondocuments/forestry/national-forest-industries-plan.pdf>

proportion of such agreements may present additional business risks in terms of encouraging optimal forest asset management and deriving greatest value from those assets.

5. As a result, ForestrySA has and intends to continue to undertake commercial sales of log products and procurement of services using appropriate competitive marketing opportunities to obtain profitable results, subject to independent probity advice for material sales process outcomes, and taking into account its broader statutory obligations, including maximising value to the State overall, as discussed above.
6. Refer also to ForestrySA's Introductory Comments on the subject of direct market competition between Nominated Applicants. Potentially more harmful is the possibility that a low-priced joint offer from Nominated Applicants could effectively exclude the Nominated Applicants from securing any of the available parcel.
 - a. Depending on the relative strength of any joint offer as compared to others that ForestrySA receives, and taking into account the range of relevant factors ForestrySA is required to consider under its Charter and legislation, there is no guarantee that a joint offer would be successful. Obviously the outcome of any procurement process would depend entirely on all the surrounding circumstances at the time.
 - b. There is however the possibility that, were the price offered to be significantly below that being offered by other competitors (including exporters and interstate operators), and only on the basis of a 10 year agreement, the available parcel may be awarded entirely to an alternative customer or customers, which are prepared by pay a better price and/or agree to other favourable terms.
7. A joint offer alone, put only on a 10 year basis, and in the absence of a log price equal to or above the current tested pricing benchmarks, could if accepted by ForestrySA:
 - a. Directly reduce the comparative sales revenue to ForestrySA by the accumulated difference between the joint offer and other likely market offer/s
 - b. Result in opportunity cost to ForestrySA in the context of volatile raw commodities markets. For example, the current benchmark prices for some log grades in ForestrySA's view are in excess of 20% higher than the current contracted prices, with those prices having been locked in less than three years ago; and/or
 - c. Hamper market agility to accommodate and react to weather and emergency events such as bushfires, which often result in the need to depart from the status quo and re-negotiate arrangements.
8. The reduced competition between Nominated Applicants stemming from a joint offer alone will hinder ForestrySA's ability to structure an optimal suite of contracts and conditions for the projected sustainable yield over the tree rotation length of 30+ years.
 - a. A direct reduction in revenue (resulting from fewer bidders for any single part of a parcel) will impact the implementation of best forest management practices which in turn generate a full range of log products to be sold.
 - b. Further, this will reduce the future yield and value of the Mount Lofty Ranges estate and, detrimentally to the Nominated Applicants themselves, will reduce the volume and proportion of high-value sawlog available to the local processing industry in the current and future tree crop rotations.
 - c. Reduced competition would not provide for good future management of the Mt Lofty Ranges estate, a valuable public resource.

Item 10: Public benefit

In respect of this item, ForestrySA makes the following comments:

1. ForestrySA refers to its comments above.
2. In relation to the conduct providing for “four timber processors continuing to operate instead of just one or two” ForestrySA disputes that the conduct would have such an effect. Under current circumstances, the market is operating effectively. It is difficult to ascertain a direct connection between the proposed conduct and the increased chances of a sawmill’s success, unless the conduct provides for lower log prices. The proposed conduct providing for lower prices would seem at odds with it also increasing competition as claimed.
3. The submission includes an assertion that there is “evidence that the logs will be exported to China if we cannot gain a log supply agreement”. No such evidence is then set out. In fact, only a small proportion of ForestrySA’s timber products are currently being exported, but not to China.
4. It is not correct that ForestrySA “want only one or two log supply contracts”. ForestrySA notes that the Applicants’ submission relies heavily on this being the case.
5. ForestrySA denies that it is not economically viable to transport Mount Lofty Ranges estate log products to other South Australian processors. As discussed above, ForestrySA has contracted with customers to transport logs from the Mount Lofty Ranges to processors outside of the Nominated Applicants, including to the Green Triangle region, and particularly in relation to higher quality log grades.
6. ForestrySA denies that Request for Proposal 2020/67 was “logistically impossible for any local processor to apply for”, and notes that 4 of the 8 respondents to this proposal had South Australian-based processing operations. The ultimately successful tenderer for this parcel was an exporter, however the unusual nature of this parcel is discussed above, and as such ForestrySA considers it ought not be considered to necessarily be representative of previous or future offerings or agreements.
7. ForestrySA has addressed the Applicant’s assertions as to the potential benefits to be derived from reduced contract administration above.
8. In reference to MSJ’s need for a 10-year agreement in order to secure bank finance in order to provide public benefit; ForestrySA reiterates that the proposed conduct will neither guarantee nor hinder the Applicant’s success. Success would depend largely on the Applicant submitting competitive enough terms to ForestrySA to secure such an agreement.

Item 11: Public detriment

In respect of this item, ForestrySA refers to its comments above and further submits:

1. In short, ForestrySA considers that there would be more competitive market participants without the conduct the subject of this application. This is evidenced by ForestrySA's recent history (past approximately 3 years) of conducting multiple competitive market approaches for log parcels. These market approaches have, when taken together, attracted good participation by both existing customers (including Nominated Applicants) and new bidders. The Applicant being “not aware of any other sawmillers in the same locality as the ones included in the group” fails to recognise these broader market implications.

2. While ForestrySA acknowledges the contribution of local sawmillers to regional communities and to down-stream industries, it is important to note that other than through existing contractual rights, no Nominated Applicant has a natural right or entitlement to the Mount Lofty Ranges estate future log supply. ForestrySA considers that a net benefit to the public is best achieved through processors, including the Nominated Applicants, continuing to compete for the future yield as has been successfully demonstrated in the past.

Item 12: Contact details

No Comment

Item 13: Additional information

In respect of this item, ForestrySA refers to its comments above.

Please contact me if you would like ForestrySA to clarify any aspects of this submission.



Julian Speed
**CHIEF EXECUTIVE
FORESTRYSA**