A review of the *Wheat Export Marketing Act 2008*

A review of the Wheat Export Marketing Act's impacts on the Western Australian wheat market

Prepared for Co-operative Bulk Handling Ltd

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ACIL Tasman

Economics Policy Strategy

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Executive summary

ACIL Tasman was commissioned by Cooperative Bulk Handling Ltd (CBH) to assist the organisation to prepare a submission for the Productivity Commission's (PC) inquiry into wheat marketing arrangements in Australia.

WA and the global wheat market

The Australian bulk export wheat market is part of a highly competitive domestic global market for wheat. WA is the most export oriented state with up to 90 per cent of wheat being exported to a wide range of regions.

Therefore the price WA growers receive is almost entirely set by international supply and demand conditions, less the costs of getting the grain to end users. Thus Australian wheat grower interests are served by an efficient export supply chain. Australia's current wheat policy is predicated on this notion.

Supply chain inefficiencies or obstructions will be borne by growers who will respond by diverting at the margin production resources to alternative uses reducing the amount of grain produced. The fact that Australia is a price taker for exported wheat imposes a significant overarching competitive constraint on the behaviour of all participants in the grain supply chain including the CBH Group.

Not only is the CBH Group subject to these competitive constraints, it is a cooperative which has a charter that specifically directs that its activities must benefit its members who are the overwhelming majority of WA grain growers. However, CBH cannot distribute financial returns to members, but rather reinvests profits into the services for the benefit of its members—these benefits spillover to all participants in the supply chain.

WA grains industry

There are two important features that characterise the WA grain industry:

- It is export dependent with between 80 and 90 per cent of all grain being exported[1]
- Growers typically are larger and are increasingly becoming more specialised grain producers and have the incentive and capacity to manage price risk and assess the commercial credentials of those that they deal with.

[1] Based on ABARE WA grain export statistics supplied to the author on the 03-11-2009 by ABARE

There are several overarching factors that will influence the development of the WA industry post deregulation:

- Increased niche marketing opportunities (although the bulk wheat supply chain will continue to dominate)
- Growers will have the choice of a wide range of marketing products, a number of which will be based on cash sales. Thus a greater proportion of wheat on average will be sold for cash rather than pooled (however this will vary from year to year).

As a result buyers and sellers will increasingly want to have more control over the supply chain to ensure they have the capacity to:

- respond to store or sell price signals
- blend grains to achieve a competitive advantage.

This is particularly so as most of the new entrants to the WA export wheat market are large multinational corporations who not only have the capacity to create integrated supply chains where they own and operate critical supply chain infrastructure, but have done so in other markets. In addition, WA grain growers have already invested in significant on farm storage capacity utilising the latest storage and handling technology. On farm storage could double within 3 years to be 20 to 25 percent of the existing central bulk storage capacity.

To achieve control over the supply chain buyers and sellers will seek to coordinate their activities through:

- Contractual arrangements with storage and handling and freight suppliers
- Invest in partial or full alternative supply chains to the current bulk handling system.

Ultimately this will lead to increased incentives to develop alternative storage and handling facilities on farm, at the regional level, and even at port, bypassing small scale local bulk handling company (BHC) facilities.

The port congestion experienced in WA in early 2009 was symptomatic of these drivers of change.

Export wheat licensing

The licensing of bulk export wheat traders is an artificial delineation in the market and could only be justified to assure growers that their interests were being protected during a policy reform process.

The Productivity Commission has expressed the view that a reliance on specific licensing requirements is most likely to confer net benefits where the potential detriment from making a poor choice is significant and:

- the costs of obtaining product information are high; and/or
- verification of quality by the consumer or other third parties is difficult. (Productivity Commission, 2008, p. 93)

In the case of wheat marketing it is difficult to claim the costs of obtaining product information are high as there are considerable incentives for firms to demonstrate their credential to growers. The majority of wheat growers have a long history of dealing with many of the firms now participating in the export wheat market.

Also it could not be claimed that verification by growers (consumers) or third parties is difficult as there are numerous market commentators providing advice on a range of marketing services for a fee. Generally the costs of these services are modest. Where there is a failure of a marketing product or a marketer industry networks quickly transmit this information.

There does not appear to be any economic justification for continuation of the licensing scheme established by the *Wheat Export Marketing Act 2008* (Cth) (WEMA) beyond the 2009-10 harvest.

Competition policy

Competition policy should not be pursued as an end in itself but as a means of promoting economic growth (or the growth of income) through preservation and promotion of economic efficiency. The struggle for Australian competition policy is to try to maintain laws that preserve and promote economic efficiency whilst avoiding the resort to populism.

Access to essential facilities

Competition can be stifled in situations where a vertically integrated firm excludes its non-integrated rivals from a vital input, thereby resulting in market foreclosure. The 1993 Hilmer report recommended the establishment of a legal regime to provide third party access to essential facilities under prescribed circumstances (Hilmer, Rayner, & Taperell, 1993, p. 266).

The inspiration for a third party access regime for essential facilities came from the antitrust jurisprudence of the United States. It is clear that the essential facilities doctrine has been applied only sparingly by US courts and that it has not created a general obligation to share one's resources. The Hilmer report in turn recommended the establishment of an access regime which had attached to it very clear safeguards in order to protect the interests of facility owners.

In response to the Hilmer report recommendations on the establishment of a third party access regime for essential facilities, the Commonwealth Government enacted Part IIIA of the Trade Practices Act (Cth) (TPA).

Imposing obligations upon facility owners to provide access to the facility or facility service is a significant imposition on their property rights. For this reason access regimes need to be very carefully applied otherwise they could result in regulatory failure. In particular, inappropriate access regulation could deter investment.

Access Regulation and the Wheat Export Marketing Act 2008

Under section 13(1)(e) of the WEMA, in order to be eligible as a wheat exporter, a party that is the operator of one or more port terminal services must pass the access test. Section 24 of the WEMA outlines the access test which imposes a number of obligations upon potential wheat exporters who are the operator of one or more port terminal service.

Section 24 of the WEMA operates as a *de facto* access declaration regime for the port terminal services of parties that also seek to export wheat but lacking in the protections afforded by Division 2 of Part IIIA of the TPA. Without any test of essentiality nor consideration of factors contained in section 44G(2) of the TPA, there is the possibility that the WEMA access test is being applied in such a manner that is detrimental to overall economic efficiency and thus resulting in regulatory failure.

The interaction of the WEMA access test with Division 6 of the TPA has had several adverse effects on wheat exporters who provide port terminal services. It has imposed significant compliance costs on parties who seek to comply with the access test under the WEMA. The deadline in the WEMA provided the ACCC with considerable leverage in negotiations for an access undertaking and effectively removed an important check on the administrative decision making power of the ACCC through merits review in the event that a draft access undertaking was rejected. The access test has been the source of enormous regulatory uncertainty for those parties that must satisfy it which has placed them at a substantial competitive disadvantage compared to non-integrated wheat exporters.

Low barriers to entry make the up-country extension of the WEMA access test completely unnecessary. Extension of the WEMA access test to up-country facilities would result in regulatory failure.

There are several constraints on the conduct of bulk grain handlers that make the operation of the WEMA access test unnecessary. Even without the

WEMA access test, the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA. In addition, parties have recourse to section 46(1) of the TPA. The potential for new entry in the provision of port terminal services may also serve to impose a further competitive constraint on the conduct of bulk grain handlers. In relation to CBH, the cooperative structure of its business and WA legislative requirements impose significant unique constraints which preclude it from exercising any market power that it may possess.

An alternative to the regulatory access arrangements under the WEMA access test is a voluntary port terminal service access regime provided for through the development of a voluntary code of conduct which makes provision for a dispute resolution process overseen by an appropriate grain industry body. A voluntary port terminal service access regime avoids the compliance costs associated with the WEMA access test while giving dissatisfied access seekers the option of pursuing other regulatory remedies.

The development of the WEMA access test has far more to do with the pursuit of populism and could be acting to the detriment of economic efficiency. With no apparent market failure to address, extension of the WEMA access test up-country would constitute yet a further departure from economic efficiency.

Monopolisation

CBH is a volume based business which needs to generate a high level of throughput though its port terminal facilities to provide sufficient revenue in order to cover its high fixed costs. According to CBH, it has never unreasonably refused any accredited exporter of grain access to the CBH Port Terminal Facilities (Cooperative Bulk Handling Limited, 2009, p. 24).

However, concerns have been expressed that the single desk export wheat monopoly of AWB could be replaced by three regional monopolies operated by the bulk grain handlers. Sections 46 and 50 of the TPA coupled with Part IIIA of the TPA provide adequate protections against potential monopolisation and abuse of market power in Australian grain related markets. On this basis, there is no need for any additional specific provisions to deal with monopolisation in grain marketing.

In consideration of any specific legislative provisions to impose structural separation in grain marketing, it is absolutely essential that such policy measures are accompanied by a thorough cost benefit analysis. There are likely to be substantial costs associated with imposing structural separation. In pursuit of structural separation of vertically integrated bulk grain handlers, it is critically important to ensure that the cure is not far worse than the disease.

Reform options and conclusions

ACIL Tasman sees no merits in retention of the WEMA whatsoever. Under these circumstances it recommends rescinding the WEMA.

However, if the Commonwealth Government is not amenable to rescinding the WEMA altogether, then:

- The licensing requirements should be diluted or the terms of the license extended indefinitely with random and infrequent high level audits
- Significant reforms should definitely be made to the WEMA access test.

Even without the WEMA access test, the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA and section 46(1) of the TPA. If the WEMA is to be retained, then ACIL Tasman believes the WEMA access test should be abolished. Instead, a voluntary port terminal service access regime provided for through the development of a voluntary code of conduct which makes provision for a dispute resolution process overseen by an appropriate grain industry body should be established. A voluntary port terminal service access regime avoids the compliance costs associated with the WEMA access test while giving dissatisfied access seekers the option of pursuing other regulatory remedies.

If the Commonwealth Government is not amenable to abolishing the WEMA access test, then the operation of the test should be amended to protect the interests of facility owners who export wheat. In the first instance, accreditation as a wheat exporter should not be made conditional on passing the access test. In the second instance, the access test should be applied by a legislative requirement for Wheat Exports Australia (WEA) to make an application to the National Competition Council under Division 2 of Part IIIA of the TPA for an access declaration of port terminal services. Both these measures would ensure that the rights of facility owners are fully respected and they are not placed at a competitive disadvantage as compared to other non-integrated wheat exporters.

1 Introduction

ACIL Tasman was commissioned by Cooperative Bulk Handling Ltd (CBH) to assist the organisation to prepare a submission for the Productivity Commission's (PC) inquiry into wheat marketing arrangements in Australia.

The PC inquiry is wide ranging covering the operations of the *Wheat Export Marketing Act 2008* (Cwth) (WEMA) and the bulk export wheat licensing scheme established by this Act. Among the matters to be considered by the Commission are:

- The effectiveness of the arrangements in meeting the objectives of the Act, including the role of Wheat Exports Australia (WEA)
- The suitability of the eligibility criteria for accreditation of exporters
- The appropriate level of assessment of each applicant for accreditation by WEA against these eligibility criteria
- The appropriateness of the access test requirements for accreditation of port operators as exporters
- The effectiveness of, and level of competition in, the transport storage supply chain for wheat
- The availability and transparency of market information.

Each of these considerations is dealt with in this submission from a Western Australian wheat export and general grain market perspective.

This submission begins with a discussion of the objectives of the WEMA and the intentions of the Government for this legislation. The submission then describes the characteristics of the wheat and general grain markets in WA, the export wheat supply chain, and key events during the 2008-09 harvest.

Having established the nature of the market which the WEMA has been applied to in WA, the submission discusses the future applicability of this Act to the WA market with particular references to the access undertaking provisions within the Act.

The submission then concludes with a series of recommendations for future wheat marketing arrangements in Australia and in particular Western Australia.

2 Characterisation of the WA grain industry

The CBH Group operates in a highly export oriented market where prices are determined by international supply and demand conditions for wheat and a

range of other grains that it can be substituted with in certain circumstances. Hence the Australian wheat price is based on the international price for wheat.

This places a significant overarching competitive constraint on the behaviour of all parties in the wheat market including CBH. This leads to a consideration of what market(s) CBH operates in, their competitiveness and how this affects the behaviour of CBH. The market for grain storage, handling and trading has widened considerably since the removal of the export wheat monopoly and could be summarised as including:

- On farm storage
- Containers
- New entrants introducing low cost aggregation and port loading facilities (including the threat of new grain storage and handling technology)
- Overseas grain origins.

Ultimately CBH enterprises are part of a supply chain which competes for grain production from other WA land uses. The most important long term driver of maintaining the current dominant role crops play on many farms is the relative productivity growth between the various enterprises considered by the farmer. Quality and farm gate grain prices are important contributors to farm level productivity growth.

CBH's performance is reliant on: the amount of grain produced; the amount that enters the bulk handling system; and the amount of grain exported through its port facilities.

Western Australia has produced on average in the five years to 2007-08, 41 per cent of Australia's wheat, 27 per cent of Australia's barley, 83 per cent of Australia's lupins and 43 per cent of Australia's canola. Typically WA does not experience the same volatility of production as the east coast (ACIL Tasman, 2005). The data in Table 1 shows that the amount of wheat, barley canola and lupins produced in WA on average between 2002-03 and 2007-08, 2008-09 and ABARE's 2009-10 latest forecast.

Table 1 **Australian and WA grain production (selected major grains)**

	Western Australia		Rest of Australia	
Wheat	Area '000ha	Production '000t	Area '000ha	Production '000t
2009-10 latest ABARE forecasts	4980	8743	8808	13977
2008-09	4900	8915	8652	12482
Five year average to 2007-08	4617	7946	8040	11569
Barley				
2009-10 latest ABARE forecasts	1230	2372	3249	5526
2008-09	1250	2527	3256	4294
Five year average to 2007-08	1237	2415	3285	5389
Lupins				
2009-10 latest ABARE forecasts	326	401	158	186
2008-09	267	341	153	144
Five year average to 2007-08	618	753	180	153
Canola				
2009-10 latest ABARE forecasts	626	825	634	895
2008-09	620	1138	545	740
Five year average t0 2007-08	446	555	732	735

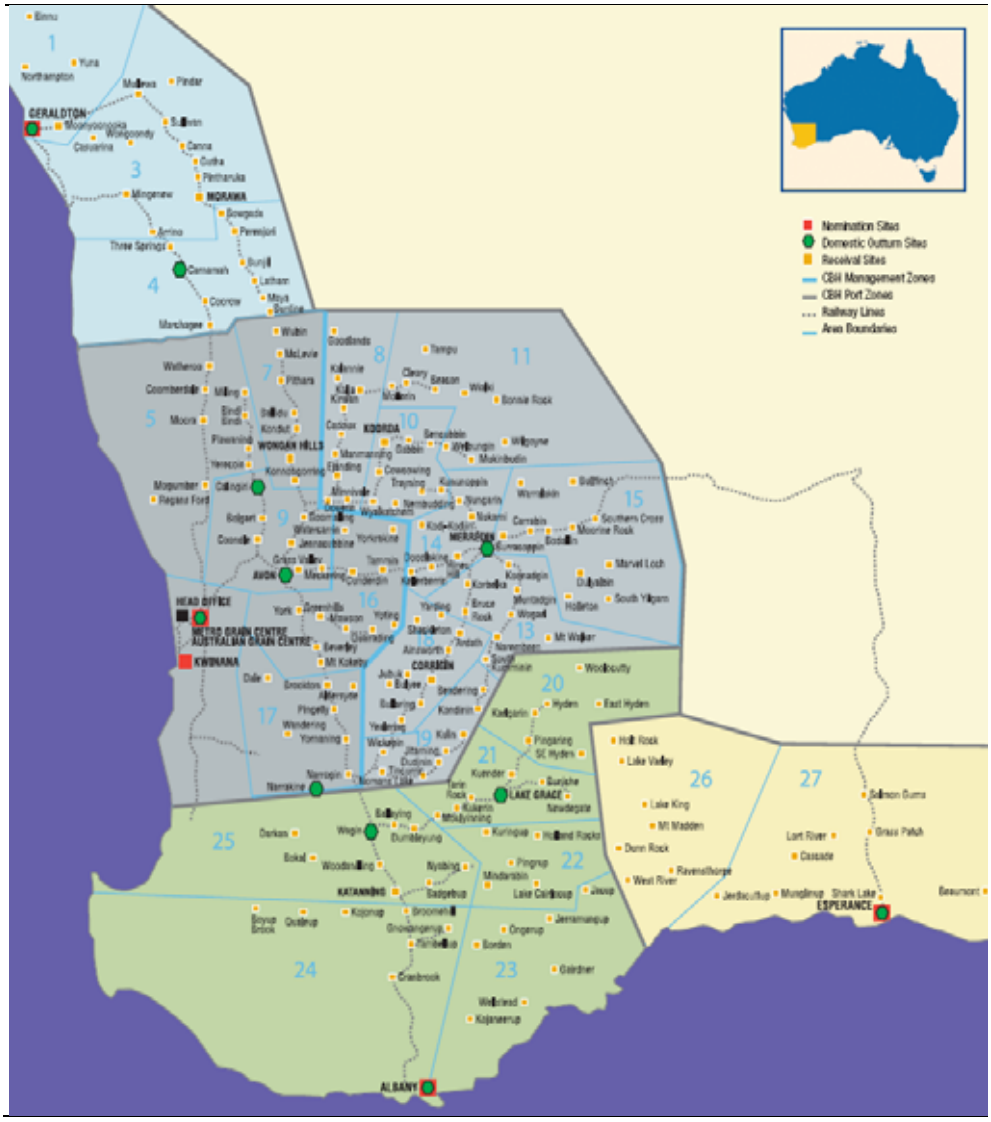
Data source: (ABARE, 2009)

On average 80 to 90 per cent of total grain production is exported annually from Western Australia. As the main grain growing regions of the state harvest the entire crop between October and January each year the storage and handling infrastructure has been developed to receive and store this grain close to production areas. Traditionally the grain is then exported over an eight to nine month period before the next harvest begins. Typically the majority of the grain is exported before June following the end of harvest. The peak grain shipment months are usually been between January and April where up to one million tonnes of grain are shipped each month. This is to ensure that the majority of the grain (mostly wheat) is exported before the northern hemisphere harvest commences.

The export program and the infrastructure to support it was developed to meet the needs of the export single desks for wheat previously operated by AWB Ltd and the statutory authorities established under WA grain marketing policies.

It can be seen in Figure 1 that WA grain storage and handling infrastructure is highly export oriented and designed around zones largely dedicated to moving grain to a particular port facility.

Figure 1 **Representation of the CBH Operations accumulation and out turn network**



Data source: CBH

The storage and handling network was also built to minimise the relative costs of transport and storage. The higher the cost of transport from the farm gate to the bulk handling system compared to the cost of constructing and operating storage and handling facilities, the more storage and handling facilities will be built.

During the period of expansion of the WA grain belt road infrastructure was poor and average truck capacity was lower than it is today. As a result the WA storage and handling system was constructed with a proliferation of small scale receival sites that have become increasingly less viable as road transport costs have fallen. At present there are 197 receival bins operated by CBH Operations in WA.

Under the export wheat monopoly, AWB Ltd operated a national pool that was sold down and exported on a regular and largely fixed sales program. The sales program was built into the Wheat Industry Benchmark (WIB) which was an instrument designed to remunerate AWB Ltd for managing the national pool (ACIL Tasman, 2005).

As with any pool arrangement, supply chain costs were passed on to growers as they are the residual claimants to the proceeds from the pool. Pooling also contained considerable cross subsidisation, particularly when operated at the national level and hence these products generally lacked the transparency of costs of a range of the services bundled into the final pool returns. The national export wheat pool therefore posted a different set of incentives for AWB Ltd as the national pool manager to actively manage the export program from WA (as part of a national export program) than individual traders will in a deregulated market.

The WA and Australian storage and handling system was largely developed to service the needs of regulated state and export grain markets.

Key points

- WA is a highly export oriented wheat production region
- The storage and handling system was built to meet the demands of regulated export markets, particularly the national wheat export pool.

2.1 Grain Express

Grain Express (GE) was introduced for the 2008-09 harvest. GE is essentially a bundled service where receival, logistics and port services are combined into one storage and handling package.

There are three key elements to GE:

- Separating the delivery of grain into the system by farmers at harvest and the decision and timing of marketing the grain. Under GE growers deliver their grain at harvest and receive a transferrable entitlement for an equivalent parcel of grain. The grower can then choose to sell the entitlement to a buyer at a later date without incurring any storage charges[2].
- Simplification of cargo assembly. Under GE buyers can post prices at port, which is accessible to every grower through the Loadnet[3] system. This system also lists standard location differential which effectively posts a price at every delivery point. Buyers can only claim entitlement to an equivalent parcel of grain at specified out turn sites (Destination Points). Growers pay the freight prices posted by CBH (referred to as location

[2] Storage for 2009/2010 grain is available without additional charges until October 2009.

[3] Loadnet is a web based notice board system that growers have to register with to access.

differentials) from their delivery point to the relevant Port or MGC at which the buyer claims entitlement of the grain

- Packaging all exporters transport needs into a single set of bilateral road and rail transport contracts held by CBH on their behalf (Mathews, 2008, p. 31).

In the Grain Express exclusive dealing notification under section 93 of the *Trade Practices Act 1974* (Cth) (TPA), GE was characterised in the following terms:

- That GE conduct is 'full line forcing' that falls within section 47(2) of the TPA
- In substance, CBH offers to supply storage and handling services on the condition that Growers or Marketers acquire:
  - Supply chain coordination services from CBH
  - To the extent that grain remains in the CBH's custody, that they acquire transport services from CBH (through its nominated carrier). (Corrs Chambers Westgarth, 2008)

Historically services have been offered by other bulk handling companies as separate services:

- Warehousing is a service offered by a number of bulk handlers in the eastern states that allows growers to store their grain at the receival site for a period of time at no charge before selling the grain
- Buyers can buy grain from sellers holding grain in the BHC system at any stage in the supply chain up to and after port. Some buyers regularly acquire cargoes FOB
- When buying grain from the bulk handling system other than directly from the grower at the initial point of delivery, a grain buyer is purchasing the grain and has already committed to handling services with the bulk handling company. After purchasing the grain the buyer can utilise the BHC's logistics services or make their own transport arrangements.

The conceptual basis of GE is that it seeks to utilise the information that CBH has including:

- Grower members that provide pre harvest information on the size of the crop across the entire wheat belt
- Has full knowledge of all of the grain volumes and grain quality (including fumigation and hygiene status) within its storage network throughout the year
- Is likely to be able to achieve economies of scale in a wide range of areas including transaction costs when dealing with growers, negotiating freight rates with rail and road transport providers.

The difference between GE and the way other grain accumulation networks operate is that by requiring buyers to use all of the services together, CBH Operations is seeking to maximise the efficiency that can be derived from the provision of a bundle of services.

To be able to bundle this package of services on an exclusive basis, CBH Operations had to seek notification of the conduct from the ACCC.[4] The ACCC allowed this notification to stand as it was of the opinion that any anticompetitive detriment was outweighed by the public benefits:

> On the basis of information before it, the ACCC is satisfied that the introduction of Grain Express is not likely to lead to a substantial lessening of competition in relevant markets.
>
> In reaching its decision the ACCC took into consideration the fact that Grain Express does not limit the ability of grain growers and grain marketers to make their own grain storage, handling or transport arrangements. (Australian Competition and Consumer Commission, 2008)

However, there are some tradeoffs that need to be considered. For many grain traders there are considerable competitive advantages that can be derived from blending grain of different origins to reduce the average cost of meeting contract specifications. There is also considerable value in maintaining physical control of the grain in some or all of the supply chain to maintain the flexibility to meet end users demands for the timing of delivery.

The extent to which buyers and sellers maintain physical control of the grain in the supply chain, referred to as vertical integration, is largely determined by the transactions costs incurred.

As a general rule, as economists see it, in open economies resources are allocated amongst uses by two methods - the price mechanism and agreements between entrepreneurs who are organised within a firm. In its purest form, an allocation by the price mechanism will occur via a spot sale – where the terms are cash and the price and quantity of the product exchanged are determined instantaneously and once-off. The equivalent polar case for an allocation by agreement is a long term contract between employees within a firm. Clearly there are many intermediate forms of allocation in between. The choices along the spectrum between each pure form are what determine business organisation.

[4] Exclusive dealing conduct that would otherwise breach the TPA gains immediate and automatic immunity from legal proceedings under the TPA when notification of it is given to the ACCC. The immunity remains unless revoked by the ACCC.

The way choices are made between the price mechanism that operate in spot sales and contractual agreements for the exchange of goods and services was explained in 1937 in a much quoted article by the 1991 Nobel Laureate for economics Ronald Coase called 'The Nature of the Firm'. It concentrated on explaining how a firm decides to buy its inputs and sell its outputs, particularly who to hire as employees as part of the internal command structure of the firm and who to deal with alternatively in a moment-by-moment market way (Coase, 1937).

Coase noticed that the productive processes that go on in firms could all be carried out in a completely decentralised way by means of contracts between individuals. But he noticed too that there are costs to those contracts: information costs, search costs, negotiation costs, monitoring costs and enforcement costs. He referred to these costs collectively as transactions costs.

There are significant transactions costs associated with dealing with over 5000 wheat growers who deliver grain to up to 197 receival points in the storage network with 53 segregations of grain type. Also in 2008 the number of buyers wishing to access grain from this system rose considerably when the export wheat market was partially deregulated. While many of these buyers were also active in the market under the WA Grains Licensing Authority (GLA) and servicing the domestic market, the number of additional transactions generated rose exponentially as these buyers gained access to the export wheat market.

Therefore to reduce the overall transaction costs and the loss of logistical efficiencies associated with the fragmentation of the grains industry in WA CBH introduced GE. However, another important point made by Coase is that transaction costs are dynamic, and therefore the incentives to deal in a spot market or coordinated resource allocation via a 'firm' will change over time (Coase, 1937).

The fundamental test of GE will be if the supply chain efficiencies (in part dependent on reducing transaction costs) generated by a bundled storage, handling and freight package outweigh the costs of merchants unable to blend site specific grain and the inability to maintain physical control of the grain in the supply chain.

This trade off was recognised by CBH and it introduced special features of GE to allow some earmarking of specialist stocks. The ACCC recognised these features when assessing the notification:

> Further, grain marketers will continue to be able to take advantage of niche marketing arrangements that provide extra financial value to growers.
>
> The ACCC also considers that Grain Express may stimulate competition for CBH transport contracts by providing greater certainty in respect of

transport volumes. (Australian Competition and Consumer Commission, 2008)

Over time this will be tested with CBH facing the prospect that if GE does not deliver a net benefit there will be strong incentives for alternative supply chains (including transport) to be developed based in part on the growing on farm storage capacity.

GE appears to offer a high level of coordination of the storage, handling and transport tasks in WA as the industry makes a transition to a deregulated export wheat market. However, over time the continuation of GE (or any other service offering) will ultimately be dependent on market forces as alternative supply chains are not only possible but are being actively developed by several groups in WA.

Some concerns have been raised that, as the CBH Group is also vertically integrated into marketing via the Grain Pool Pty Ltd (GPPL), GE may confer some competitive advantages on CBH's trading division. To deal with this the CBH Group has 'ring fenced' GPPL from CBH Operations to the satisfaction of the ACCC.

In considering this issue it is critical to question what additional competitive advantages GE confers on GPPL compared to the situation where CBH did not introduce GE.

In the absence of GE, CBH Operations would continue to have knowledge of all grain receivals in its storage system, and the activities of competitor's accumulation and shipment activities. It appears that GE may confer at best a marginal additional competitive advantage on GPPL if the ring fencing failed to prevent information passing between the divisions.

In the context of this submission a detailed analysis of GE was not undertaken as is not relevant to the WEMA or the access undertakings required under it. Concerns about the operations of GE are a matter for the ACCC under the exclusive dealing notification. However, as discussed in more detail in section 6 the access undertaking has the potential to reduce the efficiency of GE by requiring a degree of unbundling of the GE package at port.

Key points

- GE is a bundled storage handling and logistics product developed by CBH and introduced for the 2008-09 harvest.
- Notification was given and accepted by the ACCC for this product as the ACCC believed that there would not be a substantial lessening of competition in this market as a result of the introduction of GE

- Continuation of GE will ultimately be dependent on market forces as alternative supply chains are not only possible but are being actively developed by several groups in WA.

2.2 Storage and handling post deregulation

There are two important features that characterise the WA grain industry:

- It is export dependent with between 80 and 90 per cent of all grain being exported[5]
- Growers typically are larger and are increasingly becoming more specialised grain producers.

There are several overarching factors that will influence the development of the WA industry post deregulation:

- Increased niche marketing opportunities (although the bulk wheat supply chain will continue to dominate)
- Growers will have the choice of a wide range of marketing products, many of which will be based on cash sales (although this may vary from year to year). Thus a greater proportion of grain on average will be sold for cash
  - Price risk management will increasingly utilise the ASX WA wheat contract and international grain derivatives markets.

These factors are likely to be the key drivers of change to the Western Australian market post deregulation which are of relevance to the future of the WEMA.

Prior to the northern hemisphere harvest there is considerable interest in the condition of the crop, particularly in North America, which leads to considerable volatility in international grain markets during this period. There is considerable value in having the flexibility to sell and export grain to take advantage of international market volatility.

[5] Based on ABARE WA grain export statistics supplied to the author on the 03-11-2009 by ABARE

Box 1 **The launch of the ASX Western Australian Wheat Futures and Options**

On Monday 14 September the Australian Securities Exchange (ASX) launched a Western Australian delivered wheat futures and options contract. The Western Australian Wheat contracts (WAW) are based on the Kwinana track market, which means that the obligations of the contract can be met by cash or by delivery of Australian Premium Wheat (APW) (10% protein) wheat at Kwinana.

The launching of this contract based on the track market will provide a significant increase in grain price and freight market transparency. As the majority of grain produced in WA is exported the WAW contracts have the potential to be used internationally, particularly in South East Asia.

The level of price transparency afforded by highly traded WAW contracts will provide WA producers with daily price transparency at port and, combined with standard freight costs, will provide clear local prices as well.

Source: ASX media release, 7 September 2009

2.2.1 Export marketing signals

One of the more fundamental changes to the wheat market in the first year of partial deregulation has been the amount of the grain traded on the spot or cash market. Growers have opted in large numbers not to participate in pools but to fix the price of the grain at or close to harvest. When the grain is sold for cash on the spot market all of the price, storage and handling and exporting risks are transferred to the buyer.

To be able to buy the grain from the producer on the spot market the buyer must also raise sufficient capital to finance the purchase until the grain is sold and paid for.

Most international grain trading terms are based on payment (a release of a letter of credit) once the grain is received by the buyer.

There are strong signals in grain markets (cash and derivative) that tell buyers and sellers when to sell and when to store grain. This is generally referred to by traders as the 'carry' in the market. The amount the market is willing to pay for storage is, in simple terms, the difference in the grain price at different times of the year. A low price now and a high price in the future will indicate that the market is signalling to store grain. A high price now and low price in the future means the markets wants to receive the grain sooner rather than later.

With greater cash transactions, and the development of the WAW, the WA grain market prices and costs of storage and handling will be far more transparent than they have been before.

These changes will post strong incentives for buyers to develop far more flexibility to move grain to export markets in response to market signals.

Another important competitive advantage strived for in the marketing of wheat (and other grains) is the capacity to blend different parcels of grain to meet contract specifications at the lowest average cost. That is, buyers will seek to purchase a range of grain qualities, at differential prices, to meet the minimum contract specification. The more the buyer can buy low quality grain at lower cost to include in the shipment the lower the average cost. Symmetrical to the buyers are the sellers who produce a range of quality types and will want to maximise the average price of what they produce.

As a result buyers will increasingly want to have more control over the supply chain to ensure they have the capacity to:

- respond to store or sell price signals
- have the capability to blend grains to achieve a competitive advantage.

To achieve control over the supply chain buyers and sellers will seek to coordinate their activities through:

- Contractual arrangements with storage and handling and freight suppliers
- Invest in partial or full alternative supply chains.

Ultimately this will lead to increased incentives to develop alternative storage and handling facilities on farm, at the regional level, and even at port, bypassing small scale local BHC facilities.

It is likely that Grain Express will increasingly have to offer freight and logistics efficiencies to attract buyers away from developing alternative supply chains of their own.

This does not mean that producers will end up having to pay for a duplication of storage and handling facilities in WA, as much of the current infrastructure may become obsolete.

2.2.2 The development of alternative storage and handling systems

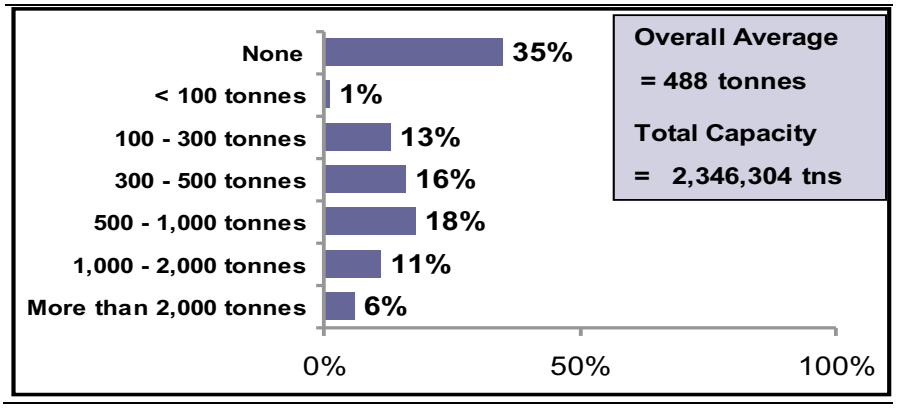
There are already increasing signs that growers are going to build more on farm storage of a larger capacity able to store grain and maintain much higher levels of quality than has historically been the case.

CBH Operations recently surveyed the majority of its grower members on their current and future on farm storage capacity. The survey results show that current on farm storage capacity appears to be at 2.35million tonnes and could possibly grow to 4.22 million tonnes within three years. The majority of this growth in capacity will be in storages of greater than 1,000 tonnes.

This means that in three years, 36 per cent of all of the average production of wheat, barley, canola and lupins could be stored on farm: 11 per cent of this will be in storage facilities greater than 1,000 tonnes.

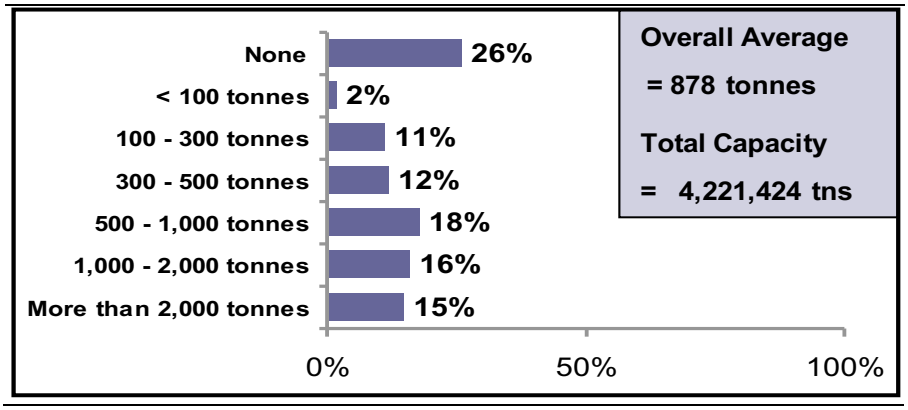
It is likely that much of this additional storage capacity will be in facilities that are up to 60 years younger than most of the 197 receival sites and a few are larger than the smaller CBH sites. Coupled with an on farm storage quality assurance or accreditation scheme as proposed by Elders Toepfer (see Box 2), on farm storage could become a significant competitor to the local and even regional storage and handling infrastructure currently owned by CBH Operations.

Figure 2 **Current on farm storage capacity**



Data source: CBH grower survey results based on 4808 grower shareholder responses

Figure 3 **Anticipated on farm storage capacity in 2012**



Data source: CBH grower survey results based on 4808 grower shareholder responses

Box 2 Elders on farm grain storage accreditation system

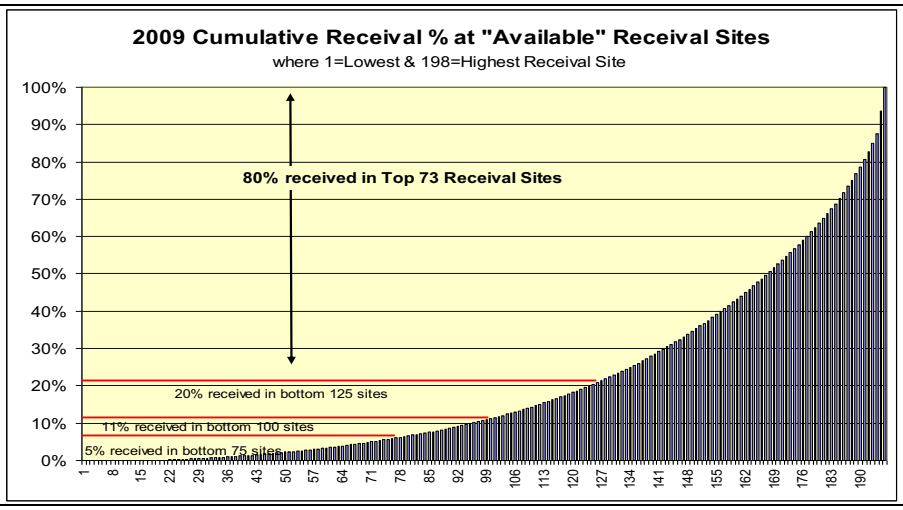
Grain Trader Elders Toepfer is introducing an on farm grain storage accreditation system based on internationally recognised storage principles using the Swiss based SGS organisation to assist with certification.

Elders will educate growers on grain storage and quality as part of the accreditation process. Elders Toepfer claim that achieving accreditation will provide growers with more marketing flexibility. However, it will also provide Elders Toepfer with a network of storage facilities that it can source grain with a lower risk of quality problems arising.

Source: The Land, Thursday September 17, 2009

The development of on farm storage can be contrasted with the proportion of deliveries spread across the CBH receival network. Clearly there is an intention by growers at least to bypass local silos and either store on farm or deliver direct to primary (regional sites) when prices and transport costs may be more favourable. The data in Chart 1 shows the distribution of receivals across the CBH Operations network.

Chart 1 **Receivals across the CBH Operations network**



Data source: CBH Operations

Key points

- On farm storage and handling is likely to grow considerably over the next three years reaching approximately 20 per cent of existing CBH storage capacity
- There are considerable incentives for firms to vertically integrate in the WA grain market
- Partial deregulation of the export wheat market in WA is likely to lead to significant changes to the organisation of the storage and handling market in WA

2.3 The export bottleneck in 2009

In early 2009 demand to export wheat from WA rose dramatically and a 'bottleneck' in the export supply chain emerged, particularly at Kwinana. The result was that some shipments that some exporters had expected to be made

over this period experienced considerable delays. These delays occurred despite record throughput at the ports over this period.

The spike in demand and subsequent bottleneck appeared to be the result of number of factors including:

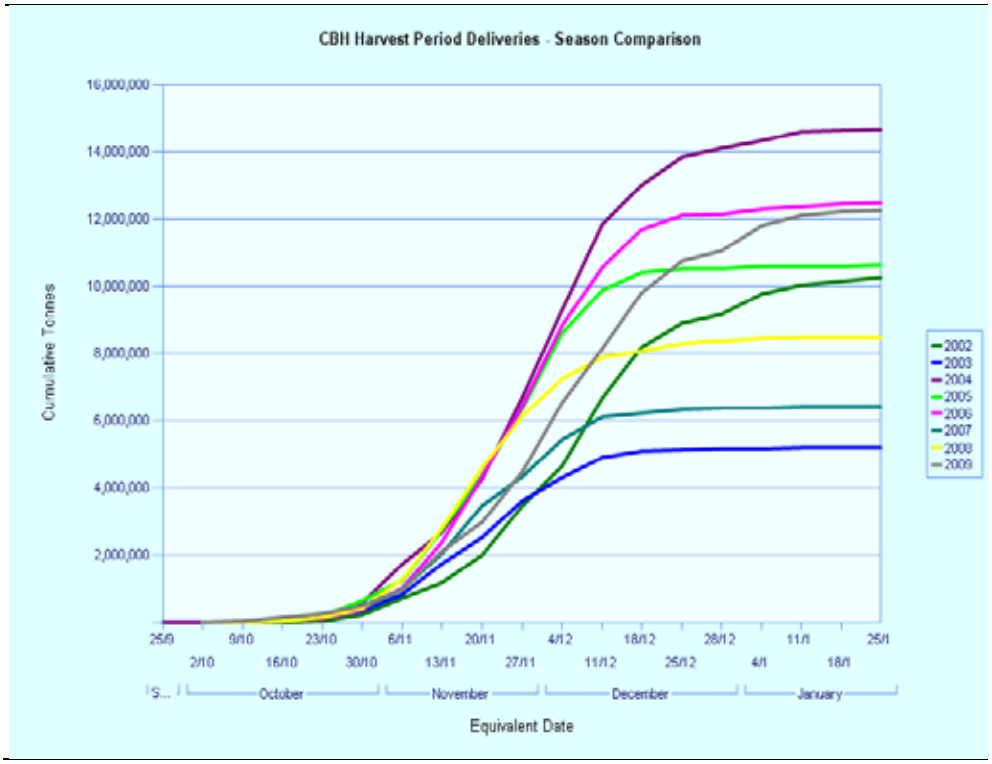
- A rain delayed harvest
- Demand for early deliveries of wheat by a number of end users
- A lack of communication between the port operator and the exporters
- Volatility in the export wheat price and bulk sea freight rates in early 2009
- Limited rail network capacity due to a number of load and speed restrictions on many branch lines

This section looks at a number of these factors in detail and how the port operators and exporters may respond to similar situations in future.

The situation received considerable media attention and it was reported that some customers that expected to be able to source grain from WA at this time were unable to do so. However, as record port throughput was achieved, for every customer not able to source grain at this time, there must have been more that could.

Over this period there were both supply and demand factors influencing the market. The 2008-09 harvest was delayed by rain in many regions compressing the period over which the grain was received (see Chart 2).

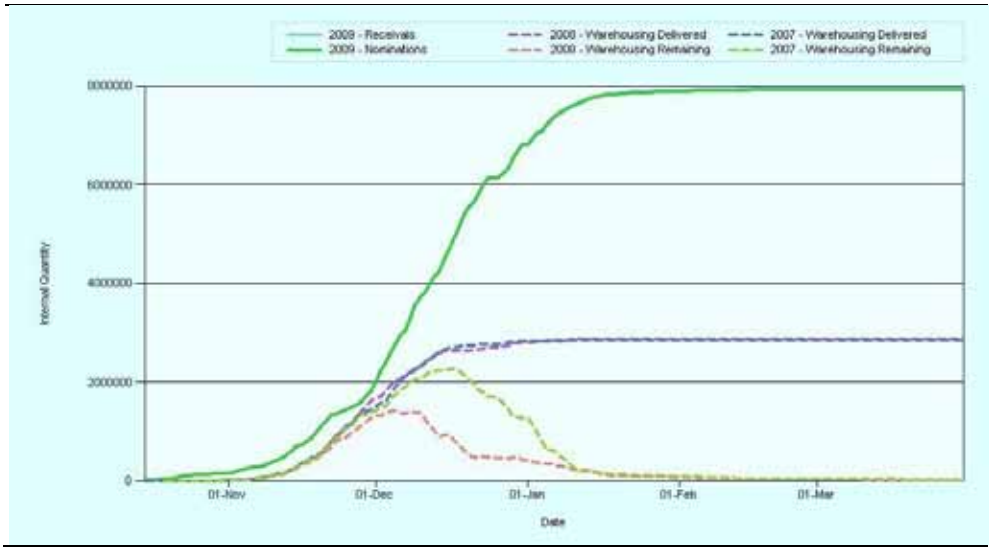
Chart 2 **Harvest deliveries**



Data source: CBH Operations

However, while the grain was harvested and delivered late it was warehoused and then nominated to a particular buyer by the grower. This was the first time producers had taken advantage of this option as in the past most of the grain would be delivered to the AWB national pool or one of a handful of intermediaries operating pooling products that would eventually be delivered to the AWB national pool (see Chart 3). The effect of warehousing then nominating the grain meant that many buyers did not acquire entitlement (that is the grower did not sell the grain) for some time after delivery. This meant that buyers did not know how much of delivered grain they would acquire until sometime after the grain had been delivered.

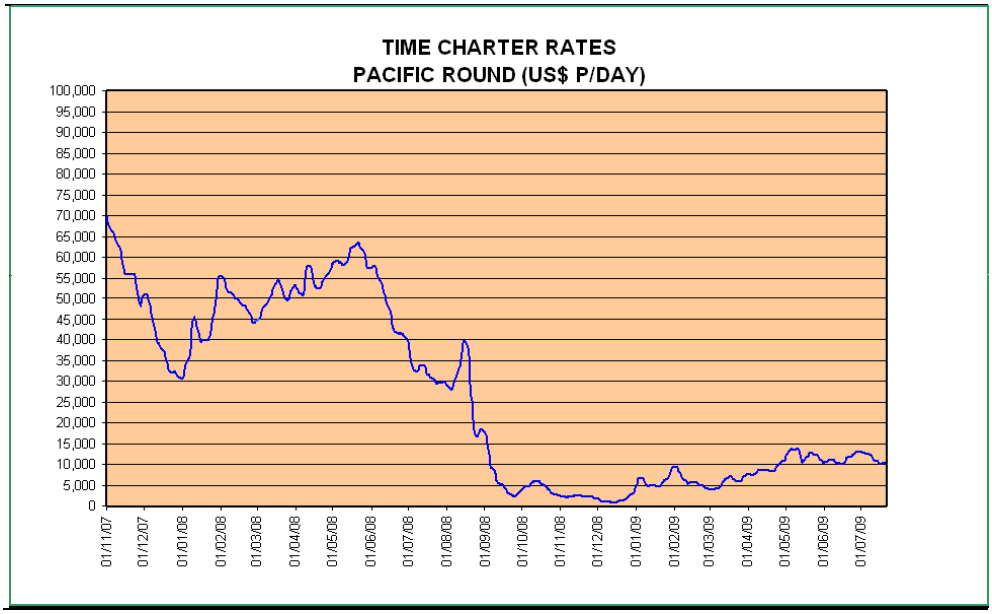
Chart 3 **Warehousing and nomination trends**



Data source: CBH Operations

The data in Chart 4 shows the dramatic fall in ship time charter rates for bulk carriers in late 2008 and early 2009. It is likely that many exporters booked freight at the lower rates and may have been inclined to commit to sales and accepted at least some risk that they may not have been able to export grain at the time they hoped to. In other words, wheat exporters would have been inclined to be more cautious about making sales over this period had the shipping rates (and hence potential demurrage costs) been higher.

Chart 4 **Ship charter rates**



Data source: CBH Operations

Another factor affecting export capacity over this period was the ability of the rail operators to meet demand. This is more critical for Kwinana as it is the

port most reliant on rail deliveries for export grain (see Table 23). At road access at Kwinana is restricted and must be hauled through the eastern edges of Perth. Road deliveries are accepted at the Metropolitan Grain Centre (MGC) at Forrestfield in the eastern Perth industrial zone. MGC is linked to Kwinana by rail (Mathews, 2008).

Table 2 **Average grain receivals at WA ports**

	Rail	Road	Port	Total
Kwinana	3,900,000	190,000	-	4,090,000
Geraldton	850,000	55,000	300,000	1,540,000
Albany	1,000,000	550,000	200,000	1,750,000
Esperance	150,000	550,000	300,000	1,000,000
Total	**5,900,000**	**1,680,000**	**800,000**	**8,380,000**

Note: The volumes in the 'Port' column are volumes delivered by truck direct to port from the farm. Typically these deliveries are by farmers within 100km of the port at harvest time.

Data source: (Mathews, 2008, p. 24)

According to the CBH Group there are over 783 restrictions on access across the state made up of load and speed limits. In a number of areas, track speeds average 25kmh. These restrictions reflect the declining state of the rail system that has been steadily losing its share of the freight task to road transport.

There is over 4,000km of track in WA (Rail Express) made up of standard and narrow gauges. The standard gauge track is well maintained as it makes up the rail link with the eastern states and is used to transport general cargo as well as grain. The above rail operations are owned by ARG a subsidiary of Queensland Rail (QR), the network of tracks is leased by WestNet Rail. There are no other companies hauling grain in WA by rail at this stage. However, there does not appear to be any reason why a company, prepared to invest in rolling stock, could not gain access to the tracks on appropriate commercial terms. Westnet is also subject to a regulatory overview and arbitration mechanism provided by the Office of the Western Australian Independent Rail Access Regulator (a division of the Economic Regulation Authority) , established under the Railways (Access) Act 1998 (WA) to ensure access to the network on fair commercial terms.

The narrow gauge system has been developed over many years to cater for the needs of the extensive storage network operated by CBH. This rail network was also developed to assist in the development of many regions of WA at a time when road transport was relatively more expensive.

There appears to be two overarching factors affecting the competitiveness of the rail network in WA:

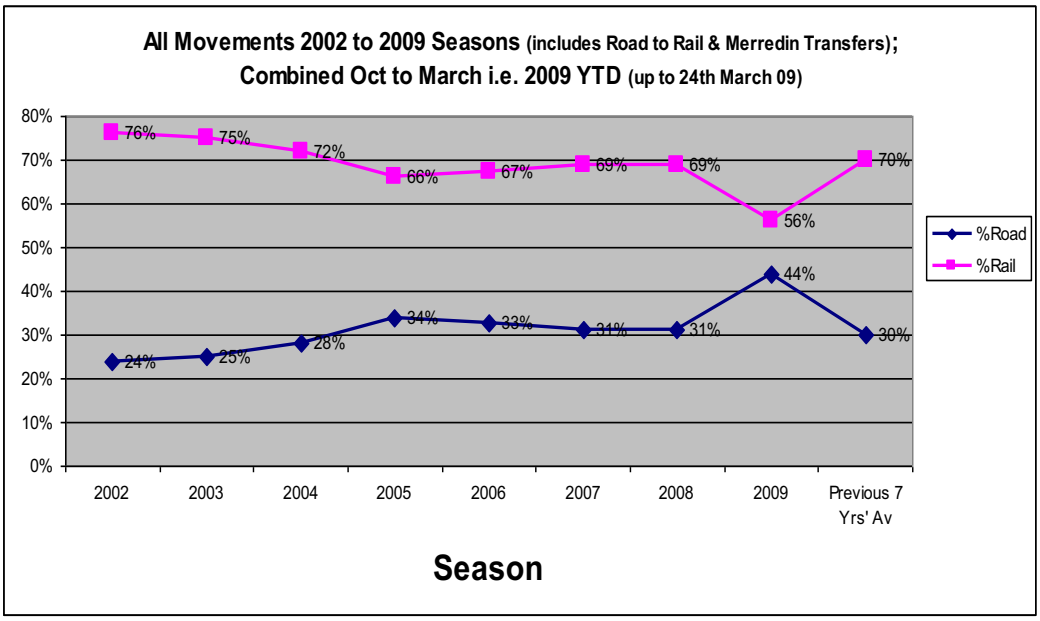
- An extensive maintenance cost for the large network of narrow gauge tracks built to service rural communities and CBH's extensive silo network

- An increase in truck capacity, and road train access to most ports receivals sites has lead to a reduction in relative costs compared to rail for some haulage distances.
- Grain freight tasks are highly variable in line with the size of the crop. This variability increases the risk that the high annual fixed cost of rail operations (above and below track) may not be met

The competition between rail and road appears to have led to a reduction in the total freight cost making the WA grain freight prices the cheapest in Australia (Mathews, 2008).

The result of these factors has been a gradual reduction on average in the amount of grain transported by rail as a proportion of the total freight task (see Chart 5).

Chart 5 **Grain transport modal share (% of total grain moved)**



Data source: CBH Group

However, the date in Chart 5 shows a dramatic increase in road freight as a proportion of the total freight task in 2009. This is probably due to the increased use of trucks over the surge period in early 2009 as trucks were used to move grain to port as the demand increased rapidly and the rail freight operator was unable to meet this demand. The relatively lower flexibility of rail to meet surge demand was a point made by KPMG in their review of the Grain Infrastructure Groups unpublished review of WA grain freight network:

> ...while upgrading roads is also capital intensive, the roads have to be there anyway, and the incremental costs imposed by using these road to transport more grain would appear modest, partly because the grain freight task is dispersed at source and all grain starts its journey by road anyway. In addition, investing in above road haulage

> operations is less capital intensive, and those assets can be used much more flexibly and therefore intensively (KPMG SAHA, 2009)

There is also considerable evidence that there has been underinvestment in railway maintenance. Mathews, 2009 suggests a maintenance debt has been accrued since privatisation of the network (Mathews, 2008). Further evidence of the need for increased maintenance of the rail system was the development of the 'Rescue Package' where $400m would be made over 10 years to improve the network. Funding of the package is split between the railway owners, the grains industry (through CBH) and the State and Federal Governments. The package requires increased maintenance, some rationalisation of rail lines, and improved road links and 'quick fill' loading facilities.

However, the WA State Government is awaiting further information on the rail network from a strategic review committee before committing any funds to the package.

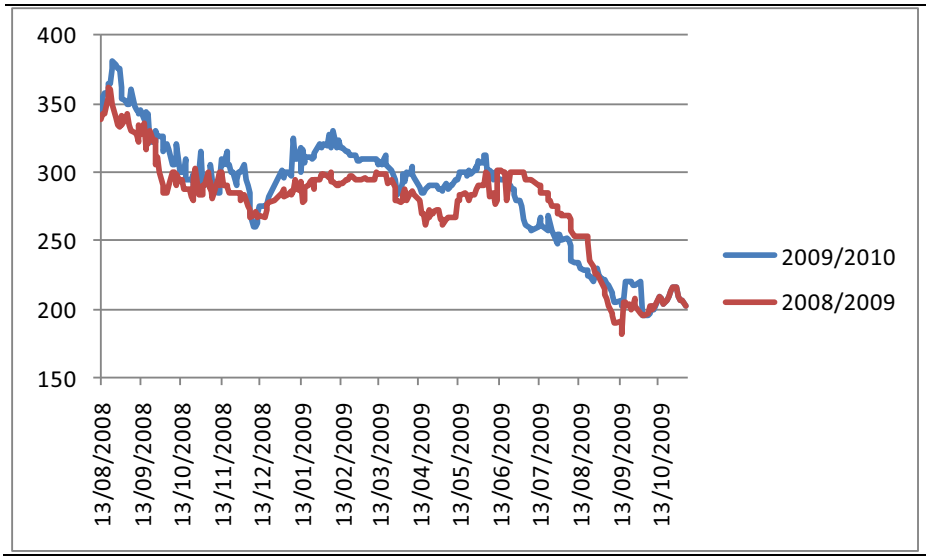
On the demand side when the 2008-09 and 2009-10 prices offered at this time are compared (see Chart 6) several things become apparent[6]:

- From late January to March 2009 the 2008-09 and 2009-10 wheat prices were converging which meant that the market was signalling that it perceived a shortage of APW from WA and wanted to receive it quickly. The market then diverged between April and May and then inverted[7] strongly until August 2009
- In November 2008 prices began to rise following step falls in 2008. However, this price rise was short lived and prices began to fall from early January and continued to do so until September losing nearly 30 per cent compared to December prices.

[6] Over the harvest period and early months of 2009 prices were posted for both the current 2008-09 crop and the 2009-10 crop as is typical in most years

[7] Inverse is when the near months are trading at a premium to deferred or later months.

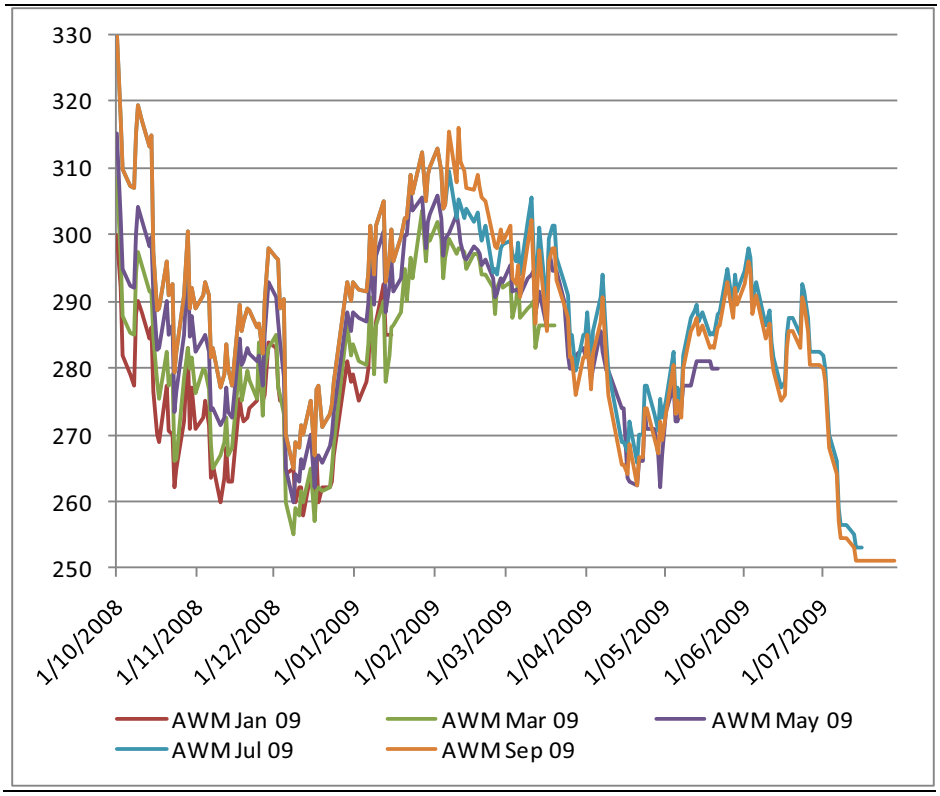
Chart 6 **Old crop and new crop cash prices in WA between August 2008 and September 2009**



Data source: Grain Pool Pty Ltd

The Australian milling wheat futures contract (see Chart 7) shows a similar but more pronounced difference in prices over the early 2009 period. It can be seen in the ASX prices that a clear and relatively large spread in prices existed until November 2008. From December 2008 on the spread spreads between the near and far months halved and became far more volatile. While the ASX milling wheat contract is based on the east coast and is affected by domestic east coast markets, it is consistent with the cash market analysis in Chart 6.

Chart 7 **Australian milling wheat contracts from Jan to Sept 2009**



Data source: ASX

The data in Table 3 shows the stocks, amount contracted for export and the grain exported between March and July 2008. The amount of grain exported in March was 1.55mt of which 1.04mt was wheat. This was 20 per cent of total stocks held and half the wheat contracted for export. The level of wheat exported over this period was the highest ever achieved by CBH.

Table 3 **WA wheat stocks, export commitments and actual exports March to August 2009**

	Stocks held by CBH '000t	Contracted for export '000t	Exports '000t wheat	Exports '000t (total grain)
31 March	4,838	2,057	1,044	1,552
30 April	4,084	1,463	778	949
31 May	3,502	1,741	598	928.
30 June	2,656	1,270	792	896
31 July	2,065	1,173	574	896
31 August	1,544	1,110	493	780

Data source: CBH and *(ABARE, 2009)*

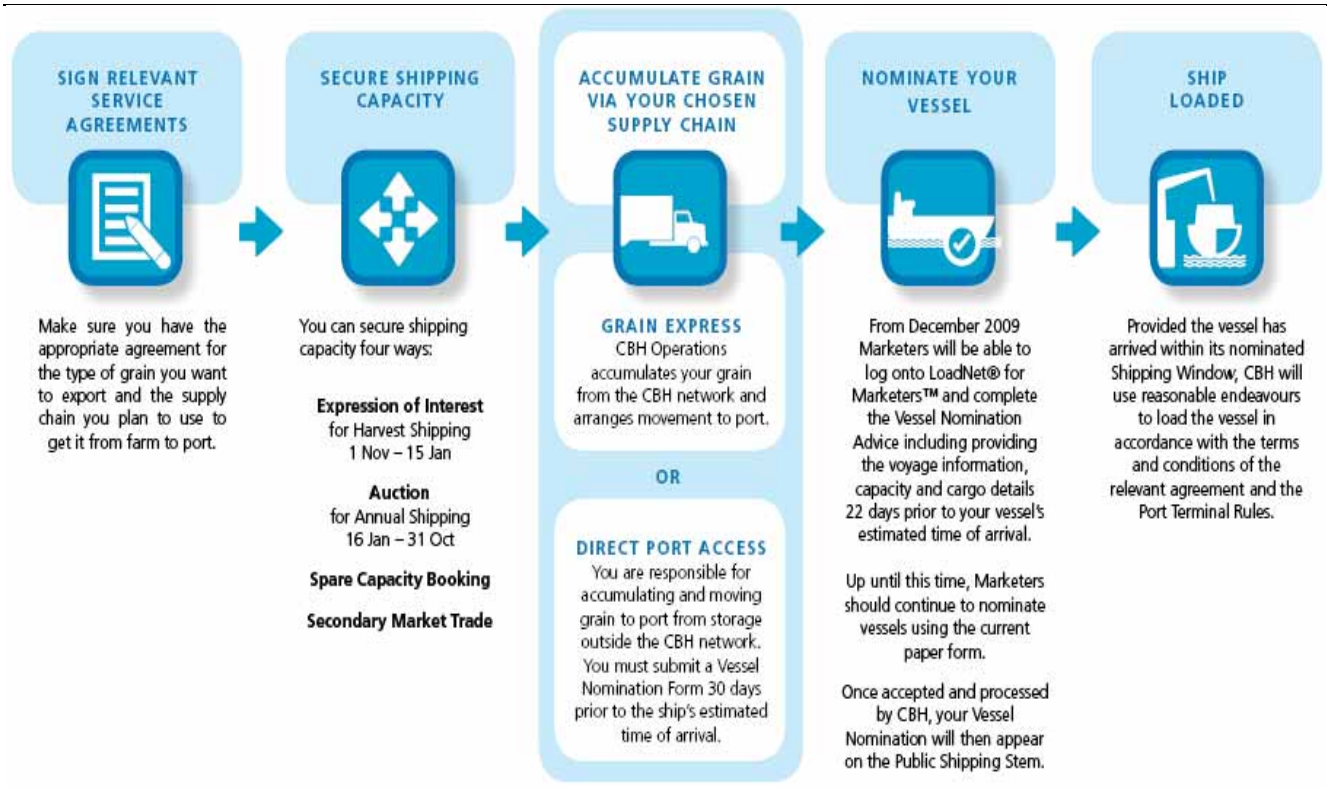
It appears that demand for export capacity was unprecedented at this time due to the new entrants in the market responding to some very clear market signals to export as much grain as possible over this period. Also there were a number of new entrants to the market at this time that wanted to establish their credentials with new overseas buyers.

Clearly the exporting capacity of the bulk handling system (inclusive of the capacity to get grain to port) did not meet the expectations of those wishing to export grain over this period. However, the onus to ensure exporting services are secured falls to those voluntarily entering into contracts to supply grain. It appears that sufficient due diligence was not undertaken by those wishing to export over this period.

However, this was a period of rapid change, and while it is the responsibility of buyers to secure necessary services to meet contractual obligations, there are also incentives for the service provider to provide the necessary information to its customers to encourage them to use their services.

It is ACIL Tasman's view that more information about emerging export demand, rail capacity and available stem spaces would have lead to better management of exporters' expectations. This is particularly so as CBH undertook to manage the delivery of wheat to the export terminal via the GE bundle as can be seen in Figure 4 below. This figure shows the export supply chain where moving grain to port is either undertaken through GE or can be delivered directly to some ports.

Figure 4 **How to export grain from WA**



Data source: CBH Group

If CBH does not manage the allocation of total export capacity, and the expectations of customers who use these services it will create strong incentives for alternative port facilities to be developed. CBH Operations have now introduced an auction system to allocate stem capacity to ensure a transparent and independent allocation process is in place to better manage peak demand periods. Given the market conditions at the time, and the number of new entrants in the market it was likely that demand for export services would have outstripped supply over this period.

This situation will be alleviated in several ways:

- CBH Operations has introduced an auction system to allocate stem capacity at peak periods in a competitive and transparent system (the value of this system is likely to be in informing the market of annual and peak stem capacity as much as allocating capacity)
- Clearer market signals will be available through the WAW
- The development of low cost alternate export capacity which is being investigated by various parties at all ports in WA
- Clear incentives posted to CBH Operations to invest in additional port capacity to meet likely increases in peak demand in a deregulated market
- Clear incentives to rationalise and invest where necessary to ensure the grain logistics are adequate to meet grain export demands

An access undertaking merely ensures that what capacity is available is distributed in an open and transparent manner. However, access undertakings do not address underlying problems of ensuring that the export pipeline capacity is optimised, and whether sufficient capacity is available at peak demand but without excessive underutilisation at other times.

As will be discussed in the following sections, creating barriers to entry by overly onerous licensing provisions and heavy handed intervention through access undertakings, may reduce the incentive to invest in export infrastructure for which there will be significant increases in peak capacity in future.

Key points

- The surge in export services demand in early 2009 which led to congestion at the WA ports was the result of a number of factors including a delayed harvest, extensive warehousing of grain by growers, an increase in demand for early delivery from end users
- The port congestion highlighted the need for improvements to export demand management at the ports which has led to the introduction of an export stem auctioning system by CBH for the 2009-10 harvest.

3 The *Wheat Marketing Act 2008*[8]

This section reviews the effectiveness of the WEMA, in particular the licensing scheme established under the Act following a full harvest cycle being completed post partial deregulation.

The critical questions in this section are:

- Is licensing and other aspects of the Act required to achieve the objectives of a competitive wheat market?
- Given that no other agricultural commodity exports require special licenses what is unique about the bulk exporting of wheat that requires this aspect of the Act?
- Are there any market failures that require licensing of bulk wheat exporters?

3.1 Background to the Act

Following over 60 years of regulation of the wheat market, the Commonwealth Government introduced legislation into Parliament in March 2008 overhauling the exportation of wheat. The repeal of the export wheat market regulations

[8] Second reading speech: Wheat Export Marketing Bill 2008', House Hansard, 29 May 2008

effectively ended a long history of statutory control of agricultural products in Australia. In the late 1990s and early 2000s a number of state based statutory marketing authorities covering lambs, barley, canola triticale and oats were abolished in preference for open and free access to export markets for anyone who could establish their credentials with buyers and sellers (inclusive of meeting AQIS and Customs requirements).

In the case of the GLA the continuation of the licensing scheme was dependant on the continuation of the export wheat regulation.

Prior to the deregulation of the grains industry during the 1990s and early 2000s government intervention in wool, lamb and beef marketing was also withdrawn.

The only aspect of the wheat export industry that appear to be unique or warrant special consideration was that wheat export marketing was virtually the last statutory marketing policy to have been wound back in Australia..

As wheat is by far the largest grain crop in Australia, assessed by value of production and export sales, deregulation of this market probably represents a significant opportunity to increase the scale of existing operations and provides sufficient scale in the Australian grain market to attract new entrants. This means that for many new wheat exporters Australia was previously only a branch office servicing the domestic market and a limited amount of the export grain market.

3.1.1 Deregulation of the wheat market

Deregulation of the export wheat market represents a considerable expansion of the grain market in Australia. However, the deregulation of the export wheat market affected by the WEMA was only one step in a long process to this point.

Several policies formed an important prelude to the partial deregulation of the export wheat market in Western Australia, these were:

- The deregulation of the domestic wheat market in 1989
- Deregulation of the exporting of wheat in containers from 27 August 2007
- The introduction of the Grains Licensing Authority (GLA).

In respect of the first two dot points, deregulation of the domestic market represented at the time a liberalisation of 30 – 40 per cent (now closer to 50 per cent) of the wheat market as a proportion of total production. Liberalisation of the container market added another 20 per cent to the wheat able to be freely traded. This means that prior to the introduction of the WEMA up between 50 and 60 per cent of the wheat produced in Australia was able to be freely traded.

The situation in WA, however, is diluted by the smaller domestic market for wheat. In WA the amount of grain freely traded prior to partial deregulation of the wheat market was approximately 40 to 50 per cent. This is made up of:

- 3.73mt of lupins, canola and barley which was not subject to the export wheat monopoly and partially deregulated under the GLA
- 1.0mt of domestic wheat consumption (deregulated in 1989)
- 1.0mt of wheat exported in containers (progressively deregulated under changes to the Wheat Marketing Acts)

It can be clearly seen from Table 4 that almost all of the accredited wheat exporters active in the WA market in 2008 have been existing customers of the CBH Group (and therefore growers also) since 2003, when they were able to export grain under the GLA.

Table 4 **Accredited wheat exporter customers of CBH Operations**

Accredited wheat exports that are existing customer of CBH Operations	First year being a CBH Operations customer
ABB Grain Ltd	2005
AWB Pools (Harvest Finance Limited)[a]	2008
Cargill Australia Limited	2005
Concordia Agritrading	2005
Elders Toepfer Grain	2007
Emerald Group	2005
Glencore Grain	2005
Grain Pool Pty Ltd	2005
GrainCorp Operations Limited	2005
JK International	2009
Lempriere Grain Pty Ltd	2006
Louis Dreyfus Australia Pty Ltd	2005
Noble Resources Australia Pty Ltd	2005

a; Note that AWB has had a long history with CBH stretching over 60 years

Data source: CBH Operations Ltd

Therefore it can be clearly seen that there has been trading in a wide range of grains and wheat prior to the partial deregulation of the export wheat market in 2008. Traders have been developing the capacity to manage price and credit risk well before 2008.

3.1.2 Second reading speech

The intentions of the Commonwealth Government when introducing the WEMA legislation could be summarised as:

- Maximising supply chain efficiency by ensuring clear market signals to all participants

- Maintaining some protection for growers that they believed they were afforded under the export wheat marketing monopoly.

In his second reading speech on the then Wheat Export Marketing Bill 2008, the Minister for Agriculture, Fisheries and Forestry, the Hon. Tony Burke, demonstrated these intentions by:

- Detailing the deficiencies of the export wheat monopoly policy and the amendments made to it in the lead up to the current system:

  The former government's policy reduced incentives for much needed investment in rail and port infrastructure.... And it prevented industry from working collaboratively to maximise supply chain efficiencies.

  We now have the absurd situation where it is the Minister for Agriculture, Fisheries and Forestry who decides who can and who cannot export wheat in bulk.

- And how the new marketing arrangements will provide a balance between transparency and efficiency and protecting growers interests:

  This bill delivers on a key election commitment to establish a system that will provide Australian wheat growers and the grains industry with a structure that will maximise incentives, minimise costs, increase supply chain efficiencies, reduce risk and protect growers.

  The bill contains an appropriate balance between the need to apply strict probity and performance tests to protect the interests of growers while not applying an excessive regulatory burden on accredited exporters. (House of Representatives, 2008, pp. 3857-3862)

3.1.3 Objectives of the Act

After the draft bill was exposed several important amendments were made. One was the introduction of several objects:

The objects of the WEMA are as follows:

a. to promote the development of a bulk wheat export marketing industry that is efficient, competitive and advances the needs of wheat growers;
b. to provide a regulatory framework in relation to participants in the bulk wheat export marketing industry.

The other significant amendment was the inclusion of a review and the nomination of who would conduct the review:

> By 1 January 2010, the Productivity Commission must begin to conduct a review of such matters relating to:
>
> (a) this Act; or
>
> (b) the wheat export accreditation scheme;
>
> as are set out in a written notice given to the Productivity Commission by the Minister.

In the terms of reference given to the Productivity Commission, the Government has directed the PC to review both the WEMA and the accreditation scheme. The inclusion of a review is prudent. Conducting the review with only two harvests having been commenced (the second harvest under the Act in 2009 -10 will only be partially complete and little of the wheat exported) suggests that the transitionary period would be short and that growers would make a rapid adjustment to a partially deregulated market.

3.1.4 The operations of Wheat Exports Australia

The licensing scheme is established under the WEMA as a scheme in sections 8 to 22. Perhaps the most striking feature of the accreditation scheme is the considerable discretion afforded the WEA in regard to the establishment and operation of the scheme.

The discretion of the WEA extends to whether a scheme should even be established: Clause 8 (1) states that WEA may, by legislative instrument, formulate a scheme (to be known as the wheat export accreditation scheme).

Once a scheme is established or continued there is considerable discretion given to the WEA as to the criteria used to assess fit and proper wheat exporters. Under Clause 13(1)(c)(i –xvi) the WEA is given some direction by having regard to the following:

- i the financial resources available to the company;
- ii the company's risk management arrangements;
- iii the company's business record;
- iv the company's record in situations requiring trust and candour;
- v the business record of each executive officer of the company;
- vi the experience and ability of each executive officer of the company;
- vii the record in situations requiring trust and candour of each executive officer of the company;
- viii whether the company, or an executive officer of the company, has been convicted of an offence against an Australian law or a foreign law, where the offence relates to dishonest conduct;
- ix whether the company, or an executive officer of the company, has been convicted of an offence against an Australian law or a foreign law, where the offence relates to the conduct of a business;
- x whether an order for a pecuniary penalty has been made against the company, or an executive officer of the company, under section 1317G of the *Corporations Act 2001* or section 76 of the *Trade Practices Act 1974*;

xi whether the company has contravened a condition of the company's accreditation under the wheat export accreditation scheme;

xii whether an executive officer of the company has been involved in a contravention of a condition of an accreditation under the wheat export accreditation scheme;

xiii whether the company, or an executive officer of the company, has been convicted of an offence against section 136.1, 137.1 or 137.2 of the *Criminal Code*;

xiv whether the company, or an executive officer of the company, has committed or been involved in repeated contraventions, or a serious contravention, of a designated sanitary or phytosanitary measure;

xv whether the company, or an executive officer of the company, has committed or been involved in a contravention of a United Nations sanctions provision;

xvi whether the company, or an executive officer of the company, has committed or been involved in a contravention of an Australian law or a foreign law, where the contravention relates to trade in barley, canola, lupins, oats or wheat…

In practice, WEA does have regard to all of the criteria listed in section 13 which creates a considerable compliance cost for accredited companies. To comply with its obligations under the WEMA the CBH Group had to meet the following requirements in 2008 and 2009:

- Preparation and submission of original application for accreditation which was accompanied by extensive and highly detailed documents in response to multiple information requests
- Undergo an external audit, in accordance with s 31(1) of the Act
- Meet three requests for information from the WEA, under 25(2) of the Act
- Preparation and submission of an Annual Export Report and Annual Compliance Report
- Preparation and submission of four notifiable matter reports
- Preparation and submission of four Executive Officer appointment reports
- Preparation and submission of a response to a draft Performance Monitoring Report
- Preparation and submission of an application for re-accreditation and submission of hundreds of pages of documents in support
- Preparation and submission of two draft access undertakings to the Australian Competition and Consumer Commission
- Daily update and maintenance of the Daily Ship Roster on the CBH website

- Upload of relevant information to the CBH website
- Regular monitoring of compliance by Risk and Assurance.

It is estimated that these obligations cost the CBH at least $1.2 million in the first year. CBH believe that the WEMA will impose an ongoing compliance cost burden of $200,000 per annum exclusive of an access undertaking. Negotiating on the terms of an access undertaking cost $1.0 million for a two year approval period.[9]

However, a more costly aspect of the accreditation scheme has been the uncertainty created for wheat exporters, particularly those such as CBH who also own port facilities. As discussed in more detail in subsection 6.4, CBH Group was subject to a great deal of uncertainty as to the continuation of its export license while the access undertaking was being negotiated and approved.

3.1.5 Distortions and efficiency of a continuation of the scheme

Section 13 of the WEMA provides WEA with some guidance as to what criteria should be included in the licensing scheme. Broadly this section can be divided into:

- Probity of the licensed exporters
- General compliance with Australian Corporations law
- Illegal conduct in international markets

The second and third dot points appear to be a duplication of existing credit worthiness checks by financiers and buyers (the benefits of which would spill over to growers), and general requirements under a range of Corporations Law administered by the Australian Securities and Investment Commission.

The first dot point appears to incur the majority of the WEMA compliance costs and possibly offers the least benefits for growers.

Section 13(c) states that the WEA is satisfied that the company is a fit and proper company, having regard to the following:

(i). The financial resources available to the company

(ii). The company's risk management arrangements

(iii). The company's business record[10]

All parties trading in the grain supply chain have strong incentives to actively and constantly scrutinize those with whom they are dealing. Commercial or

[9] CBH Group personal communications.

[10] It should be noted that there are a further 14 criteria specified in section 13(c) of the WEMA in addition to those listed.

counterparty risk assessment is made on a case by case basis for many producers. This assessment relies on an assessment of the risks of each transaction taking into account the terms of the contract and the reputation of the counterparty. For example, cash sales of small parcels of grain with short terms of trade (i.e. cash on delivery, cash 7 days after delivery etc) require a buyer to demonstrate different capital adequacy to the large transactions with extended payment terms, such as those for substantial quantities of pooled grain.

In many instances buyers and sellers will rely on the performance of the counter party in previous transactions. Over time each party establishes a commercial history.

Assessing the financial resources of the company requires a continual assessment of the:

- volumes the marketer will be trading
- types of products the trader will be offering
- counter party risks the trader will be exposed to themselves.

It is prohibitively expensive to undertake this level of risk assessment on behalf of growers by the licensing authority, a point which is implicit in the design of the licensing system. Therefore to attempt to overcome this, licenses are based on an overall assessment of the company's capacity to be able to offer the marketing services it intends to at the time of application. License applications also require the exporter to specify:

- The amount of wheat likely to be exported
- From whom the wheat will be purchased from (particularly the amount purchased directly from growers)
- The timing of purchases (harvest, rest of the year etc)
- The products used to accumulate the wheat (cash pools or other)
- The terms of the transaction (timing of payment)
  - The amount purchase on through spot or forward contracts
  - Whether agents will be used to accumulate the grain.

In addition to the requirements of section 4 of the application form specified in the above dot points section 3 requires applicants to describe their risk management policies and practices.

The specifications of the application place considerable restrictions on the flexibility of a company to adapt to market conditions and most importantly respond to the demands of growers should they change through the marketing year. For example, a company intending to offer pools may find that growers in a particular year have a preference for using cash based products.

Licensing increases the barriers to entry for an artificially defined segment of the market. This barrier to entry is likely to increase costs and decrease the flexibility of companies to trade grain and adapt to changing market circumstances. As the market matures this restriction is likely to become more costly as risk management and wheat marketing products and services become more sophisticated and growers capacity to utilize these produces increases.

Once a license is granted, annual reports are required from the licensee at the end of each marketing year. Under Part 3 of the WEMA, WEA has extensive powers to compel companies to provide information that are relevant to the functions and powers of the WEA.

It must also be kept in mind that these regulations are only applicable to exporters of bulk wheat and not to any other individual or organization acquiring wheat or another commodity from growers.

However, while it may lead to less efficiency in the market, it does little to reduce the costs of assessing credit risk by growers. The WEMA provides no recourse for compensation by growers if a licensed exporter fails to honor contractual obligations; hence growers are likely to undertake their own assessment.

3.1.6 Duplication of the existing regulations

There also appears to be considerable regulatory overlap with the licensing provisions of the WEMA and sections of corporate law as administered by the Australian Investment and Securities Commission.

In particular the *Financial Services Reform Act 2001* (Cth) requires grain marketing companies selling derivative based products (futures and options) to maintain a Financial Services License. Companies offering pooled grain products must also seek Managed Investment Scheme exemptions from the Australian Companies and Securities Investment Commission (ASIC).

There is also a risk that WEMA duplicates generic consumer protection laws. Whilst grain growers may not strictly be defined as consumers in the sense intended by the PC in their consumer protection law review, there are sufficient similarities between consumer of products and services and the way growers deal with grain merchants (particularly if participating in pools) to enable some of the findings of the consumer law review to be applicable to the WEMA review.

According to the Productivity Commission, industry specific consumer protection laws can be problematic as:

- a need to supplement the generic consumer law is not always clearly demonstrated – with industry-specific consumer regulation sometimes

introduced mainly because of a reluctance to enforce generic law and/or a lack of resources to do so, or to provide quick responses to problems raised by a vocal interest group

- some specific regulation is overly prescriptive, reducing the responsiveness of suppliers to changing needs to customers and increasing costs and therefore prices
- certain regulations appear to be primarily designed to protect existing businesses from competition, rather than to assist consumers. (Productivity Commission, 2008, p. 25)

The Productivity Commission has expressed the view that a reliance on specific licensing requirements rather than generic consumer law is most likely to confer net benefits where the potential consumer detriment from making a poor choice is significant and:

- the costs of obtaining product information are high; and/or
- verification of quality by the consumer or other third parties is difficult. (Productivity Commission, 2008, p. 93)

In the case of wheat marketing it is difficult to claim the costs of obtaining product information are high as there are considerable incentives for firms to demonstrate their credential to growers. For the majority of growers of wheat, they (or their peers) have a long history of dealing with many of the firms now participating in the export wheat market.

Furthermore, it could not be claimed that verification by growers (consumers) or third parties is difficult as there are a number of market commentators providing advice on a range of marketing services for a fee. Generally the costs of these services are modest. Where there is a failure of a marketing product or a marketer industry networks quickly transmit this information.

Key points

- The bulk wheat export licensing scheme could only be justified as a transitional arrangement to assure growers that their interest would be protected during a significant policy reform process
- The bulk export wheat licensing scheme artificially delineates a section of the market and does not reflect any unique transactions undertaken between bulk export wheat buyer and growers
- The cost of complying with licensing requirements appears high compared to the negligible benefits received by growers.

3.2 The continued need for licensing

The rationale for ongoing licensing of wheat exporters as a unique subset of grain or commodity traders more generally has never been convincingly made.

It appears that the intent has been to provide some assurance that growers' interests were protected as they emerged from in excess of 60 years of regulated wheat exporting.

Governmental market entry regulations are usually treated under the keyword "licensing" (Mause, 2008, p. 57). The need for licensing has traditionally been predicated upon the need to protect the public interest. This has usually been justified on the existence of information asymmetries:

> The benefits of licensing derive from the reality that in some situations consumers lack sufficient information about the services provided by an occupation to make a rational choice between service providers; that the consequences of a wrong choice are serious (death, injury, serious financial loss); and that in an unregulated market wrong choices are frequently made.(Cranston, 1980, p. 246)

In the event that informational asymmetries exist between buyers and sellers in a market, the 2001 Nobel Laureate for economics George Akerlof demonstrated that this would give rise to the problem of adverse selection (Akerlof, 1970). Akerlof used the example of the market for used cars where buyers could buy either good cars or defective cars that were described as "lemons". In the case of export wheat adverse selection would be to sell wheat to a merchant that would:

- Either default on payment due to unscrupulous behaviour or insolvency
- Diminish the reputation of Australian wheat in international markets.

In the presence of asymmetric information, Akerlof showed that the used car market would either contract into a market for "lemons" or collapse altogether. In order to address the problem of asymmetric information and adverse selection, Akerlof suggested that government intervention may be warranted in some instances:

> There are many markets in which buyers use some market statistic to judge the quality of prospective purchases. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual sellers. As a result there tends to be a reduction in the average quality of goods and also in the size of the market. It should also be perceived that in these markets social and private returns differ, and therefore, in some cases, government intervention may increase the welfare of all parties. (Akerlof, 1970, p. 488)

It is important for government to determine what is the necessary qualification standard that is consistent with protecting consumers (Deighton-Smith, Harris, & Pearson, 2001, p. 5). This will entail a trade-off between providing protection against the risk of an adverse outcome occurring and the promotion of access to the service (Deighton-Smith, Harris, & Pearson, 2001, p. 5). That is reducing the supply of the service by increasing the barrier to entry. Once a certain point is reached, requirements for tighter licensing will probably entail

diminishing marginal reductions in the level of risk of an adverse outcome occurring coupled with progressively higher consumer costs incurred (Deighton-Smith, Harris, & Pearson, 2001, pp. 5-6).

The guiding principle set out under the Competition Principles Agreements between the Commonwealth and State/Territory Governments as part of the National Competition Policy was that legislation should not restrict competition unless it could be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the cost; and
- the objectives of the legislation can only be achieved by restricting competition.

Given that there does not appear to be any clearly differentiating feature of export wheat buyers with other wheat buyers for domestic purposes and that licensing export wheat buyers only covers a proportion of wheat buyers, it is difficult to see how licensing could deliver benefits to the community (and farmers) other than as a short term transitional arrangement to encourage broader economic reforms in the wheat industry.

The establishment and continuation of the WEMA establishes an artificial delineation between merchants exporting or intending to export wheat to all other grain merchants operating in Australia. This delineation of exporters is not based on the services they provide to growers but on whether some or all of the wheat they purchase is exported in bulk. The destination of the wheat and in what form it is exported in bears almost no relationship with the potential or actual transaction that these companies have with growers who are the intended beneficiaries of the legislation.

Inherent in the debate leading up to the partial deregulation of the export wheat market was the hazard of a rogue grain trader damaging the reputation of Australian export wheat. In regard to ensuring that products exported are not unduly prejudicial to international trade, economic theory suggests that it is the responsibility of export-oriented firms to ensure that their products meet international standards and that their products and supply chains do not unduly affect others. Again, if they do they may suffer the consequences of a fall in export revenue and/or demands for compensation— which will be fully internalised by the export-oriented firm. In other words, there is no clear economic reason as to why licenses should be imposed on export bulk wheat merchants.

The Productivity Commission's recent research study into the regulation of the chemicals and plastics industry pointed out that regulation should, wherever possible, be light handed and commensurate with the risk:

> There is more likely to be a net benefit if regulation is tailored to the *risk* posed by a chemical in a particular circumstance (its use), rather than the blunter approach of intervening whenever there is a *hazard*. (Productivity Commission, 2008a, p. 14)

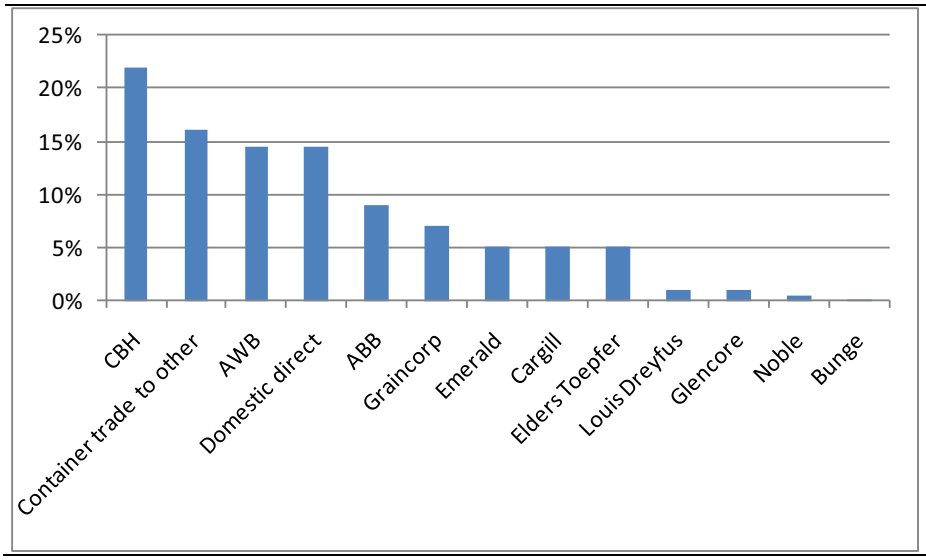
Clearly the selling of grain does not pose the same types of risks as the use of chemicals. However, the principle that regulation is more effective when dealing with risks rather than with hazards applies equally to the WEMA. Clearly there are commercial hazards in any transaction between growers and those that buy their produce. But the risks are small as growers and buyers have considerable capability and experience in dealing with the commercial hazards of dealing in agricultural commodities. This is particularly so as the WEMA deals with an artificial distinction between transactions dealing with export wheat in bulk and the other selling options for wheat and all other agricultural commodities.

If there are information asymmetries between growers and grain buyers then it is unlikely to be confined to buyers operating exclusively in the export market. Licensing exporters of bulk wheat could only ever provide some assurance to growers that their interests have been overseen by government during a period of policy reform.

3.2.1 WEMA as a transitional instrument

The political and popular justification for Commonwealth Government involvement in the wheat market was to guide the transition of the market from over 60 years of regulation to partial deregulation and beyond. The perception was that growers and the industry would need time to adjust. However, this adjustment process was not likely to be long and the experience of the 2009 harvest and preparation for the 2010 harvest indicates clearly that both the industry and growers are adapting well.

Chart 8 **Estimated wheat market share grower accumulated tonnes**



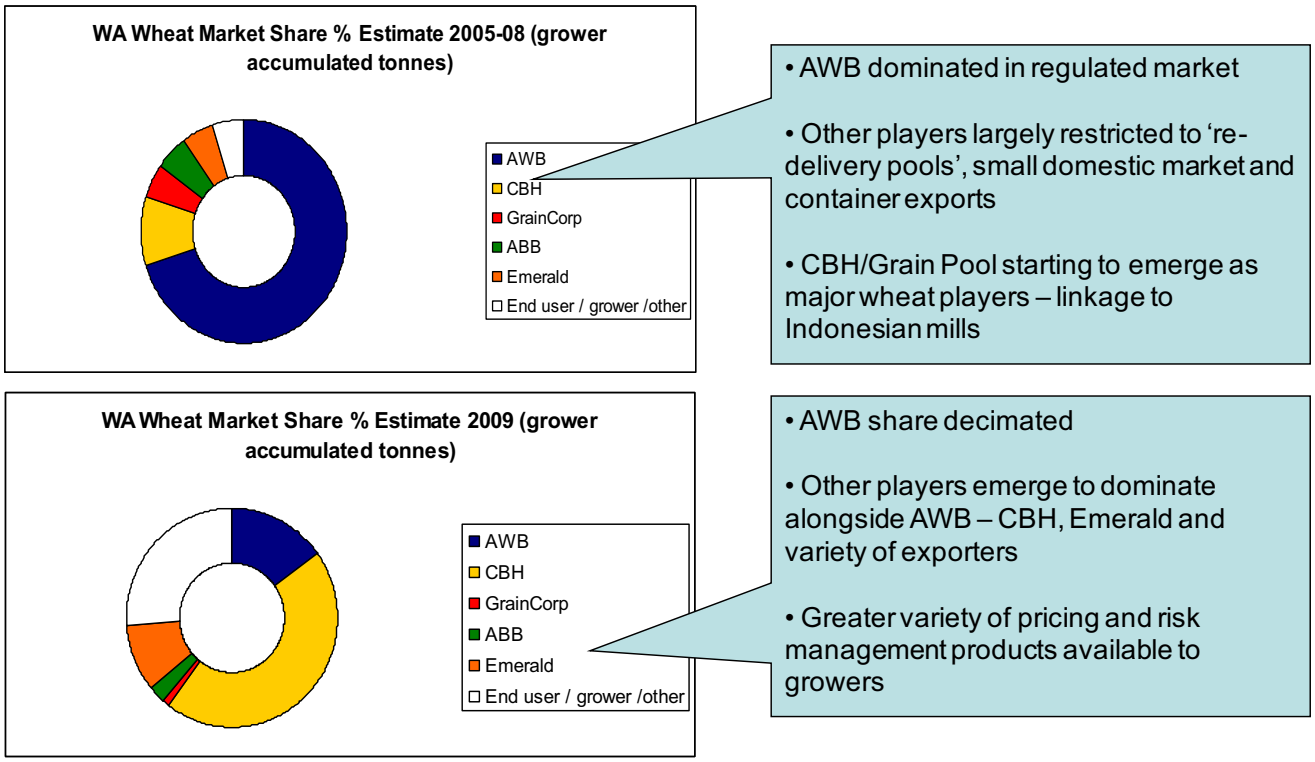
Data source: (Chaseling, 2009)

Clear evidence of this is the dramatic increase in growers opting to sell their wheat via other means than pools and the increase in market share of new entrants at the expense of AWB Pty Ltd (sole manager of the former export pool).

The switching of market share is even more dramatic in WA, as can be seen in Figure 5, where a number of new entrants gained considerable market share in the first year of export wheat trading. Many WA growers dealt with merchants that they had dealt with prior to deregulation as intermediaries in the wheat market (such as Emerald or CBH) or largely new entrants to the WA market such as GrainCorp.

Another observation made by Mike Chaseling in Figure 5 is the increase in new grain marketing products and services offered to growers in 2009.

Figure 5 **Estimated market share of grower accumulated market share in WA**



Data source: (Chaseling, 2009)

3.2.2 Risks associated with continuing the WEA

In addition to the flawed economic concepts underpinning the continuation of the WEMA there are risks associated with a continuation of the WEMA.

- Regulatory failure by exercising more onerous accreditation than is required by growers (that is a divergence between growers demands for prudential oversight of the bulk export wheat buyers and the oversight provided by the WEA)
  - There are incentives for WEA to continue to expand its activities, leading to higher costs and increasing barriers to entry
- Crowding out commercial providers of commercial and market information by providing market commentary and other information that the private sector can and does provide for a fee.

Key points

- Continuation of the bulk export wheat licensing scheme erects a barrier to entry for an artificial segment of the market when viewed from a grower marketing perspective

- The barrier to entry erected by the licensing scheme has the potential to distort the market and increase the cost and reduce the range of wheat marketing products and services offered to growers
- Growers have demonstrably adapted to the new marketing arrangement as they have utilised a range of new products and services and licensees have gained considerable market share.

4 Industry good functions what is required and who will provide the services?

Broadly, industry good functions are services that an industry requires to operate more efficiently, that are not delivered by private interests due to market failure or policy distortions. Markets may fail to invest in these services for a number of reasons, which are outlined in the following section.

Emeritus Professor Gordon MacAulay (2007) in *Market Failure and Public Goods in the Australian Grains Industry*, commissioned by Grain Growers Association (GGA), characterises industry good services by their excludability and rivalry.

The modern definition of a public good is a good that is non-rivalrous and non-excludable (MacAulay 2007). That is, the consumption of the good by one party does not reduce the amount of that good able to be consumed by others; and others cannot be excluded from using the good. Examples of public goods include national defence and law and order.

Under conditions of non-rivalrous and non-excludable consumption, private interests have low incentives to invest sufficiently in the provision of these goods, giving rise to a potential market failure.

It is difficult to identify many services in the Australian grains industry that are non-rivalrous and non-excludable. Perhaps the most often quoted industry good activities are:

- crop quality monitoring and reporting
- international promotion
- technical support
- classification, standards and quality assurance
- trade advocacy and agreements
- research and development.

The Independent Wheat Expert Group commissioned to review industry good services that would be required post deregulation concluded that there were a number of areas the market may fail to direct sufficient resources to and

recommended that existing organisations within the grains industry that, with some assistance from industry and the Government, could provide these services. In response to the Expert Group report, the Australian Government provided $9.37 million to fund a wheat projects during a three year industry transition package. Part of this funding is for the wheat industry information package (Department of Agriculture Fisheries and Forestry).

Therefore many of the purported industry good functions were dealt with prior to deregulation and are not dependant on the continuation of the WEMA. As they are undertaken by a range of voluntary organisations (GTA, Wheat Classification Council etc) the continuation of this functions will depend on the industry's assessment of their value.

Continuation of additional Government funding for any industry good functions, including the provision of information, should be subject to a thorough cost benefit analysis on a regular basis using the market failure principles described above.

Several additional points need to be considered when considering the provision of information to the market as an industry good:

- The establishment of the WAW ASX contracts will reflect a wide range of views held by buyers and sellers about the wheat market. The prices for a range of contract months will reflect buyers and sellers views of stocks held, grain quality, supply, export intentions and a host of other factors. New information obtained by any one market participant will, once they begin to use it, be reflected in the futures prices almost immediately. The WA contracts will also be closely monitored against the east coast and international futures and cash markets
- Some information could be considered a private good and should be subject to the same broad property rights safeguards as storage and handling infrastructure, and other tangible assets held by participants in the grain market. Forcing disclosure will be subject to similar efficiency tradeoffs highlighted in the following sections. In regard to information of stocks held by the bulk handling companies currently reported by ABARE, if alternative supply chains are developed, the continued publishing of this information could place the bulk handlers at a commercial disadvantage.

5 Competition policy and access regimes

This section provides essential background and contextual information on the structure and operation of competition policy and access regulation in Australia. This information will underpin the analysis of access arrangements under the WEMA conducted in section 6.

5.1 Objectives of competition policy

Competition policy is not pursued as an end in itself but as a means of promoting economic growth (or the growth of income) through the preservation and promotion of economic efficiency. In the Australian context, this view was reflected in the 1993 independent committee of inquiry into National Competition Policy (Hilmer report):

> Competition policy is not about the pursuit of competition per se. Rather, it seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives. (Hilmer, Rayner, & Taperell, 1993, p. xvi).

Economic efficiency is generally defined under the following categories:

- Allocative efficiency where resources used to produce a set of goods and services are allocated to their highest valued uses (ie those that provide the greatest benefit relative to costs)
- Technical or productive efficiency which is achieved where individual firms produce the goods and services that they offer consumers at least cost
- Dynamic efficiency reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities. (Hilmer, Rayner, & Taperell, 1993, p. 4)

Another category of economic efficiency that has been suggested is transactional efficiency where market participants design business practices, contracts, and organisational forms to minimise transaction costs and, in particular, to mitigate information costs and reduce their exposure to opportunistic behaviour or "hold-ups" (Kolasky & Dick, 2003, p. 249).

A critical component of competition policy is the application of competition law, also referred to as antitrust law in the United States.[11] It is generally accepted that the primary goal of competition law is to promote economic efficiency as outlined by the late William F. Baxter[12] in 1983:

> In recent years, a broad consensus has developed that the antitrust laws are a "consumer welfare prescription"-that is, they are intended to promote economic efficiency, broadly defined. (Baxter, 1983, p. 619)

More recently, the Global Forum on Competition[13] observed:

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[11] The term antitrust has its origins in combating the effects of trusts – combinations by which businesses prevented competition among themselves. (Barnes, 1999, p. 115)

[12] William F. Baxter served from 1981 to 1983 as Assistant Attorney General in charge of the Antitrust Division of the US Department of Justice.

[13] The Global Forum on Competition provides a policy dialogue between OECD member countries and non-OECD member countries on competition law and policy matters.

> The promotion of efficiency is generally regarded as the most fundamental goal of competition law and policy. In this context, "efficiency" includes not only the efficient use of firms' resources – what economists call "productive efficiency" – but also efficiency in using society's overall resources – "allocative efficiency" – and in developing new processes and products that create new resources – "dynamic efficiency." (Winslow, 2004, pp. 41-42)

In commenting on the development of antitrust laws in the United States, the major influence behind the design of Australia's competition laws, prominent US antitrust jurist Richard Posner has commented that:

> … although non-economic objectives are frequently mentioned in the legislative histories, it seems that the dominant legislative intent has been to promote some approximation to the economist's idea of competition, viewed as a means toward the end of maximising efficiency. (Posner R. A., 1976, p. 20)

Australia's primary competition law statute is the Trade Practices Act 1974 (TPA). Former Commonwealth Assistant Treasurer George Gear described the underlying rationale for the TPA in the following terms:

> While the Act does not have an explicit objective, it is generally agreed that the primary goal of its antitrust provisions is to promote market competition, and thus to increase economic efficiency. (Gear, 1994, p. 476)

Populism is a political term that stands for a set of poorly defined goals and masks considerable conflict among various interest groups, all of which claim to be populist (Areeda & Hovenkamp, 2006a, p. 98). Populism could also be used to describe the push by some groups to amend competition law in pursuit of non-economic goals.

While the pursuit of populism may not necessarily conflict with economic efficiency, significant costs will be imposed upon society if populist policies are pursued to the detriment of economic efficiency. Prominent US antitrust jurists, the late Phillip Areeda and Professor Herbert Hovenkamp of the University of Iowa have warned about the dangers of enacting populist competition law at the expense of economic efficiency:

> … populist goals should be given little or no independent weight in formulating antitrust rules and presumptions. As far as antitrust is concerned, they are substantially served by a procompetitive policy framed in economic terms. Where they conflict with economic efficiency, antitrust courts either cannot materially promote them or can do so only at unacceptable costs. Any even where there is no evident conflict, injection of populist goals, by broadening the proscriptions of business conduct, would multiply legal uncertainties and threaten inefficiencies not easily recognised or proved. (Areeda & Hovenkamp, 2006a, p. 99)

A recent example of the resort to populism in Australian competition law was the enactment of section 46(1AA) of the TPA by the Howard Government, the so-called 'Birdsville amendment' to deal with predatory pricing. According

to Professor Stephen Corones of Queensland University, section 46(1AA) is bad law for three reasons:

1. It increases compliance costs
2. It reduces the likelihood that consumers will benefit through lower prices. Its policy objective is to protect competitors rather than competition
3. It increases the risk for regulatory error. (Corones, 2009, p. 122)

Commonwealth Government Minister Craig Emerson, now the Minister for Competition Policy and Consumer Affairs, described the Birdsville amendment last year in the following terms:

> … poorly designed competition laws such as the Birdsville amendment are the enemy of competition. The Birdsville amendment was written at the urging of a group of businesses that wanted protection from competition. (Emerson, 2008)

Another slide towards populism would be amending the TPA to deal with creeping acquisition in the absence of a clear economic rationale. In recommending against the inclusion of a provision in the TPA to deal with creeping acquisitions, the independent review of the competition provisions of the Trade Practices Act chaired by Sir Daryl Dawson (Dawson report) concluded that:

> … while a genuine competitive environment exists, the preservation of the number of competitors in a market is more a matter for industry policy than for competition policy. A concentrated market may be highly competitive. Whilst there may be a desire to preserve the number of competitors in a competitive market, it will ordinarily be for policy reasons other than the promotion of competition. Part IV of the Act is concerned with the promotion of competition rather than industry policy. (Dawson, Segal, & Rendall, 2003, pp. 67-68)

The struggle for Australian competition policy is to try to maintain laws that preserve and promote economic efficiency whilst avoiding the resort to populism.

Key points

- The primary goal of competition policy is to preserve and promote economic efficiency
- The pursuit of non-economic goals is a resort to populism which could serve to undermine economic efficiency.

5.2 Competition and access

5.2.1 Access to essential facilities

Competition can be stifled in situations where a vertically integrated firm excludes its non-integrated rivals from a vital input, thereby resulting in market

foreclosure. The fundamental effect of any successful foreclosure is a restriction of output in both the upstream and the downstream markets, with a corresponding increase in price coming at the expense of customers in the downstream product market (Mullin & Mullin, 1997, p. 77). Market foreclosure due to the inability of a non-integrated rival to access a vital input may result in a loss of allocative efficiency.

The 1993 Hilmer report recommended the establishment of a legal regime to provide third party access to essential facilities under prescribed circumstances (Hilmer, Rayner, & Taperell, 1993, p. 266). The Hilmer report defined essential facilities according to two criteria:

- Facilities that exhibit natural monopoly characteristics in the sense that they cannot be duplicated economically.[14] Examples given of natural monopolies were electricity transmission grids, telecommunications networks, rail tracks, major pipelines, ports and airports.
- Facilities must occupy a strategic positions in an industry in the sense that access to the facility is required if a business is to be able to effectively in upstream or downstream markets. (Hilmer, Rayner, & Taperell, 1993, p. 240)

The Hilmer report saw the problem of denying third party access to essential facilities in the following terms:

> Where the owner of the 'essential facility' is vertically-integrated with potentially competitive activities in upstream or downstream markets … the potential to charge monopoly prices may be combined with an incentive to inhibit competitors' access to the facility. For example, a business that owned an electricity transmission grid and was also participating in the electricity generation market could restrict access to the grid to prevent or limit competition in the generation market. Even the prospect of such behaviour may be sufficient to deter entry to, or limit rigorous competition in, markets that are dependent on access to an essential facility. (Hilmer, Rayner, & Taperell, 1993, p. 241)

The inspiration for a third party access regime for essential facilities came from the antitrust jurisprudence of the United States.

5.2.2 Essential facilities doctrine

The essential facilities doctrine primarily concerns vertical integration. The essential facilities doctrine imposes an obligation on a vertically integrated

[14] Natural monopoly is the situation where the entire demand within the relevant market can be satisfied at lowest cost by one firm (Posner R. A., 1969, p. 548). It usually reflects the existence of unexhausted economies of scale, but can persist beyond the point at which economies of scale have been exhausted and average costs begin to rise.

monopolist to share an essential input with a competitor. To establish that an input is in fact essential, two different criteria must be met:

1. The claimed input must be essential for the competitor's survival in the market
2. The claimed input must not be available from another source or capable of being duplicated by the competitor. (Areeda & Hovenkamp, 2002, p. 198)

Three decisions by the US Supreme Court have been taken to imply the existence of the essential facilities doctrine (Waller, 2008, p. 361). However, it should be noted that the US Supreme Court commented in 2004 that it had never actually recognised the existence of such a doctrine.[15]

The origins of the essential facilities doctrine can traced back to the US Supreme Court's decision in the *Terminal Railroad* case.[16] In this case, the Terminal Company which owned and controlled all railway bridges and switching yards into and out of St. Louis was owned by an association of railway companies that prevented competing railway companies from offering transportation to and through St Louis. The Terminal Company's monopoly was natural not only in the sense that it could satisfy the entire demand within the market at lowest cost but also in that the topographical features of the terrain made construction of an alternative impossible or prohibitively expensive (Areeda & Hovenkamp, 2002, p. 177). Rather than order the dissolution of the association, the Supreme Court required association members to admit their railroad competitors to the association (Areeda & Hovenkamp, 2002, p. 177).

Some 1,200 newspapers created the Associated Press both as a vehicle for transmitting and exchanging among themselves news reports generated by its members and certain foreign publications and as a new enterprise that would generate news reports through its own employees in important world news centres (Areeda & Hovenkamp, 2002, p. 178). Because of the economies of scale it achieved and the skill with which it performed, the Associated Press became very successful (Areeda & Hovenkamp, 2002, p. 178). While the Associated Press welcomed new members in order to provide additional news input and to share costs, existing members were allowed to obstruct the admission of rival newspapers (Areeda & Hovenkamp, 2002, p. 178). While it was the largest news gathering organisation of its type, Associated Press was not a monopoly and faced competition from other news gathering organisations (Areeda & Hovenkamp, 2002, p. 178). In the matter of *Associated Press* before the Supreme Court, the Court required that Associated Press offer

[15] *Verizon Commications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004)

[16] *United States v. Terminal Railroad Association of St Louis*, 224 U.S. 383 (1912)

non-discriminatory membership to rival news organisations that competed with its existing members.[17]

The final matter generally cited for the implied existence of the essential facilities doctrine is the case of *Otter Tail*, which involved a partially regulated electricity transmission company.[18] In this matter the Supreme Court affirmed the grant of an injunction against a regulated electricity company that refused to transmit electricity generated by competing companies through its transmission network to municipal distribution systems that wanted to purchase cheaper electricity from the defendant's electricity-generating competitors.

The matter of *MCI Communications Corp v. AT&T Co.*[19] concerned AT&T's refusal to allow MCI to connect its long distance telephone calls with AT&T's local telephony network, thus preventing MCI from being able to offer long distance telephone calls. The US Court of Appeals for the Seventh Circuit found that AT&T's refusal to provide interconnection, which was technically and economically feasible, constituted an act of monopolisation in breach of US antitrust laws. Most significantly, the Seventh Circuit set out a four-part test for the application of the essential facilities doctrine:

1. The monopolist controls access to the essential facility
2. The facility cannot be reasonably duplicated by a competitor
3. The monopolist denies access to a competitor
4. It was feasible for the monopolist to grant access to the competitor.

Other US courts have added a fifth factor to the test applied by the Seventh Circuit which was that the monopolist lacks a valid business justification for its refusal to deal (Waller, 2008, p. 363).

While the essential facilities doctrine has been widely adopted by lower courts in the United States, the actual winning of cases based on the doctrine is rare. According to Professor Spencer Weber Waller of Loyola University:

> The courts rarely imposed liability for either damages or injunctive relief, and when they did so, they rarely used the essential facilities doctrine by name, more often imposing liability under other theories. (Waller, 2008, p. 363)

Key point

- The essential facilities doctrine has been applied only sparingly by US courts and has not created a general obligation to share one's resources.

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[17] *Associated Press v. United States*, 326 U.S. 1 (1945)

[18] *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973)

[19] 708 F.2d. 1081.1132-33 (7th Cir. 1983)

5.2.3 Hilmer report

While the Hilmer report recommended the establishment of third party access regime for essential facilities, it did not recommend the creation of a general duty to share one's resources. As is the case in US jurisprudence, the Hilmer report envisaged an access regime that would be used only sparingly:

> The Committee proposes the establishment of a new access regime potentially applicable to any sector of the economy. In practice, however, such a regime should be applied sparingly, focusing on key sectors of strategic significance to the nation. (Hilmer, Rayner, & Taperell, 1993, p. 260)

The Hilmer report recommended the establishment of a legislated right of access through Ministerial declaration, with the requirement that Ministerial discretion be limited by an explicit legislative criteria and that the requirement be recommended by an independent and expert body (Hilmer, Rayner, & Taperell, 1993, p. 250).

The Hilmer report sort to ensure that access would only be granted in situations where it was absolutely essential, rather than merely convenient (Hilmer, Rayner, & Taperell, 1993, p. 251). For this reason, it recommended that access to a facility could only be declared where:

> Access to the facility in question is essential to permit effective competition in a downstream or upstream market. (Hilmer, Rayner, & Taperell, 1993, p. 251)

The Hilmer report also sought to limit the declaration of a facility to the situation where it was in the public interest, having regards to:

- The significance of the industry to the national economy.
- The expected impact of effective competition in that industry on national competitiveness. (Hilmer, Rayner, & Taperell, 1993, p. 251)

The Hilmer report was extremely careful to limit the scope of the recommended access regime to ensure that it did not have a deleterious effect upon investment:

> The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to the owners of such facilities has the potential to undermine incentives for investment. (Hilmer, Rayner, & Taperell, 1993, p. 248)
>
> … when considering the declaration of an access right to facilities, any assessments of the public interest would need to place special emphasis on the need to ensure access rights did not undermine the viability of long-term investment decisions, and hence risk deterring future investment in important infrastructure projects. (Hilmer, Rayner, & Taperell, 1993, p. 251)

Key point

- The Hilmer report recommended the establishment of an access regime with very clear safeguards to protect the interests of facility owners.

5.2.4 Part IIIA of the Trade Practices Act

In response to the Hilmer report recommendations on the establishment of an of third party access regime for essential facilities, the Commonwealth Government enacted Part IIIA of the TPA. In the Competition Principles Agreement between the Commonwealth Government and State and Territory governments which was one of the intergovernmental agreements for the implementation of National Competition Policy, clause 6 stated:

> … the Commonwealth will put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities where:
>
> (a) it would not be economically feasible to duplicate the facility;
>
> (b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;
>
> (c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and
>
> (d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

Applications for the declaration of access to an essential facility infrastructure service are provided for by Division 2 of Part IIIA. Applications for the declaration of access to an essential facility infrastructure service are assessed by an independent organisation, the National Competition Council.

The National Competition Council makes recommendations on declarations to the relevant government minister. Once the relevant government minister has made a decision of whether to declare access to an essential facility infrastructure service, decisions are then subject to merits review by the Australian Competition Tribunal.

In the Commonwealth Government's access regime, there was one subtle difference with the Hilmer report in that Part IIIA puts the emphasis on access to the services provided by the facility rather than on access to the facility per se. The purpose of this was to draw a distinction between the fact that a facility may provide a range of services, but only one of these services may be essential to provide competition in an upstream or downstream market. Section 44B of the TPA provides for a definition of a service.

The criteria that must be satisfied before the National Competition Council can recommend the declaration of access to a service is set out under section 44G(2) of the TPA:

> (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
>
> (b) that it would be uneconomical for anyone to develop another facility to provide the service;
>
> (c) that the facility is of national significance, having regard to:
>
> (i) the size of the facility; or
>
> (ii) the importance of the facility to constitutional trade or commerce; or
>
> (iii) the importance of the facility to the national economy;
>
> (d) that access to the service can be provided without undue risk to human health or safety;
>
> (e) that access to the service is not already the subject of an effective access regime;
>
> (f) that access (or increased access) to the service would not be contrary to the public interest.

Division 6 of Part IIIA also facilitates another avenue for third parties to obtain access to essential facilities. Under section 44ZZA of the TPA, a person who is, or expects to be, the provider of a service may give a written undertaking to the Australian Competition and Consumer Commission (ACCC) in connection with the provision of access to the service. If the ACCC accepts an access undertaking for a service, then the access service cannot be declared. Under section 44ZZAA, an industry is able to provide the ACCC with a written code setting out the rules for access to a service.

Division 2A of Part IIIA enables a state or territory that wishes to implement an access regime for services to apply to the National Competition Council for certification of the regime. The National Competition Council will then make a recommendation to the relevant Commonwealth Government Minister on whether the state or territory access regime should be certified as effective. Certification of the access regime as effective will exempt those services from declaration or from the provision of an access undertaking to the ACCC.

Following the recommendation of the Productivity Commission's inquiry report on the review of the national access regime (Productivity Commission, 2001), an objectives clause was added to Part IIIA through the enactment of section 44AA of the TPA:

> The objects of this Part are to:

(a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and

(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Key points

- Access to essential facilities is provided for through Part IIIA of the TPA
  - The objectives of Part IIIA are to promote economic efficiency and a consistent approach to access regulation
- Parties seeking access to essential facility services must apply for a declaration of access under Division 2 of Part IIIA
  - The facility service must satisfy the criteria set out under section 44G(2) of the TPA in order to be declared
- A service provider can provide an access undertaking to the ACCC for the provision of access to the service. If accepted by the ACCC, the access undertaking will prevent declaration of the access service.

5.3 Access regulation and the risk of regulatory failure

Regulatory failure can be assessed based on applying the criteria of effectiveness and efficiency. Regulation can fail because it doesn't achieve its objectives. Regulation can also fail because the costs outweigh the benefits. Sandrine Labory from the University of Bergano and Marco Malgarini from the Centro Studi Confindustria in Rome have classified regulatory failure according to the typology set out in Table 5 below (Labory & Malgarini, 2000, p. 97).

Table 5 **Regulatory success/failure**

Market failure: Intervention leads to:	Corrected (regulation is effective)	Not corrected (regulation is not effective)
Net benefits (efficient regulation)	Regulatory success	Regulatory failure (Type II)
Net costs (inefficient regulation)	Regulatory failure (Type I)	Regulatory failure (Type III)

Source: (Labory & Malgarini, 2000, p. 97)

Type I regulatory failure occurs when regulation is effective in achieving its goals but is inefficient in that it imposes costs that outweigh the benefits (Labory & Malgarini, 2000, p. 97). Type II regulatory failure occurs when the regulation produces net benefits, but does not correct or only imperfectly corrects for market failure (Labory & Malgarini, 2000, p. 98). Type III

regulatory failure occurs when the regulation is both ineffective and inefficient (Labory & Malgarini, 2000, p. 98).

Professor Harold Demsetz of the University of California at Los Angeles has described some of the characteristics of private property in the following terms:

> Crucially involved is the notion that individuals have control over the use to which scarce resources (including ideas) can be put, and that this right of control is saleable or transferable. A private property right system requires the prior consent of "owners" before their property can be affected by others. (Demsetz, 1966, p. 62)

Imposing obligations upon facility owners to provide access to the facility or facility service is a significant imposition on their property rights. Indeed, the imposition of access regulation constitutes a regulatory taking[20].

Concerns regarding the imposition upon property rights from the application of Part IIIA of the TPA have been expressed by Professor Maureen Brunt of Monash University, one of Australia's foremost experts on competition law:

> The legislators and their advisors have been unwilling to make the achievement of declaration easy, being worried by the potential interference with property rights and the impact upon business incentives.
>
> To my mind the legislators are right to be worried. Economic efficiency (not to mention fairness) requires a clear specification of property rights (coupled with the promotion of competition). Business firms must have incentives for investment and innovation. (Brunt, 2000, p. 3)

The National Competition Council has also recognised that access regulation could impose potential costs on infrastructure owners with other adverse implications for infrastructure investment.

> Potential costs of declaration include administrative and compliance costs for businesses. They also include the costs of "regulatory failure" caused by the interference in property rights. If applied inappropriately, Part IIIA could undermine price signals, innovative activity or the incentives for investment.
>
> It is important to avoid applying Part IIIA in ways which may yield short-term static gains in technical and allocative efficiency but which constrain the realisation of longer-term dynamic efficiency gains. (National Competition Council, 2001, p. 85)

The Productivity Commission has previously observed that the intrusion on property rights from access regulation can give rise to a range of costs which includes:

- administrative costs for government and compliance costs for business

[20] A regulatory taking is a valid government action that reduces the value of a private owner's property (Ulen, 1998, p. 570).

- constraints on the scope for access providers to deliver and price their services efficiently
- reduced incentives to invest in facilities to provide new essential services or to maintain existing facilities
- inefficient investment in downstream markets
- wasteful strategic behaviour by both service providers and access seekers. (Productivity Commission, 2001, pp. xviii-xix)

In 2001 the Productivity Commission opined that concerns regarding the *potential* for access regulation to deter investment were well founded (Productivity Commission, 2001, p. 67). According to the Productivity Commission:

> … the mere existence of access regulation may well have some deleterious impacts on investment in essential infrastructure. (Productivity Commission, 2001, p. 70)

The Productivity Commission believed that access regulation may deter investment for two reasons:

- Potential exposure to access regulation is likely to increase the general level of risk attaching to investment in essential facilities
- Investments in essential infrastructure will also be deterred if regulated terms and conditions are not expected to provide a sufficient return. (Productivity Commission, 2001, p. xix)

Due to the danger of deterring infrastructure investment through access regulation, the Productivity Commission came to the conclusion that access regulation should only be used in cases where significant market power could be exercised:

> … given the potentially large costs of inappropriate or poorly-applied intervention to facilitate access, the use of access regulation should be confined to situations where significant monopoly power is likely to be present. (Productivity Commission, 2001, p. 94)

Drawing on the work of Areeda and Hovenkamp in relation to the essential facilities doctrine (Areeda & Hovenkamp, 2002, pp. 172-173), access regulation and the right to share an essential facility may discourage firms from developing their own alternative inputs. The loss of competitor incentive to invest in their own inputs could be extremely serious in the event that rivals could enter the market by some alternative means not requiring access to the essential facility (Areeda & Hovenkamp, 2002, p. 173). In this case, the access regulation could serve to reduce the incentive for the development of realistically available competitive alternatives (Areeda & Hovenkamp, 2002, p. 173).

Key points

- Regulatory failure can be assessed based on the criteria of effectiveness and efficiency
- Access regulation is a significant imposition on the property rights of facility owners
- Inappropriate access regulation can result in regulatory failure.

6 Access Regulation and the Wheat Export Marketing Act 2008

This section will assess the following issues:

- The consistency of the WEMA access test with other access arrangements
- The WEMA access test and economic efficiency
- The WEMA access test undertaking process
- Extending the WEMA access test upstream or up-country
- The necessity for the WEMA access test.

6.1 Wheat Export Marketing Act 2008 and the access test

Under section 13(1)(e) of the WEMA, in order to be eligible as a wheat exporter, a party that is the operator of one or more port terminal services must pass the access test.

Section 24 of the WEMA outlines the access test which imposes a number of obligations upon potential wheat exporters who are the operator of one or more port terminal service. For the period until 1 October 2009, exporters would pass the access test by agreeing to provide access to accredited exporters and publish the terms and conditions for access to other exporters on their internet site before they can be accredited. For the period after 1 October 2009, exporters must have in effect an access undertaking under Division 6 of Part IIIA of the TPA, or there must be a certified effective access regime in place under Division 2A of Part IIIA of the TPA which provides accredited wheat exporters with access to the port terminal services.

The access test was implemented to address concerns that bulk grain handlers could, by virtue of their vertical integration, abuse their position to foreclose on wheat export markets. The Senate Standing Committee on Rural and Regional Affairs and Transport conducted an inquiry into the proposed draft legislation. According to the report of the Senate Standing Committee on Rural and Regional Affairs and Transport:

> A number of witnesses before the committee expressed concern about the role and potential market power of bulk handling companies under the proposed changes. It was argued that bulk handling and storage facilities throughout Australia are owned and controlled by a limited number of companies. Concerns were raised that, in the event that some or all of these companies became accredited exporters under the proposed legislation they may be in a position to limit access to these facilities by other exporters. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 37)

Aside from the access test for port terminal services in the proposed draft legislation, the Senate inquiry heard from parties that sought to have the access test extended further upstream:

> The committee also received evidence that the access arrangements in the bill are essential and should be expanded to include access to the point of receival at upcountry storage and handling facilities. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 44)

The Senate inquiry came to the view that the access test for port terminal services should be further extended upstream:

> The committee notes that regulation of access to infrastructure at the point of delivery is at least as significant to growers and potential exporters as access to port infrastructure. The committee considers that all bulk handling and storage facilities owned by an accredited exporter should be subject to the same access requirements…
>
> The committee favours the application of a consistent set of access arrangements and considers that further consideration must be given to the specific issues raised during this inquiry regarding access to 'up-country' facilities. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 56)

Liberal Party Senators further opined:

> It is essential that non-discriminatory access to bulk storage and handling facilities is provided to all market participants. Non-discriminatory access needs to apply to: 'up country' storage facilities; port storage facilities; shipping stem; and, information…
>
> … we consider that these issues must be dealt with by access undertakings through the ACCC under the powers provided for in Part IIIA of the Trade Practices Act 1974. The interests of wheat growers must be protected and we consider the access provisions to be the mechanism to achieve this outcome. The success or otherwise of the legislation will largely pivot upon the access provisions. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, pp. 62-63)

Similarly, the National Party Senators also sought the operation of an access regime from the passage of the bill at all points at and between receipt and port (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 74).

In his second reading speech on the then Wheat Export Marketing Bill 2008, the Minister for Agriculture, Fisheries and Forestry, the Hon. Tony Burke, justified the access test on the following basis:

> One of the concerns identified during consultation was the risk of a single wheat export monopoly being replaced by three regional monopolies…
>
> … we have decided to impose specific requirements on accredited exporters that operate bulk grain terminals at ports, as these are the facilities with natural monopoly characteristics and are the infrastructure bottleneck in the export supply chain.
>
> Unless all exporters can obtain access to these critical facilities on fair and reasonable terms then one of the major objectives of the policy could be frustrated.
>
> Compliance with these requirements will be a condition of accreditation. If Wheat Exports Australia is satisfied that an exporter has breached these conditions it will have the power to suspend or revoke its accreditation…
>
> After 1 October 2009, they must have an approved access undertaking with the Australian Competition and Consumer Commission. (House of Representatives, 2008, p. 3860)

In response to the Senate inquiry's suggestion that the access test should be further extended upstream, the Minister for Agriculture, Fisheries and Forestry commented:

> The Senate inquiry also identified concern in relation to the potential for bulk-handling companies to restrict access to up-country storage facilities in a similar manner to concerns in relation to port facilities.
>
> It is unclear from the evidence presented to the Senate inquiry whether the problem would necessarily arise, and if so, the extent of legislation that would be required to correct it.
>
> If the highest level of regulation were to be imposed on the more than 500 up-country [197 of which are in WA] facilities, there is no doubt that this would create increased compliance costs which would almost certainly be directly passed back to growers.
>
> The government will, therefore, continue to monitor the ability of exporters to access up-country storage facilities.
>
> Let me say here, if any problems are identified then the government will take steps to remedy the situation including, if necessary, the development of a code of conduct. (House of Representatives, 2008, p. 3860)

Key points

- Wheat exporters who provide port terminal services must pass the WEMA access test
- For the period after 1 October 2009, wheat exporters who provide port terminal services must have in effect an access undertaking under Division 6 of Part IIIA of the TPA (assuming there is no access regime certified as effective).

6.2 Consistency of the WEMA with Australian access regulation

As discussed in subsection 5.3, the imposition of access regulation through Part IIIA of the TPA is a significant imposition on the property rights of facility owners. This point has previously been recognised by the Productivity Commission, the National Competition Council and Professor Maureen Brunt amongst others. Unfortunately, the imposition on the property rights of facility owners from the WEMA access test was not given much consideration by the Senate Standing Committee on Rural and Regional Affairs and Transport in its final report (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008).

In effect, the WEMA compels the operator of one or more port terminal services to seek an access undertaking from the ACCC if they wish to be accredited as a wheat exporter.[21] Essentially, a wheat exporter, who is also the operator of one or more port terminal services, is required to provide the ACCC with a written undertaking under section 44ZZA of the TPA.[22]

Under section 44ZZA of the TPA, a party may provide the ACCC with a written undertaking in connection with the provision of access to the service. The Productivity Commission has described the aim of section 44ZZA in the following terms:

> The aim of the undertaking arrangements is to provide owners/operators of infrastructure facilities … with an opportunity to remove any uncertainty as to the access conditions which will apply to the services in question. (Productivity Commission, 2001, p. 24)

The Productivity Commission has previously recognised the voluntary nature of undertakings and that any attempt to impose an undertaking on parties would, in effect, constitute a determination (Productivity Commission, 2001, p. 262).

Under the formal access declaration regime under Division 2 of Part IIIA of the TPA there are several safeguards built in to protect the interests of facility owners. In making recommendations to the relevant government minister on an access declaration, the National Competition Council must be satisfied in relation to all matters outlined in section 44G(2) of the TPA. The decisions

[21] This assumes that there is no access regime certified as effective through Division 2A under Part IIIA of the TPA which is the existing situation in relation to all current port terminal services for wheat.

[22] This assumes that no written code has been provided to the ACCC under section 44ZZAA of the TPA setting out the rules for access to a service which is the existing situation in relation to all port terminal services for wheat.

made by government ministers on access declarations are also subject to merits review by the Australian Competition Tribunal.

Because of the perceived voluntary nature of access undertakings under section 44ZZA of the TPA, the safeguards afforded to facility owners under Division 2 of Part IIIA of the TPA do not apply in the case of access undertakings. It is arguably the case that it was never envisaged that pressure would be applied to parties in the manner prescribed by section 24 of the WEMA as to compel them to procure an access undertaking. In effect, section 24 of the WEMA operates as a *de facto* access declaration regime for the port terminal services of parties that also seek to export wheat but lacking in the protections afforded by Division 2 of Part IIIA of the TPA.

While there are checks under the formal access declaration regime under Part IIIA of the TPA, there are no equivalent set of checks under the WEMA access test. On this basis the WEMA access test raises compliance issues with one of the objectives of Part IIIA of the TPA in section 44AA(b) "to provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry". It would appear that WEMA access test is inconsistent with other access regimes.

Key points

- The WEMA access test operates as a *de facto* access declaration regime for the port terminal services of parties that also seek to export wheat
- There are not appropriate checks under the WEMA access test to protect the interests of facility owners
- It appears the WEMA access test is inconsistent with other access regimes which in turn raises compliance issues with section 44AA(b) of the TPA.

6.3 The WEMA access test and economic efficiency

The major policy failing of the WEMA access test is that it allows for absolutely no consideration of the essentiality of access. In this case, the WEMA access test risks facilitating access to facility services in situations where it is not absolutely essential, but merely convenient. This in turn has significant implications for investment in infrastructure and the long term upkeep and maintenance of infrastructure facilities.

In relation to CBH, there is anecdotal evidence to suggest that its wheat port terminal services in Western Australia would not necessarily meet a test of essentiality nor the criteria for an access declaration under section 44G(2) of the TPA. The anecdotal evidence comes from two sources independent of CBH who are aware of proposals to develop alternative wheat port terminal

facilities in Western Australia. According to the Pastoralists and Graziers Association of Western Australia (PGA of WA) in its submission to the inquiry by the Senate Standing Committee on Rural and Regional Affairs and Transport:

> … alternative port facilities (or even the threat of their presence) will apply a strong market discipline to CBH. Whilst alternative port infrastructure cannot be built overnight, there are projects on the drawing board in WA that could offer commercial alternatives to CBH. (PGA of WA, 2008, p. 8)

According to the Western Australian Department of Agriculture and Food (DAFWA) in a submission made to the ACCC:

> There are currently discussions of new entrants in WA establishing a port terminal to compete with CBH. From a DAWFA perspective this is not a desirable outcome. There is already sufficient ship-loading capacity in WA to handle even a bumper crop. In our view it is far more desirable for the current assets to be utilised efficiently and equitably rather than investing in duplication of resources. (Department of Agriculture and Food WA, 2009, p. 2)

There have also been several newspaper stories suggesting that work is progressing on the development of alternative wheat port terminal facilities in Western Australia. According to an article in *The Countryman* newspaper on 5 March 2009:

> The Pastoralists and Graziers' Association is pushing for a competitor to WA-based storer and handler CBH, to set up port loading and storage and handling facilities for grain at James Point, near Kwinana.
>
> PGA grains chairman Leon Bradley said he convened a meeting last week between interested grain traders and James Point Consortium chairman, Chris Whitaker to discuss bulk grain shipping requirements and how they might fit in with the development of the new port. (Anon, 2009)

According to an article in *The Countryman* newspaper on 12 March 2009:

> In a move set to shake up WA's grain supply chain, a group of growers has set the wheels in motion to break the monopoly WA's co-operative storer and handler has in loading bulk grain at port.
>
> Newdegate farmer and spokesman for the WA Grain Group Doug Clarke said his group met an undisclosed third party on Monday, in a bid to have an alternative arrangement for exporting wheat in bulk from Albany. (Ladyman, 2009)

According to an article in *The Countryman* newspaper on 19 March 2009:

> A small group of Wheatbelt farmers has launched what could be the first step in shattering the CBH monopoly at WA ports.
>
> The farmers have met Geraldton Port and shipping company Patrick to investigate loading their own grain at a fraction of the price.

> Countryman understands the farmers met Patrick at the Wooree home of Mid West graingrower Bruce Ley at the weekend to break the competition at the port and pursue a feasibility study on loading their own grain. (Quinton, 2009)

Given there appear to be parties considering the construction of alternative wheat port terminal facilities in Western Australia to CBH, this castes serious doubt as to the essentiality of access to CBH's wheat port terminal services and whether the criterion set out in section 44G(2)(b) of the TPA which states "that it would be uneconomical for anyone to develop another facility to provide the service" would be satisfied. Similarly, this also raises a compliance issue for the Commonwealth Government under clause 6(a) of the Competition Principles Agreement.

In its assessment of the Victorian grain handling and storage access regime earlier this year, the Victorian Essential Services Commission (ESC) found that:

- Obtaining access to services at a particular port terminal may not be necessary to permit effective competition in an upstream or downstream market
- The existence of more than one unaffiliated port terminal facility and a significant degree of substitutability between services provided by them may constitute an effective duplication of the services. (Essential Services Commission, 2009, p. 64)

On this basis, the ESC commented that this tended to indicate that Victorian export grain terminals were no longer "significant infrastructure facilities" for the purposes of state access regulation based on the Competition Principles Agreement (Essential Services Commission, 2009, p. 64).

Because there is no assessment as to whether it is necessary for parties to provide an access undertaking, such as through satisfying the requirements set out under section 44G(2) of the TPA, the WEMA access test contains absolutely no safeguards against the risk of regulatory failure. In this case, the main risk of regulatory failure comes from imposing regulatory costs that outweigh the benefits.

In relation to Western Australia, regulatory failure could be manifesting itself through a lack of investment in port terminal facilities. Parties able to 'free ride' on CBH's port terminal facility services through the imposition of inappropriate access regulation have reduced incentive to invest in their own alternative port terminal facilities. Furthermore, the application of inappropriate access regulation may act as a disincentive for CBH to maintain and upgrade its existing port terminal facilities.

In addition, the operation of the WEMA access test leaves open the possibility that other parties could 'game' the access undertaking process in an attempt to

eliminate wheat exporters who provide port terminal services from wheat export markets. While section 24(3) of the WEMA immediately prevents this possibility following an ACCC access undertaking decision through suppressing the operation of section 44ZZBA(1) of the TPA, third parties could still threaten the accreditation of wheat exporters who provide port terminal services through challenging an ACCC access undertaking decision in the Australian Competition Tribunal in an attempt to have the ACCC decision set aside. A decision by the Australian Competition Tribunal to set aside an ACCC access undertaking in this case would result in the removal of an export accreditation under the WEMA of a wheat exporter for failing the access test. In this manner, parties could try to use Division 6 of the TPA to foreclose wheat export markets on wheat exporters who provide port terminal services. ACIL Tasman is not suggesting that the opportunity for merits review should be removed, but making the point that third parties could exploit the interaction of the access undertaking process with the WEMA for mischievous purposes.

The National Competition Council has previously warned that if applied inappropriately, Part IIIA of the TPA could undermine price signals, innovative activity or the incentives for investment (National Competition Council, 2001, p. 85). In turn the National Competition Council has warned against applying Part IIIA in ways which may yield short-term static gains in technical and allocative efficiency but which constrain the realisation of longer-term dynamic efficiency gains (National Competition Council, 2001, p. 85).

Without any test of essentiality nor consideration of factors contained in section 44G(2) of the TPA, there is the possibility that the WEMA access test is being applied in such a manner that is detrimental to overall economic efficiency and thus resulting in regulatory failure. On this basis, the WEMA access test raises compliance issues with one of the objectives of Part IIIA of the TPA under section 44AA(a) to "promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets".

Key points

- It is possible the WEMA access test is being applied in a manner that is detrimental to economic efficiency
  - This in turn raises compliance issues with section 44AA(a) of the TPA.

6.4 WEMA access test and the undertaking process

The WEMA access test has imposed significant compliance costs upon wheat exporters that also provide port terminal services. The extent of these

compliance costs has been exacerbated by the inherent uncertainty created by the access undertaking process with the deadlines imposed by the WEMA access test with significant commercial implications if they are not met.

It is also recognised that the deadlines imposed under the WEMA access test also placed considerable time pressures upon the ACCC which forced it to expedite its processes. For example, it took the ACCC over seven months to consider and accept a new access undertaking from the Australian Rail Track Corporation setting out the terms and conditions of access to interstate mainline standard gauge tracks. By way of comparison, the ACCC took just 5 days to consider and accept CBH's revised undertaking.

In all, CBH incurred external costs of around **$1 million** in the process of obtaining an access undertaking from the ACCC.

Meeting the deadline set of 1 October 2009 under the WEMA access test gave the ACCC considerable leverage in negotiations and effectively removed an important check on the administrative decision making power of the ACCC. Because wheat exporters who provide port terminal services needed to have an access undertaking in place by 1 October to be accredited to export wheat, their bargaining position to push back on ACCC demands was effectively removed. Furthermore, because of the deadline set of 1 October 2009 for the WEMA access test, wheat exporters who provide port terminal services were effectively denied the opportunity to seek merits review of an ACCC decision to reject an access undertaking before the Australian Competition Tribunal. For all intents and purposes, the operation of the WEMA access test with its imposed deadlines, effectively removed an important check on the administrative decision making power of the ACCC.

Merits review is an important check against regulatory error. The purpose of merits review is to decide whether the decision under challenge is correct, in the sense that it is made according to law, and preferable, in the sense that, if there is a range of decisions that are correct in law, the decision settled upon is the best that could have been made out on the relevant facts.[23] Dr Mitchell Landrigan has outlined the benefits of merits review in the following terms:

> Public confidence in administrative decision-making is generally enhanced if there is the scope for an independent second tier review by a competent body that can re-consider the merits of a case – particularly when significant personal or commercial rights are at stake. (Landigran, 2002, p. 56)

The deadline imposed through the WEMA access test effectively removed the opportunity for wheat exporters who provide port terminal services to seek

[23] *Drake v Minister for Immigration and Ethnic Affairs* (1979) 2 ALD 60 at 68; *Re Becker and Minister for Immigration and Ethnic Affairs* (1977) 1 ALD 158 at 161-162.

merits review of an ACCC decision to reject an access undertaking and compelled parties to accede to ACCC conditions.

One example where CBH was compelled to accede to ACCC conditions in order to meet the 1 October 2009 deadline was in relation to unpicking the port terminal services component of its Grain Express bundle of services. While the bundling of products, also known as tying, can potentially have anti-competitive effects, the circumstances in which bundling would lead to anticompetitive effects are very restricted (Ahlborn, Evans, & Padilla, 2004, p. 53).

Bundling can also be the source of important efficiencies. One potential source of bundling efficiencies arises from economies of scope in consumption where there are advantages for the customer in purchasing complementary products from the same company rather than two separate suppliers which in turn leads to transaction cost savings (Kuhn, Stillman, & Caffarra, 2004, p. 16). Bundling may also give rise to economies of scale in production (Kuhn, Stillman, & Caffarra, 2004, p. 17).

Prominent US antitrust economist Gregory Sidak and Professor Daniel Spulber of the Kellogg School of Management at Northwestern University have warned that unbundling can increase transaction costs:

> Excessive unbundling eliminates the reduced transaction costs that result from bundling features that increase consumer convenience. (Sidak & Spulber, 1998, p. 131)

Bundling could have been one significant issue for consideration during the course of merits reviews of the ACCC's initial decision to reject CBH's draft undertaking.

While CBH sought an access undertaking which lasted for a period of 3 years, the ACCC granted the access undertaking for a period of only 2 years. In making this decision, the ACCC commented:

> In light of the transitional state of the industry, the September Undertaking has been approved for duration of two years – commencing on 1 October 2009 and expiring on 30 September 2011. The relatively short duration of the undertaking will ensure that future regulatory arrangements can adapt to any changes to the industry environment. (Australian Competition and Consumer Commission, 2009b, p. 5)

The effect of the ACCC decision is that CBH will have to begin preparations in little more than 6 months time on its next access undertaking. CBH was keen to avoid having to expend additional resources on obtaining a new access undertaking so soon after the initial undertaking was accepted.

The interaction of the WEMA access test with Division 6 of the TPA put wheat exporters who provide port terminal services at a serious competitive disadvantage to other wheat exporters. The regulatory uncertainty surrounding

whether wheat exporters who provide port terminal services will pass the WEMA access test and thus be accredited to export wheat can be used to advantage by other wheat exporters in negotiating wheat export contracts with overseas customers. In addition, the access undertaking period of 2 years means that wheat exporters can only be accredited to export wheat for 2 years, compared to the accreditation of 3 years given to non-integrated wheat exporters. This gives non-integrated wheat exporters a clear advantage in securing longer term export contracts. Thus the operation of the WEMA access test and Division 6 of the TPA serves to create an uneven playing field which puts vertically integrated wheat exporters at a clear competitive disadvantage.

It is also noted that two accredited wheat exporters have escaped coverage under the WEMA access test even though they provide port terminal services through a joint venture company at the Melbourne Port Terminal. It appears that the WEMA access test has created an uneven playing field even amongst wheat exporters who provide port terminal services. The reason given for this anomaly is that WEA did not consider the facility operator to be an associated entity of any companies that are accredited wheat exporters (Wheat Exports Australia, 2009, p. 21). This is despite the fact that Melbourne Port Terminals is fully owned by three companies that are also accredited as wheat exporters.

The interaction of the WEMA access test with Division 6 of the TPA has had several adverse effects on wheat exporters who provide port terminal services. It has imposed significant compliance costs on parties who seek to comply with the access test under the WEMA. The deadline in the WEMA provided the ACCC with considerable leverage in negotiations for an access undertaking and effectively removed an important check on the administrative decision making power of the ACCC through merits review in the event that a draft access undertaking was rejected. The access test has been the source of enormous regulatory uncertainty for those parties that must satisfy it which has placed them at a substantial competitive disadvantage compared to non-integrated wheat exporters.

Key points

- The WEMA access test has imposed significant compliance costs
- The deadline imposed by the WEMA access test provided the ACCC with considerable leverage in negotiations for an access undertaking
  - This in turn had the effect of removing an important check on the administrative decision making power of the ACCC through merits review
- The WEMA access test is the source of enormous regulatory uncertainty which puts parties at a substantial competitive disadvantage.

6.5 Upstream/Up-Country extension of the access test

Proposals to extend the scope of the WEMA access test up-country or upstream are predicated on concerns regarding the abuse of market power by existing bulk grain handlers.[24] These concerns relate to current bulk grain handlers either charging too much for their services or denying access to services altogether. The Grains Policy Institute has summed up concerns regarding the abuse of market power up-country by current bulk handlers in the following terms:

> To act as an "effective" monopolist up-country, growers and grain traders would have be in a situation where there are no viable storage and handling alternatives to the networks operated by bulk handling companies. (Grains Policy Institute P/L, 2008, p. 9)

However, it is submitted that both the existence of alternative storage facilities to those provided by current bulk handlers and the existence of low barriers to entry to bulk handling imposes a significant competitive constraint on the conduct of existing bulk grain handlers. In terms of existing alternative facilities to those offered by the current bulk handlers, the Grains Policy Institute has observed:

> Alternatives to established silos and accumulation sites do exist, in the form of on-farm storage (silos, bunkers and silo bags) and alternative service providers such as AWB Grainflow and local grain traders. These alternative storage solutions pose a significant competitive threat to established infrastructure.

In relation to Western Australia, the PGA of WA commented last year:

> Already we are seeing an increase in both on-farm storage (both permanent silos and temporary 'sausages'[25]) and storage owned by other commercial operators. Whilst the total volumes are small, particularly when compared to CBH, it is a certainty that any failures by CBH will result in more storage being constructed. (PGA of WA, 2008, p. 8)

Prominent industrial organisation economist Joseph Bain considered the force of potential competition as a regulator of price and output of comparable importance to that of actual competition and focused on the height of barriers to entry as the critical determinant of the price level (Bain, 1956). According to Bain, the extent of barriers to entry in an industry indicated the advantage that

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[24] A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions (Kaysen & Turner, 1959, p. 75).

[25] Sausages or Silo bags are made from polyethylene, and individual silo bags can hold over 300 tonnes of grain for up to a year (PGA of WA, 2008, p. 8n).

existing sellers enjoyed over potential entrant sellers that in turn reflected the capacity of existing sellers to raise their price over the competitive level without attracting new entry.[26]

Bain postulated that where entry into a market was easy or unimpeded was associated with the inability of firms to raise the price above the competitive level without attracting new entry. On the other hand, if the price persistently exceeded the competitive level without inducing entry, then Bain asserted that entry was somewhat impeded. The greater the discrepancy between the price and the competitive level price without inducing entry, the more difficult entry into the market was.

The fact that new storage capacity is being developed suggests that barriers to entry in the provision of up-country services are not significant. This position is entirely consistent with the Explanatory Memorandum for the WEMA legislation which commented:

> Up-country facilities do not display natural monopoly characteristics as they have low barriers to entry and there are already a number of competitors in the industry who provide up-country storage services. (Commonwealth of Australia, 2008, p. 17)

With low barriers to entry, current bulk grain handlers cannot exercise market power as this will invite new entry. According to the Grains Policy Institute:

> If bulk handlers either exclude companies from their networks, or price their services too high, they are at risk of encouraging the establishment of alternative, lower cost, storage options that will bypass existing infrastructure. (Grains Policy Institute P/L, 2008, p. 9)

Due to low barriers to entry, it is submitted that the capacity of bulk grain handlers to exploit market power is extremely limited. Under these circumstances, there is no market failure and thus no policy rationale to extend the WEMA access test any further. In this situation, extension of the WEMA access test to up-country facilities would constitute regulatory failure. In this case regulatory failure would arise due to ineffectiveness and inefficiency.

However, despite the inability of bulk grain handlers to exploit market power, there have been calls from several parties to extend the WEMA access test to cover upstream or up-country facilities. For instance, in its submission to the ACCC on CBH's draft access undertaking, the PGA of WA commented:

> Competition in bulk wheat export markets requires that any bulk handler provide access to *all* of the services provided by facilities which are upstream from and separate to port terminal facilities. It is artificial to seek to compartmentalise port

[26] Bain defined the competitive level of prices as the minimum attainable average cost of production, distribution, and selling for the good in question, such cost being measured to include a normal interest return on investment in the enterprise.

> terminal services from the upstream services when such services are all provided by the same company and under the same contract.[27] (PGA of WA, 2009, p. 2)

In its decision accepting the draft access undertaking from CBH, the ACCC expressed some qualified support for extending the scope of the access test upstream:

> … there may be some benefits to the proposed Undertaking applying to CBH's up-country storage and handling facilities and well as to the ports. (Australian Competition and Consumer Commission, 2009b, p. 95)[28]

Similarly, the Senate Standing Committee on Rural and Regional Affairs and Transport also gave support for the notion of extending the access test in the WEMA to up-country facilities:

> The committee considers that a consistent set of access requirements should be applied to all owners of bulk handling and storage facilities, whether they are located at port terminals or at the up-country point of receival. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 50)

The fundamental problem with extending the WEMA access test to upstream or up-country facilities is that it would fail the test of essentiality due to low barriers to entry. The extension of the WEMA access test in this situation would serve only to grant access to the facility services that were merely convenient rather than essential, contrary to the Hilmer report recommendations.

Extension of the access test to up-country facilities would raise compliance issues for the Commonwealth Government under clause 6 of the Competition Principles Agreement. Any attempt to cover up-country facilities in the WEMA access test would certainly raise compliance issues under clause 6(a) of the Competition Principles Agreement which requires the Commonwealth to apply a third access regime only where "it would not be economically feasible to duplicate the facility". Due to low barriers to entry up-country facilities are quite capable of being duplicated. This point has been recognised by the PGA of WA (2008, p. 8) as well as by the Grains Council of Australia:

> It is true that there is greater competition in up-country sites, particularly with the increasing levels of on-farm storage that is being established. (Grains Council of Australia Limited, 2008, p. 22)

Extending the scope of the WEMA access test would also raise compliance issues under clause 6(c) of the Competition Principles Agreements which

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[27] Italics is as it appeared in the original.

[28] It should be noted that the ACCC also commented that the question of whether the access test should be extended up-country was a question of policy for government (Australian Competition and Consumer Commission, 2009b, p. 96).

requires that an access regime only apply where the facility is of national significance. While grain storage and handling facilities are undoubtedly important in the distribution chain for wheat, it may be stretching to credulity to characterise each individual facility as being of national significance.

Low barriers to entry make the up-country extension of the WEMA access test completely unnecessary. Extension of the WEMA access test to up-country facilities would result in regulatory failure. Extension of the access test would also raise compliance issues for the Commonwealth Government under clause 6 of the Competition Principles Agreement.

Key points

- Low barriers to entry make the extension of the WEMA access test up-country unnecessary
- Extension of the WEMA access test would result in regulatory failure and raise compliance issues for the Commonwealth Government under clause 6 of the Competition Principles Agreement.

6.6 Is the WEMA access test necessary?

There are three general constraints on the conduct of bulk grain handlers that make the operation of the WEMA access test unnecessary. In addition, there are two unique constraints on the conduct of CBH that obviate the need for the WEMA access test. As an alternative to the WEMA access test, it is possible that access issues for port terminal services could be dealt with through voluntary arrangements. Each of the constraints will now be considered in turn followed by consideration of a voluntary port terminal service access regime.

6.6.1 Part IIIA of the TPA

Even without the WEMA access test, the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA. Section 24 of the WEMA operates as a *de facto* access declaration regime for the port terminal services of parties that also seek to export wheat but lacking in the protections afforded by Division 2 of Part IIIA of the TPA. However, removal of the WEMA access test does not remove providers of port terminal services from the scope of Part IIIA of the TPA.

Any person can make a written application to the National Competition Council to have a service declared under section 44F(1) of Division 2 of Part IIIA. The National Competition Council will then assess the application according to the criteria set under section 44G(2) of the TPA.

Removing the *de facto* declaration of access regime operating through the WEMA access test will still leave parties seeking access with the option of applying for a formal access declaration. This would provide facilities owners with the protections afforded under 44G(2) of the TPA and full access to merits review and in turn reduce the risk of regulatory failure.

Clause 4.1a of the 2006 Competition and Infrastructure Reform Agreement (CIRA) between the Commonwealth Government and State and Territory governments states that:

> ...ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power

Given the operation of Division 2 of the Part IIIA of the TPA, it could be argued that the WEMA access test is unnecessary duplicating regulation. This in turn raises a compliance issue for the Commonwealth Government under clause 4.1a of the CIRA.

6.6.2 Section 46(1) of the TPA

Another means through which the conduct of bulk grain handlers is constrained is through the operation of section 46(1) of the TPA[29] that prohibits the misuse of market power:

> (1) A corporation that has a substantial degree of power in a market shall not take advantage of that power in that or any other market for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
>
> (b) preventing the entry of a person into that or any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

Conduct where parties refuse to supply a good or service may constitute a breach of section 46(1). The fact that a refusal to supply can be in breach of section 46(1) was confirmed by the High Court's decision in the *Queensland Wire* case.[30] In this matter, BHP who was responsible for 97 per cent of Australia's steel production, manufactured Y-bar[31] which it supplied to its fully owned subsidiary Australian Wire Industries (AWI). When Queensland Wire Industries (QWI) sought to purchase Y-bar, it was offered the product for sale

[29] Explicit reference is made here to section 46(1) of the TPA to ensure that this provision is not confused with the operation of the predatory pricing provision contained in section 46(1AA) of the TPA.

[30] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co. Ltd* (1989) 167 CLR 177.

[31] Y-bar was used for the construction of star picket fencing.

at prices that were prohibitively expensive. QWI successfully claimed before the High Court that BHP had misused its market power in contravention of section 46(1). According to the then Chief Justice and Justice Wilson:

> In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked the market power - in other words, if it were operating in a competitive market - it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor.[32]

The Hilmer report recognised that section 46(1) could be one potential means of seeking access to essential facility infrastructure:

> Section 46 is potentially applicable in essential facility situations. If a facility is truly essential, its owner will always have a substantial degree of market power within the meaning of s.46. There should also be little difficulty in establishing that a refusal to deal in an essential facility context constitutes a "taking advantage" of that market power, given that in the absence of such market power access to the facility would be available. A refusal to provide access to an essential facility could conceivably occur for any of the three proscribed purposes. (Hilmer, Rayner, & Taperell, 1993, p. 243)

For infrastructure that doesn't meet the declaration criteria under section 44G(2) of Part IIIA of the TPA, section 46(1) could be used as a fall-back provision to obtain access as previously suggested by the Law Council of Australia (2001, p. 9). According to Associate Professor Brenda Marshal of Bond University:

> … 'residual' access disputes, falling outside the ambit of the regime enacted by Part IIIA, remain justifiable under s 46. (Marshall, 2003, p. 51)

Parties can pursue their own private actions for breaches of section 46(1) in the Federal Court. Furthermore in relation to section 46(1), the ACCC can launch civil proceedings for a breach and can also bring representatives actions seeking compensation for persons identified as having suffered, or likely to suffer, loss or damage as a result of the breach and who would otherwise have had to bring action of their own.

6.6.3 Role of potential competition

The potential for new entry in the provision of port terminal services may serve to impose a further competitive constraint on the conduct of bulk grain handlers.

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[32] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co. Ltd* (1989) 167 CLR 177, 192.

The theory of contestable markets was developed by American economists William Baumol, John Panzar, and Robert Willig (Baumol, Panzar, & Willig, 1982), Under this theory, an entry barrier has been defined as "anything that requires an expenditure by a new entrant into an industry, but that imposes no equivalent cost upon an incumbent" (Baumol & Willig, 1981, p. 408).

From this definition, a distinction is drawn between fixed costs and sunk costs. Fixed costs do not necessarily constitute a barrier to entry because they affect incumbents and entrants alike. However, any entry cost that is unrecoverable is a sunk cost. The need to sink costs into a new firm imposes a difference between the incremental cost and the incremental risk that are faced by an entrant and an incumbent (Baumol & Willig, 1981, p. 418). In the case of an incumbent, such funds have already been expended and they are already exposed to whatever risks the market entails (Baumol & Willig, 1981, p. 418). In contrast, the new firm must incur any entry costs on entering the market that incumbents don't bear.

Entry will occur in the event that the profits expected by a successful entrant outweigh the unrecoverable entry costs that will be lost in the case of failure (Baumol & Willig, 1981, p. 418). Hence, the need to sink costs can therefore constitute a barrier to entry.

The construction of port terminal storage and handling facilities may involve the need for a new entrant to incur considerable sunk costs. However, based on the views of the PGA of WA, it would appear that the need to sink costs into new port terminal storage and handling facilities may not constitute a prohibitive barrier to entry such as to deter new entry:

> In combination with the access to road freight opportunities, alternative port facilities (or even the threat of their presence) will apply a strong market discipline to CBH. Whilst alternative port infrastructure cannot be built overnight, there are projects on the drawing board in WA that could offer commercial alternatives to CBH. (PGA of WA, 2008, p. 8)

6.6.4 Incentives facing CBH

The problem with the exercise of market power (also referred to as monopoly power) is that it undermines economic efficiency. In commenting on why competition is generally preferred to monopoly, William J. Kolasky and Andrew R. Dick, former officials with the US Department of Justice Antitrust Division, have remarked:

> The fundamental reason we favor competition over monopoly is that competition tends to drive markets to a more efficient use of scarce resources… Competition promotes allocative efficiency by leading firms to produce output up to the point where the marginal cost of each unit just equals the value of that unit to consumers. Competition promotes productive efficiency by forcing firms to cut their costs in

> order not to lose sales to more efficient rivals. Competition promotes dynamic efficiency by stimulating investment and innovation. And competition promotes transactional efficiency because, faced with competition, firms will seek out the least expensive means of carrying out transactions.

Even if one contends that CBH's has the potential to misuse a position of market power, there are two unique constraints on its behaviour which serves to reduce the incentive.

CBH is a co-operative that is owned by around 4,800 grain growing shareholding members. CBH was incorporated on 4 April 1933 and is governed by the *Companies (Co-operative) Act 1943* (WA) (Cooperative Act). CBH's objectives are contained in article 2(a) – (ee) of its Memorandum of Association. Its main objectives are contained in articles 2(a), (b) and (f) which are:

> (a) To establish maintain and conduct any schemes or systems for handling of wheat and/or other grain in bulk or otherwise.
>
> (b) To receive, handle, transport, grade, classify and store wheat and/or other grain…
>
> (f) To carry on either in conjunction with or separately from the businesses authorised to be carried on by the preceding paragraphs or any of them all or any businesses or business which in the opinion of the Directors may be conveniently carried on by the Company or promote assist be incidental or conducive to the attainment of its objects or any of them.

In general, grain growers are eligible to become a CBH member and receive a $2 share in the cooperative if they deliver 600 tonnes of grain into the CBH network within a 3-year period, including at least some tonnage in the previous two years. A grain grower who ceases to deliver 100 tonnes over a three year period will no longer be eligible to be a CBH shareholder.

Nine directors of CBH are directly elected by the members from five districts while there is provision for the appointment of up to three other Directors to the Board who possess special skills that will broaden the overall expertise of the Board. The term of office for a district-elected Director expires at the third ordinary general meeting after election. The term of office for Directors appointed for their special skills is up to three years with their appointment to be ratified by members at the next general meeting following their appointment or re-appointment. Control of CBH is very much within the hands of members.

Any attempt by CBH to misuse a position of market power would ultimately be to the disadvantage of its members who must be grain growers. Under these circumstances, grain growers are in a very strong position to discipline CBH Directors, and thereby in turn CBH management, in the event that CBH sought to engage in activities detrimental to the interests of grain growers.

CBH is also obliged to provide access to its services under section 19 of the *Bulk Handling Act 1967* (WA) which provides that:

> Subject to this Act and the regulations, the Company shall allow a person, on payment of the prescribed charges, the use of any bulk handling facilities and equipment controlled by it at ports in the State.

Through both the cooperative structure of its business and by virtue of WA legislative requirements, CBH has significant unique constraints imposed upon it conduct which it preclude from exercising any market power that it may possess.

6.6.5 Voluntary access arrangement

An alternative to the regulatory access arrangements under the WEMA access test is through a voluntary access arrangement. This could be provided for through the development of a voluntary code of conduct which makes provision for a dispute resolution process overseen by an appropriate grain industry body. Grain Trade Australia Ltd may be such an appropriate body to undertake this function.

Implementation of a voluntary port terminal service access regime would be consistent with part of recommendation 2 by the Exports and Infrastructure Taskforce which suggested that the Council of Australian Governments explore the scope for simplifying and streamlining the regulatory process as it applies to export oriented infrastructure:

> … by providing a presumption that issues to do with export oriented infrastructure will be resolved by commercial negotiation between the infrastructure provider and users. (Exports and Infrastructure Taskforce, 2005, p. 52)

A voluntary port terminal service access regime was never given an opportunity to work in regard to wheat exports following the abolition of the AWB wheat export monopoly through the imposition of the WEMA access test. In keeping with the recommendation of the Exports and Infrastructure Taskforce, a voluntary port terminal service access regime should at least be given an opportunity to demonstrate its efficiency and effectiveness before resort is made to more heavy-handed regulatory interventions.

A voluntary port terminal service access regime has the advantage of avoiding the compliance costs associated with the WEMA access test. A further advantage with a voluntary system is that dissatisfied access seekers would still have the option of seeking redress through other regulatory remedies.

Key points

- The WEMA access test is unnecessary for several reasons:

  - Part IIIA and section 46(1) of the TPA already provide sufficient protections for parties that wish to obtain access to port terminal services
  - The potential for new entry in the provision of port terminal services may serve to impose a further competitive constraint on the conduct of bulk grain handlers
  - CBH faces a set of unique constraints from WA legislative requirements and its cooperative structure which prevents it from misusing any market power that it may possess
- A voluntary port terminal service access regime would avoid the compliance costs associated with the WEMA access test while still giving dissatisfied access seekers the option of pursuing other regulatory remedies.

6.7 Conclusions

Section 24 of the WEMA operates as a *de facto* access declaration regime for the port terminal services of parties that also seek to export wheat but lacking in the protections afforded by Division 2 of Part IIIA of the TPA. On this basis, the WEMA access test is inconsistent with other access regimes and therefore raises compliance issues with section 44AA(b) of the TPA.

Without any test of essentiality nor consideration of factors contained in section 44G(2) of the TPA, there is the possibility that the WEMA access test is being applied in such a manner that is detrimental to overall economic efficiency and thus resulting in regulatory failure. On this basis, the WEMA access test raises compliance issues under section 44AA(a) of the TPA.

The interaction of the WEMA access test with Division 6 of the TPA has had several adverse effects on wheat exporters who provide port terminal services. It has imposed significant compliance costs on parties who seek to comply with the access test under the WEMA. The deadline in the WEMA provided the ACCC with considerable leverage in negotiations for an access undertaking and effectively removed an important check on the administrative decision making power of the ACCC through merits review in the event that a draft access undertaking was rejected. The access test has been the source of enormous regulatory uncertainty for those parties that must satisfy it which has placed them at a substantial competitive disadvantage compared to non-integrated wheat exporters.

Low barriers to entry make the up-country extension of the WEMA access test completely unnecessary. Extension of the WEMA access test to up-country facilities would result in regulatory failure. Extension of the access test would also raise compliance issues for the Commonwealth Government under clause 6 of the Competition Principles Agreement.

There are several constraints on the conduct of bulk grain handlers that make the operation of the WEMA access test unnecessary. Even without the WEMA access test, the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA. In addition, parties have recourse to section 46(1) of the TPA. The potential for new entry in the provision of port terminal services may also serve to impose a further competitive constraint on the conduct of bulk grain handlers. In relation to CBH, the cooperative structure of its business and WA legislative requirements impose significant unique constraints which preclude it from exercising any market power that it may possess.

An alternative to the regulatory access arrangements under the WEMA access test is a voluntary port terminal service access regime provided for through the development of a voluntary code of conduct which makes provision for a dispute resolution process overseen by an appropriate grain industry body. A voluntary port terminal service access regime avoids the compliance costs associated with the WEMA access test while giving dissatisfied access seekers the option of pursuing other regulatory remedies.

The objectives clause was added to Part IIIA of the TPA following the recommendations of the Productivity Commission in 2001. Given that the WEMA access test raises compliance issues with both parts of the objectives clause of Part IIIA, it would appear that the development of the WEMA access test has had far more to do with the pursuit of populism that could be acting to the detriment of economic efficiency. With no apparent market failure to address, extension of the WEMA access test up-country would constitute yet a further departure from economic efficiency.

7 Monopolisation

This section addresses monopolisation issues within Australian grain related markets.

CBH is a volume base business which needs to generate a high level of throughput though its port terminal facilities to provide sufficient revenue in order to cover its high fixed costs[33]. According to CBH, it has never unreasonably refused any accredited exporter of grain access to the CBH Port Terminal Facilities (Cooperative Bulk Handling Limited, 2009, p. 24).

However, concerns have been expressed that the single desk export wheat monopoly of AWB could be replaced by three regional monopolies operated

[33] Fixed costs are costs that do not vary with the quantity of output.

by the bulk grain handlers. According to AWB Managing Director Gordon Davis:

> It is critical that the new arrangements don't replace one national monopoly with three regional monopolies dominated by the bulk handling companies (BHCs). (AWB Limited, 2008)

In commenting on the draft WEMA legislation, National Party Senators warned about the lack of adequate legislative provisions to deal with monopolisation in bulk grain handling:

> More dangerously, the draft bills lack sufficient safeguards to prevent regional monopolies from arising. (The Senate Standing Committee on Rural and Regional Affairs and Transport, 2008, p. 67)

Going further than the National Party Senators, The Allen Consulting Group has suggested that it may be necessary to impose structural separation on bulk grain handlers:

> … in the longer term, the most effective means through which to minimise the potential exploitation of market power by operators of export grain facilities is for formal structural separation of the natural monopoly parts of the business from the competitive areas. (The Allen Consulting Group Pty Ltd, 2008, p. 55)

There are two fundamental problems with this policy prescription: it fails to consider what existing protections are already in place to prevent monopolisation; and it doesn't address whether the costs of structural separation outweigh the benefits. An inability to address these problems in policy development risks a further slide towards populism in competition policy. The following subsections consider the protections that already exist under Australian competition law against monopolisation, and the problems associated with structural separation.

7.1 Protections against monopolisation

There are two sections contained within Part IV of the TPA that provide generic protections against monopolisation. Section 46(1) prohibits corporations from misusing substantial market power to harm or eliminate competitors or competition generally. Section 50 prohibits mergers or acquisitions which would have the effect or likely effect of substantially lessening competition in a substantial market for goods or services within Australia (SLC test).

The effectiveness of section 46(1) has been questioned in several quarters, including on occasions by the competition regulator, the ACCC. Dissatisfaction with the operation of section 46(1) was the primary catalyst behind the adoption of the Birdsville amendment contained in section 46(1AA) against predatory conduct. However, it is submitted that following

several amendments to clarify the operation of section 46(1) that any lingering dissatisfaction probably has more to do with its inability to provide blanket protection for small business which in turn reflects a fundamental misunderstanding of the purpose of the TPA.

According to the majority decision by the High Court of Australia in the *Boral* case[34], the overarching goal of the competitive conduct provisions of the TPA are to protect competition, not competitors. According to then Chief Justice Gleeson and Justice Callinan:

> The purpose of the [Trade Practices] Act is to promote competition, not to protect the private interests of particular persons or corporations. Competition damages competitors. If the damage is sufficiently serious, competition may eliminate a competitor.[35]

One concern with the operation of section 46(1) has been the difficulty involved in proving purpose. However, the Dawson report concluded that:

> The difficulty in proving purpose may be doubted. Not only may the purpose be inferred, but the proof that is required is on the civil standard of the balance of probabilities only, and not on the criminal standard of proof beyond reasonable doubt. The purpose does not have to be the sole or dominant purpose. An admission of purpose is not required, much less an admission in the documentary form of a 'smoking gun'. (Dawson, Segal, & Rendall, 2003, p. 77)

With recent clarifying amendments to the operation of section 46(1) by both the former Howard and Rudd governments, the ACCC has expressed confidence that the changes made have been sufficient (Samuel, 2008, p. 7).

Mergers law such as section 50 is an attempt to preserve competitive market structures in order to guard against the accumulation and exercise of market power. The enactment of mergers law is predicated on the belief that market competition is the principal means for achieving an efficient allocation of scarce resources throughout society (Davey, 2003, p. 17). The Dawson report concluded that:

> Section 50 serves the object of enhancing the welfare of Australians through increasing economic efficiency. The achievement of economic efficiency is an important goal because it is reflected in high productivity which in turn is important in sustaining economic welfare. (Dawson, Segal, & Rendall, 2003, p. 68)

Further protection against monopolisation is provided through access to essential infrastructure services by Part IIIA of the TPA which has already been discussed in subsection 5.2.

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[34] *Boral Besser Masonry Limited (now Boral Masonry Ltd) v Australian Competition and Consumer Commission* [2003] HCA 5.

[35] ibid., at 87.

Key points

- Sections 46 and 50 of the TPA coupled with Part IIIA of the TPA provide adequate protections against potential monopolisation and the abuse of market power in Australian grain related markets
- There is no need for any additional specific provisions to deal with monopolisation in grain marketing.

7.2 Problems with structural separation

In consideration of any specific legislative provisions to impose structural separation in grain marketing as proposed by The Allen Consulting Group, it is absolutely essential that such policy measures are accompanied by a thorough cost benefit analysis. In considering the effects of additional regulatory measures, a group of prominent economists in 1996, including the 1972 Nobel Laureate for economics Kenneth Arrow, contended that it was vitally important to undertake cost benefit analysis:

> Because society has limited resources to spend on regulation, benefit-cost analysis can help illuminate the trade-offs involved in making different kinds of social investments. In this regard, it seems almost irresponsible to not conduct such analyses, because they can inform decisions about how scarce resources can be put to the greatest social good. Benefit-cost analysis can also help answer the question of how much regulation is enough. From an efficiency standpoint, the answer to this question is simple: regulate until the incremental benefits from regulation are just offset by the incremental costs. (Arrow, et al., 1996, p. 221)

There are likely to be substantial costs associated with imposing structural separation. In particular, structural separation will unwind the benefits achieved through vertical integration. According to the OECD Competition Committee, structural separation can impose potentially significant costs including:

- A loss of economies of scope from integrated operation
- Increased transaction costs for consumers
- Direct costs of separation can be high
- System reliability may fall when investments are not made jointly
- Accountability for interface problems may be difficult to assign. (OECD Competition Committee, 2006, p. 7)

According to Robert Crandall from the Brookings Institute and prominent US antitrust economist Gregory Sidak, vertical integration enables a firm to coordinate investment and production decisions across divisions (Crandall & Sidak, 2002, p. 365). According to Crandall and Sidak:

> A comparison of the costs of contractual exchange with those of internal exchange often reveals vertical integration to be the least-cost method of achieving the desired level of coordination. (Crandall & Sidak, 2002, p. 365)

Structural separation can impose significant transaction costs as internal transactions within the firm are replaced by outside contractual arrangements:

> The transaction costs of negotiating and enforcing contracts make it prohibitively costly to write contracts that specify all obligations under all contingencies. In such circumstances, contracting parties may engage in opportunistic behavior, which undermines the likelihood of maximizing joint profits. (Crandall & Sidak, 2002, p. 366)

Crandall and Sidak contend that relative to contracting at arm's length, vertical integration reduces transaction costs (Crandall & Sidak, 2002, p. 367).

In considering the policy question of whether Telstra should be subject to structural separation, the Productivity Commission recognised that structural separation would impose significant costs:

> Moreover, vertical solutions have their own offsetting and potentially sizeable efficiency costs. In particular, they can reduce or remove opportunities to exploit economies of scope and create significant hurdles to further innovation and investment. (Productivity Commission, 2005, p. 241)

In deliberating on the merits of imposing a structural separation upon Telstra, the Productivity Commission came to the view that the significant transaction costs imposed would outweigh the benefits (Productivity Commission, 2005, p. 242).

In considering the merits of structural separation, one also needs to consider the efficacy of previous attempts to increase competition through forced divestitures. In assessing the historical record in the United States, Robert Crandall from the Brookings Institute has come to a largely negative assessment of government attempts to increase competition through the use of forced divestiture:

> US antitrust policy began in earnest almost 100 years ago with attempts to create competition by breaking up dominant firms, such as Standard Oil and American Tobacco, into a number of smaller, competing companies. In later years, the government would succeed in requiring divestitures in the shoe machinery, motion picture, network television, and telecommunications industries. There is no evidence that any of these extreme measures, other than the AT&T divestiture, had salutary effects, and even the AT&T divestiture could have been avoided if the Federal Communications Commission had adopted a simple rule of requiring equal access to AT&T's local facilities for all long distance carriers. (Crandall, 2003)

In considering the need for structural separation, care needs to be exercised to ensure that advocates are not trying to impose additional costs on bulk grain handlers for ulterior purposes. An incumbent burden is said to exist if incumbents face costs owing to regulation that is not imposed on new entrants (Sidak & Spulber, 1997, p. 30). Incumbent burdens are analogous to the

phenomenon of raising rivals' costs except the rival whose costs are being raised is the incumbent firm rather than the new entrant (Sidak & Spulber, 1997, pp. 30-31).

Raising rivals' costs (RRC) is a form of anti-competitive exclusion whereby conduct by a predatory firm or firms places rival competitors at a cost disadvantage sufficient to allow the predatory firm or firms to exercise market power by raising prices (Krattenmaker & Salop, 1986, p. 214). As a means of predatory conduct, Professor Steven Salop of Georgetown University and Professor David Scheffman of Vanderbilt University have identified a number of advantages of RRC, particularly as compared to predatory pricing conduct:

- It may induce a rival to exit the market
- It is far better to compete against a high cost competitor than a low cost competitor, and thus RRC can be a profitable strategy even if the target firm doesn't exit the industry
- A higher-cost rival quickly reduces output, allowing the predator to immediately raise price or market share
- There is no need to sacrifice profits in the short run for a speculative and indeterminate level of profits in the long run (such as the case with predatory pricing)
- There is no need for deep pockets or superior access to financial assets. (Salop & Scheffman, 1983, p. 267)

Professor Jonathan Baker[36] has described exclusionary practices of RRC as creating an involuntary or coerced cartel (Baker, 1995)

Crandall and Sidak have identified several adverse consequences arising from raising rivals' costs through the imposition of an incumbent burden:

- It is a method of facilitating inefficient entry into a market.
- Higher costs of rivals are passed along ultimately in higher prices to consumers and reduced levels of output.
- Reducing the productive efficiency of rivals erodes profitability and, hence, reduces returns to investors, thus discouraging investment
- It reduces the ability of the rival firm to fund its own investment through retained earnings, because the pool of earnings diminishes by the amount of the inefficiency by which the rival has been handicapped. (Crandall & Sidak, 2002, p. 400)

In grain export markets where final prices are determined by international commodity markets, the imposition of incumbent burdens is likely to reduce

[36] Professor at the American University's Washington College of Law and former Director of the Bureau of Economics at the US Federal Trade Commission.

the returns accruing to grain growers. In this instance, rather than impose a higher price on overseas purchasers of grain, the imposition of incumbent burdens will extract some of the quasi-rents accruing to grain growers.[37]

In pursuit of structural separation of vertically bulk grain handlers, it is critically important to ensure that the cure is not far worse than disease.

Key points

- Proposals to impose structural separation in grain marketing should be subject to a thorough cost benefit analysis
- There are significant costs associated with imposing structural separation
  - Structural separation can unwind the benefits associated with vertical integration
- The historical record suggests that government attempts to increase competition through the use of forced divestiture have not generally been successful
- Structural separation can impose incumbent burdens analogous to the anti-competitive detriment associated with raising rivals' costs.

8 General discussion of effectiveness and efficiency

The Australian, and particularly the WA, bulk export wheat market is part of a highly competitive global market for wheat. The price Australian growers receive is largely set by international supply and demand conditions less the costs of getting the grain to end users. Thus, Australian wheat grower interests are served by an efficient export supply chain. Australia's current wheat policy is predicated on this notion. Supply chain inefficiencies or obstructions will be borne by growers who will respond by diverting production resources, at the margin, to alternative uses, reducing the amount of grain produced. The fact that Australia is a price taker for exported wheat imposes a significant overarching competitive constraint on the behaviour of all participants in the grain supply chain including the CBH Group. Not only is the CBH Group subject to these competitive constraints, it is cooperative which has a charter that specifically directs that its activities must benefit its members who are the overwhelming majority of WA grain growers. However, CBH cannot distribute financial returns to members, but rather reinvests profits into the services for the benefit of its members—these benefits spillover to all participants in the supply chain.

[37] The quasi-rent value of an asset is defined as the excess of its value over its salvage or its value in its next best use to another renter (Klein & Crawford, 1978, p. 298).

There are no incentives for CBH Group to obstruct or seek quasi-rents from the supply chain in WA, to do so would place CBH in breach of its cooperative charter and would also be detrimental to the interests of its members.

The current wheat marketing policy, which has introduced partial deregulation of the bulk wheat export market, is the last in a long series of grain market reforms in Australia. Growers and the industry have been successfully and rapidly adjusting to liberalised, domestic and export wheat markets for many years.

The introduction of partial deregulation of the wheat export market in Australia has introduced a period of far greater transparency of wheat prices and supply chain costs. New products and services have and will continue to be introduced by a range of existing grain market participants and new entrants. A significant sign of confidence in the efficiency of the market under the new policy is the introduction of the WA wheat futures contract by the Australia Stock Exchange.

Many growers have been using these products to market other grains and in most instances have been dealing with most of the licensed bulk wheat exporters who have long since established their credentials with growers.

The rationale for ongoing licensing of wheat exporters as a unique subset of grain or commodity traders more generally has never been convincingly made. It appears that the intent has been to provide some assurance that growers' interests were protected as they emerged from in excess of 60 years of regulated wheat exporting.

It is apparent that growers have adapted rapidly to partial deregulation and continuation of the licensing scheme is likely to act as a barrier to entry and reduce the number of new products and services offered to growers.

The new marketing arrangements will create incentives for investments in on farm, regional and port infrastructure as many new entrants to the wheat market implement vertical integration strategies developed by their experiences in most of the major grain producing regions of the world.

The general success of the first year of deregulation under some challenging market conditions in WA suggests that many of the assumptions underpinning the WEMA have proven not to be well founded.

While there were congestions at the WA ports between March and May 2009, it is not apparent that an access regime would prevent a repetition of this situation. Rather the introduction of a compulsory access regime may reduce incentive for investment in new port infrastructure, which is likely to be needed as the market adjusts to new levels of transparency and new entrants.

The assumptions made in the lead up to the introduction of the WEMA led to the coupling of export wheat licenses for those who provide port terminal services with an obligation to provide access to the port services. Thus Section 24 of the WEMA operates as a *de facto* access declaration regime for the port terminal services but lacking in the protections afforded by Division 2 of Part IIIA of the TPA. Given this has been done without any test of essentiality nor consideration of factors contained in section 44G(2) of the TPA, there is the possibility that the WEMA access test is being applied in such a manner that is detrimental to overall economic efficiency and thus resulting in regulatory failure.

This policy has imposed significant compliance costs on parties who seek to comply with licensing provisions in general and the access test under the WEMA.

The WEMA access test provided the ACCC with considerable leverage in negotiations for an access undertaking and effectively removed an important check on the administrative decision making power of the ACCC through merits review in the event that a draft access undertaking was rejected. The access test has been the source of enormous regulatory uncertainty for those parties that must satisfy it which has placed them at a substantial competitive disadvantage compared to non-integrated wheat exporters.

There are low barriers to entry to develop 'up country' storage and handling services which is evident by the amount of on farm storage farmers anticipate building over the next three years. In the eastern states, considerable investments have been made, or are planned in regional or primary aggregation sites by corporate grain producers and some new entrants to the market.

There are several constraints on the conduct of bulk grain handlers that make the operation of the WEMA access test unnecessary:

- the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA
- In addition to Division 2 parties have recourse to section 46(1) of the TPA
- The potential for new entry in the provision of port terminal services may also serve to impose a further competitive constraint on the conduct of bulk grain handlers
- WA legislative requirements and its cooperative structure impose a further constraint on the exercise of any market power that CBH may possess.

The Australian grains industry is introducing a range of voluntary processes to manage its activity aimed at reducing the costs of doing business. A voluntary code of conduct has recently been introduced for grain buyers when dealing

with growers by Grain Trade Australia. These processes could include port terminal access arrangements if required.

A voluntary port terminal service access regime avoids the compliance costs associated with the WEMA access test while giving dissatisfied access seekers the option of pursuing other regulatory remedies.

8.1 Reform options

ACIL Tasman sees no merits in retention of the WEMA whatsoever. Under these circumstances it recommends rescinding the WEMA.

However, if the Commonwealth Government is not amenable to rescinding the WEMA altogether, then reforms should definitely be made to the WEMA access test.

Even without the WEMA access test, the conduct of bulk grain handlers is constrained as parties still have recourse to Division 2 of Part IIIA of the TPA and section 46(1) of the TPA. If the WEMA is to be retained, then ACIL Tasman believes the WEMA access test should be abolished. Instead, a voluntary port terminal service access regime provided for through the development of a voluntary code of conduct which makes provision for a dispute resolution process overseen by an appropriate grain industry body should be established. A voluntary port terminal service access regime avoids the compliance costs associated with the WEMA access test while giving dissatisfied access seekers the option of pursuing other regulatory remedies.

If the Commonwealth Government is not amenable to abolishing the WEMA access test, then the operation of the test should be amended to protect the interests of facility owners who export wheat. In the first instance, accreditation as a wheat exporter should not be made conditional on passing the access test. In the second instance, the access test should be applied by a legislative requirement for the WEA to make an application to the National Competition Council under Division 2 of Part IIIA of the TPA for an access declaration of port terminal services. Both these measures would ensure that the rights of facility owners are fully respected and they are not placed at a competitive disadvantage as compared to other non-integrated wheat exporters.

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