



Australian Grain Exporters Association

Response to the Productivity Commission Wheat
Export Marketing Arrangements Draft Report

April 2010



Executive Summary

The Productivity Commission's draft report into Wheat Export Marketing Arrangements finds that deregulation of the wheat export industry has proceeded relatively smoothly and that there should be further reduction of regulation over the period to 2014.

The Productivity Commission has recommended removal of accreditation of exporters in 2011, a move to a less onerous port access regime and decoupling of accreditation and port access.

While, in general, AGEA supports the recommendation to reduce regulation, it does not believe that the Productivity Commission has recognised the substantial issues that still remain in relation to port access and the likely impact of taking the industry backwards if its recommendations are implemented in full. The grains industry is still in a transition period and the supply chain is not yet of a structure that provides for an efficient and effective model in a commercial environment.

The Productivity Commission's approach to the next phase of wheat export marketing arrangements of removing accreditation for exporters and moving port access undertakings from the current WEMA provisions to Part IIIA of the Trade Practices Act (TPA) is a very significant shift and will substantially alter the competitive playing field.

The approach of accreditation plus port access undertakings was adopted in the 2008 Act to ensure a competitive market developed and to avoid the creation of regional monopolies. AGEA believes that any new arrangements should not cause the industry to inadvertently revert to a position that was not supported at the time of deregulation.

AGEA's view regarding the key issues of exporter accreditation, port access and Grain Express are summarised following. The AGEA submission comments on these issues as well as a range of other findings/recommendations in the Productivity Commission's draft report.

Access to port terminal facilities and exporter accreditation

AGEA agrees with the Productivity Commission finding that export accreditation does not deliver a net benefit in terms of improving security for growers. However, the link with port access has provided considerable value to exporters and growers by safeguarding against the development of an uncompetitive industry structure.

The ACCC undertakings have only been in place since September 2009 and this is a very limited time in which to judge their effectiveness in delivering the outcome sought in terms of fair access to port terminal services. However, there are already examples that suggest the bulk handling company behaviour and outcomes of the access undertakings are not fully aligned.

AGEA believes that the link with accreditation is an appropriate sanction and does not support the decoupling of accreditation and port access.

AGEA recommends that:

- Accreditation and access undertakings not be decoupled
- Accreditation under WEA remain until 2012 for exporters, excepting bulk handling companies which have accreditation until September 2011, and any new exporters accredited through to 2012
- Accreditation for bulk handling companies be reviewed in September 2011 and ongoing accreditation be subject to demonstration of appropriate access arrangements and compliance with ACCC access undertakings

Draft recommendations 5.3 and 5.4 represent a fundamental shift in the playing field for Australian wheat exporters versus the bulk handling companies from that established under the 2008 Wheat Export Marketing Act.

The 2008 Act was designed to create a competitive market for the wheat industry.

Shifting from the access test under the WEMA to under Part I/IA of the Trade Practices Act effectively shifts the access test from applying to total capacity of the port terminal to spare capacity.

This is a fundamental shift in the competitive playing field and will be to the detriment of Australian wheat exporters and consequently Australian wheat growers.

Shifting the access test to 'spare or excess capacity' will allow the bulk handling companies to control the supply of capacity available to exporters other than their trading arm with the inevitable consequence of increasing the price of capacity. Furthermore, the ability for bulk handling companies to reserve capacity for their own use impacts on the relative terms and conditions on which the port terminal services are provided.

AGEA recommends that:

- Access undertakings for bulk handling companies be maintained
- The Productivity Commission specify the mechanism/sanctions that would apply under the model outlined in the draft report and demonstrate that they deliver the same or improved impact as revoking accreditation
- port access regime apply to total capacity

CBH auction system

The auction system was put forward by CBH as mechanism to deliver fair and transparent access to vessel slots. The auction system has not delivered a viable or effective mechanism for allocation of capacity.

AGEA finds that the CBH auction system has:

- Not been effective in managing infrastructure allocation, if indeed, there is a capacity constraint. AGEA believes that any constraints are related to the CBH supply chain model and removing Grain Express would provide greater transparency as to where there are constraints in the system

- Resulted in significant costs for exporters due factors such as the fee structure; upfront payment; payments for services that may or may not be used; and inflexible rules
- Not delivered any benefits, but has reduced competition and increased costs for the supply chain, while the charging regime has reduced transparency and camouflaged price signals to growers
- Prevented the operation of an effective secondary market

Grain express

Grain Express has had a significant detrimental impact on the efficiency and cost of the wheat industry supply chain in WA. Under the current arrangements there is no ability to measure the efficiency and cost effectiveness of the services provided and no visibility on the individual cost components.

AGEA believes that Grain Express is anticompetitive and restricts the ability of any party to build any competing infrastructure or transport capability as well as reducing competition in rail and road freight.

Exporters are essentially forced to use Grain Express as the auction rules require exporters to nominate within five days whether or not they are using Grain Express or direct access; and the flat fee charging structure impedes direct access.

Grain Express has not delivered any overall improvement in the supply chain. AGEA strongly recommends that ACCC acts to remove the Exclusive Dealing Notification (N93439) lodged by CBH enabling Grain Express to operate.

Introduction

The Productivity Commission has invited submissions on its draft report into Wheat Export Marketing Arrangements (WEMA).

Australian Grain Exporters Association (AGEA) is the representative body of exporters of Australian grain. It was formed in 1980. Its members include 18 Australian wheat exporters.

The Productivity Commission is seeking comment on a range of draft recommendations and draft findings. The Productivity Commission is also seeking feedback on some specific issues.

Overall, the report finds that deregulation of the wheat marketing arrangements have proceeded relatively smoothly and that there should be further reduction of regulation over the period to 2014. The Productivity Commission has recommended removal of accreditation of exporters in 2011, a move to a less onerous port access regime and decoupling of accreditation and port access.

In general, AGEA supports the recommendation to reduce regulation, however, believes that the industry is still in a transition period and requires more time to enable the supply chain to adjust to a commercial environment in a fair and equitable manner.

The first two years of deregulation have seen very different scenarios. Deregulation occurred at a time of high market prices and strong demand for Australian wheat. Thus, in 2008/09 the market was characterised by a high level of activity concentrated early close to harvest and, due to Australian supply conditions, demand was centred on WA. In contrast the 2009/10 season saw wheat prices considerably lower, large global supplies and limited early demand for Australian wheat. In both seasons, exporters have incurred considerable losses through either delays in shipping and associated high demurrage costs as in case of the first year; and having to purchase costly and inflexible capacity in year two. The experience of these two seasons illustrates that whilst the marketing of the Australian wheat crop has proceeded smoothly under a deregulated model, the supply chain still requires time to adjust to ensure the full benefits of deregulation are captured.

In essence, the Productivity Commission's approach to the next phase of wheat marketing arrangements is to remove accreditation for exporters and extend Access Undertakings until 2014. However, the recommendations around the Access Undertakings are to move this from the current WEMA provisions which put it under the auspices of ACCC to Part IIIA of the Trade Practices Act (TPA). This is a very significant shift and will substantially alter the competitive playing field.

AGEA does not believe that the industry has settled into a sustainable post deregulation model and that the access arrangements need to be continued with no decoupling of accreditation and access. These provisions were included in the 2008 Act in order to ensure a competitive market developed and avoid the creation of regional monopolies. AGEA believes that any new arrangements should not cause the industry to inadvertently revert to a position that was not supported at the time of deregulation.

Thus, while the Productivity Commission's approach is generally in line with AGEA principles, AGEA does not believe that the recommended light handed approach to regulating terminal access is what the industry is ready for at this point of time.

AGEA believes that the approach outlined in its original submission to the Productivity Commission is still the appropriate way forward. That is, accreditation be retained until 2012 (the current length of accreditation approvals for all exporters excepting BHCs) which would enable the effectiveness of the ACCC Port Access Undertakings to be assessed while still retaining sufficient sanctions on bulk handling companies (BHC).

AGEA does not support the decoupling of accreditation and port access until the current Undertakings have reached their completion and effectiveness reviewed. At this point of time, a decision could be made to move to a less rigorous approach if appropriate.

This submission deal firstly with the critical issue of port access and related to this, accreditation. AGEA believes that the Productivity Commission recommendations will lead the industry to a structure and industry environment which the 2008 Act was designed to avoid. AGEA believes that the industry needs more than two seasons to allow the market to establish a competitive playing field and that it would be premature to commit to removing access provisions.

The submission also comments on the important and high priority issue of direct access for competing supply chains and the limitations imposed by existing arrangements such as Grain Express. Further, the submission also comments on a range of other issues on which the Productivity Commission has requested more information or made recommendations on.

AGEA is happy to meet with the Productivity Commission to discuss any of its views provided in this submission.

Access to port terminal facilities & exporter accreditation

The Productivity Commission has recommended removal of accreditation of exporters in 2011, a move to a less onerous port access regime and decoupling of accreditation and port access.

While in principle AGEA supports a move to less regulation, AGEA indicated in its original submission that significant issues around port access remain and that the current process had not had sufficient time to demonstrate whether the Undertakings were effective or not. This situation has not changed and experience from the 2009/10 season reinforces that there are still significant issues in relation to fair access.

AGEA does not support the decoupling of exporter accreditation and port access and believes there will be significant adverse impacts on the industry if this occurs.

AGEA agrees with the Productivity Commission finding that export accreditation does not deliver a net benefit in terms of improving security for growers. The major benefit of the accreditation process has been to provide a level of confidence to growers in relation to the capacity and capability of the parties participating in wheat export market to meet their obligations.

However, the link with port access has provided considerable value and exporters and growers with a safeguard against the development of an uncompetitive industry structure.

AGEA believes that the existing legislation requiring those companies seeking accreditation, and with port facilities, to submit access undertakings to the ACCC should be maintained. The move recommended by the Productivity Commission for access to be dealt with under Part IIIA of the TPA has some serious limitations and moving to this level of regulation at this time would have a number of adverse impacts on the industry.

The current access undertakings have a term of two years. The Undertakings need to be allowed to continue for the nominated term i.e. to September 2011 and bulk handling company accreditation beyond this period should be linked to a review of their performance against the undertakings and demonstration of appropriate behaviours.

Current accreditations have recently been renewed for a three year period, with exception of the bulk handling companies where accreditation is to September 2011 in line with access undertakings and AGEA believes that this provides an appropriate date to sunset the WEA arrangements i.e. 2012 rather than the recommended 2011 date. Accreditation for exporters with three year approvals should not be continued past 2012. Accreditation for new entrants should be maintained until 2012 and BHC accreditation should be reviewed in 2011 when ACCC undertakings expire.

Draft recommendations 4.1 – 4.3

This series of recommendations are concerned with the removal of accreditation and thus, decoupling accreditation and port access.

A key concern in relation to the decoupling of accreditation and port access is what mechanism will be in place to ensure that the bulk handling companies provide fair access to the port terminals. The Commission itself acknowledges in Draft Finding 5.2 that “Section 46 of the Trade Practices Act is unlikely to deal adequately with matters relating to port access.” The draft report also makes reference to ACCC reservations about the effectiveness of Section 46 as a mechanism to deliver the outcomes outlined in the 2008 Act.

The Commission’s draft recommendation 5.4 refers to sanctions i.e. “The Australian Government should amend the Wheat Export Marketing Act 2008 (or use another legislative instrument) to ensure port terminal owners and operators face a sanction if they fail to meet the access test requirements from 1 October 2011 to 30 September 2014”, however, there is no definition or clarification in relation to sanctions.

AGEA believes that the link with accreditation is an appropriate sanction and does not support the decoupling of accreditation and port access.

As the existing Undertakings have only been in place since September 2009 and it is yet to be seen whether or not the bulk handling companies will provide fair access, AGEA believes it is premature to remove the incentive for bulk handling companies to behave in a fair manner. It is impossible for AGEA to evaluate the option proposed by the Commission when there is no detail in relation to factors that would require the BHCs to provide fair access.

AGEA believes that it is essential that the two year period for which the Undertakings apply should be allowed to run its course. As the Undertakings were only approved by the ACCC end September 2009, there has not been sufficient time to see how ACCC undertakings will impact and change BHC behaviour. Under provisions of the Undertakings, there are a number of steps for exporters to take prior to initiating an arbitration in the event that there is not agreement and thus, absence of any arbitrations to date is not an appropriate measure of whether behaviour has changed and there is fair access.

Further in relation to a number of the ring fencing issues, whether there have been any breaches will be determined by the ACCC and there is time required for ACCC to gather evidence to determine whether or not an investigation is warranted and then a further time for the investigation to take place. Thus again the absence of any breaches reported by ACCC is not an appropriate indicator that the Undertakings have worked at this early stage.

Thus AGEA believes that Wheat Exports Australia (WEA) should remain in place until end of the 2011/12 marketing season and that accreditation arrangements should be retained. As all exporters (except bulk handling companies) are accredited through to this period, there will be minimal impacts and any successful new applicants would be given accreditation for the same period.

However, AGEA does see that WEA could be reduced as they would only have a minimal activity in relation to accreditation during this period i.e. assessment of any new applications and review of the BHC accreditation post September 2011 in relation to satisfying the Access Undertakings obligations.

AGEA would recommend that the WEA charter be reviewed and modified to reflect its revised role and that the cost of the WEA could be reduced, perhaps leaving funding available for other industry good activities.

The Productivity Commission recommends that if accreditation is retained that this should be under the less interventionist ESCOSA style accreditation. If this approach was to be adopted, there need to greater clarity around the basis for revoking accreditation. This could include such elements as falsifying declarations to customs/AQIS; misrepresenting product (falsifying quality certificates); failure to maintain an access undertaking with ACCC; etc

In summary AGEA's view is that:

- Accreditation and access undertakings should not be decoupled
- Accreditation under WEA remain until 2012 for exporters excepting bulk handling companies, and any new exporters accredited through to 2012
- Accreditation for bulk handling companies be reviewed in September 2011 in relation to the Access Undertakings under ACCC.

In the event that the Access Undertakings have not delivered fair access during this period, Access Undertakings be required to be revised and approved by ACCC before accreditation is renewed

If the Access Undertakings are determined to have been complied with this does not necessarily provide a basis for removal of access undertakings as this may still be the appropriate tool to ensure that fair and equitable access is maintained.

Draft recommendations 5.3 – 5.4

Draft recommendations 5.3 and 5.4 represent a fundamental shift in the playing field for Australian wheat exporters versus the bulk handling companies from that established under the 2008 Wheat Export Marketing Act.

The 2008 Act was designed to create a competitive market for the wheat industry. The Act recognised that to achieve this that there needed to be contestability in service provision if the benefits of deregulation were to be delivered.

The Explanatory Memorandum to the 2008 Act states “The Bill will introduce competition into the bulk wheat export industry. Rather than forcing growers to sell their wheat through a single exporter they will be able to choose from a number of accredited exporters as well as domestic outlets. This will also mean greater contestability in service provision, which will drive down the cost that growers pay for services associated with marketing their grain”.

The option of accreditation of bulk wheat exporters plus an access test was adopted and reflected in the Act because it was recognised that “the objective of reform may be mitigated if bulk handling companies (and potential exporters) deny other potential exporters reasonable access to critical handling and storage infrastructure”. This recognised that without the access test, an exporter having difficulty gaining access to port terminal services would need to apply to the National Competition Council for a declaration that the port terminal facility was essential infrastructure and then rely on Part IIIA of the Trade Practices Act to ensure access by declaration. It was recognised that this approach had significant limitations.

According to the *Wheat Export Marketing Act 2008 Explanatory Memorandum*, the access test was intended to ensure that accredited wheat exporters that own, operate or control port terminal facilities provide “*fair and transparent access to their facilities to other accredited exporters*”. This aims to avoid regional monopolies unfairly controlling infrastructure necessary to export wheat in bulk quantities, to the detriment of other accredited exporters.

Bulk handling companies are monopoly providers of port terminal services within geographical areas, with exception of Melbourne Port Terminal. There is either very limited, or no, alternative providers of port terminal services within a distance that make them commercially viable competitors. Access to port terminal services is essential to export bulk wheat from Australia. Australian wheat exporters have no option but to use BHC services where they wish to export wheat from BHC terminals. There is limited ability to physically move wheat from one port to another owned by another terminal service provider. The cost of interstate movement of grain is prohibitive.

Minister Burke in his 2nd reading speech said that “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”.

The Commission’s recommendations, and the inflexibility of practices by the BHCs such as the CBH auction system, are likely to see a number of these concerns being realised and the industry slip back to a model that is not acceptable to the Government and industry.

Shifting from the access test under the WEMA to under Part IIIA of the Trade Practices Act provides for a port terminal operator to use for its own purposes that capacity that is “a existing or reasonably foreseeable use of the facility” before needing to accommodate others. This effectively shifts the access test from applying to total capacity of the port terminal to spare capacity. This is reflected in the Commission’s comments “.... access negotiations should relate only to spare or excess capacity”.

This is a fundamental shift in the competitive playing field and will be to the detriment of Australian wheat exporters and consequently Australian wheat growers. There is a real risk that the export wheat industry may result in a scenario where control is with three regional monopolies. The port access regime must apply to total capacity, not spare or excess capacity.

At the time of deregulation all exporters were new entrants (excepting AWB) and thus, no player had any established market share. Thus, none of the BHCs had established their own existing use in relation to wheat, but there have now been two marketing seasons post deregulation which has allowed players to establish a market presence and this will be further established by 2014. The BHCs could claim that its current and foreseeable use for wheat and other grains is significant and consequently substantially lessen the capacity available to other exporters.

It should also be noted that the two marketing years under deregulated have been very different in terms of both the international market environment and the Australian supply scenario. The port access arrangements have also constrained the ability of some parties to participate, or participate as fully, as they would like in the bulk wheat market. Thus, AGEA believes that it would be premature to utilise the data from this period as a basis for establishing future demand for port capacity.

The objective of the current access provisions are to ensure that Australian wheat growers have access to real competition that is provided on a level playing field and to reduce the overall cost of the supply chain in order to maintain and improve competitiveness of the Australian wheat industry.

Shifting the access test to 'spare or excess capacity' will allow the bulk handling companies to control the supply of capacity available to exporters other than their trading arm with the inevitable consequence of increasing the price of capacity.

Furthermore, the ability for bulk handling companies to reserve capacity for their own use impacts on the relative terms and conditions on which the port terminal services are provided. It is our understanding that there is no obligation for the port terminal operator to offer third parties access on terms equivalent to those offered to their own trading arms. Rather the Act simply refers to terms and conditions needing to be 'commercial', with little clarity around what this means.

This could result in terms offered to BHC trading arms being more favourable than those offered to third parties and/or may result in terms being based on benchmarks (e.g. unrealistic rates of returns) that are not seen as commercial by other industry operators.

The 2008 Act recognised the specific nature of the wheat industry and that the objectives sought would not be achieved via the TPA. This conclusion is also reached by the Productivity Commission and appears to contradict their draft recommendations. AGEA believes that any changes to the WEMA should not move the industry to a scenario that was not acceptable at the time of deregulation in 2008.

In summary AGEA believes it is critical that:

- There is fair and transparent access to port terminal facilities is available to all Australian wheat exporters
- Access undertakings for bulk handling companies is maintained

- The Productivity Commission specify the mechanism/sanctions that would apply under their recommended model, and if unable to identify mechanisms that provide the same or improved impact as revoking accreditation, then this should be maintained
- The port access regime must apply to total capacity, not spare or excess capacity

Draft recommendations 5.1

This recommendation suggests that changes to the undertakings of the bulk handlers should be kept to a minimum between now and 2014. AGEA disagrees with this recommendation. There are still some major limitations with the current undertakings such as the option for direct access and where there are elements like this that have a considerable industry-wide benefit, they should be changed as soon as possible regardless of whether it is a major or minor change.

There has been little evidence of improvements in supply chain or port efficiencies. The system needs to be such that it provides incentives for the bulk handling companies to increase efficiencies. The current situation and requirements under the access undertakings provide little incentive to maximise supply chain efficiencies as exporters are taking all the risk and paying for services even where they are not used.

Furthermore, grain markets are dynamic and customer requirements and shipping schedules can readily change. Thus, it is essential that there is flexibility in all aspects of the supply chain, and that exporters are not locked into a set of rules that do not deliver the ability for exporters to be competitive in global markets.

It is, therefore, critical that where changes can be made within the existing undertakings to improve efficiencies that these are enforced.

Draft recommendations 5.2

Draft recommendation 5.2 is that the Government should proceed with the scheduled independent review of the National Access Regime. Again it would appear premature to remove the port access requirements ahead of this review.

CBH auction system

Request for information - page XL

The Commission is seeking further comment on the CBH auction system and its effectiveness in delivering an efficient and effective means of allocating port capacity. The Commission is also seeking feedback on the requirement to give early notice in regard to use of Grain Express or direct access.

AGEA in its initial submission indicated its strong views that the CBH auction proposal fell short of the objective above. AGEA indicated at this time that it believed the proposed CBH auction process would be labour intensive, time consuming and complicated and do nothing to ensure fair and transparent access to vessel slots. The operation of the system for the 2009/10 season has confirmed these views and the auction system has not delivered a viable or effective mechanism for allocation of capacity.

It is understood that there is in order of \$62 million in the CBH auction premium fund. (This is another incidence to lack of transparency where those paying the fees do not have access to this information). While the intent is that this be distributed back on basis of tonnage shipped through the CBH system (it is understood that those who forfeit shipping slots do not share in the return of the auction premium), this is a significant cost impost on the industry and may inhibit the ability for smaller players to participate in the market. Furthermore, it is also inequitable as those who paid the higher premium do not get this back and may result in cross-subsidisation to those participants who shipped the largest tonnage.

In effect, the current arrangements in WA effectively allow CBH to operate a 'risk free' logistics operation, with fixed costs, variable costs and margins covered and prepaid via the auction system. This is unsustainable and unacceptable.

Key issues include:

- The requirement to declare Grain Express or direct access restricts development of alternative supply chains and limits the ability of a secondary market to operate effectively
- The effectiveness of the secondary market is also impacted by the unjustified (in the AGEA's view) capacity transfer fee that CBH applies each time a slot is traded on the secondary market. This charge is tonnage based and therefore not reflective of the cost of providing the service. A flat fee would be more appropriate, if in fact, there is any justification for this charge
- The inability to allow capacity to be moved to other periods where there is spare capacity. AGEA noted in its supplementary submission that this was in contrast to international best practice where shipping slots can typically be rolled forward and/or swapped thus, reducing risk and losses for exporters. This lack of flexibility in relation to transfer of slots is a major impediment to the efficient operation of a secondary market; and the industry is being made to pay for CBH inefficiency

- The charging regime where exporters are effectively paying up front in full for a service that may not be delivered and in advance of when the exporter may know whether or not the service is needed. This fee is in the order of \$25 per tonne covering the marketer fee, auction premium and full fob fee. CBH requires exporters pay in full the export fobbing charge for "lost capacity" i.e. unshipped fobbing slots.

In effect, the exporters pay up front, via the auction premium, for a service that may or may not be used and effectively underwrite the CBH business by either:

- using the capacity and paying the full \$17.10 per tonne fobbing fees; or
- forfeiting the capacity and paying the full \$17.10 per tonne fobbing fees i.e. the lost capacity charge.

This is not a typical practice in most commercial markets.

Thus, in summary and in answer to the Commission's questions:

- *The auction system has not been effective in managing infrastructure allocation due to the CBH business rules*

As indicated in the AGEA original submission, it does not believe that there is a capacity constraint, rather the constraint is related to the CBH supply chain. Removing Grain Express would provide transparency as to where constraints in the system really occur.

- *The auction system has not delivered benefits to exporters, growers or the wheat industry*

It can be argued that the auction has distorted market signals (due to the fixed carry and FOB fee at port which reduces transparency and camouflages price signals to the growers), reduced competition and increased costs for the supply chain which will flow through to lower prices for growers.

The first quarter (of the marketing year) showed a high level of matching of capacity acquired and capacity shipped. (This should not be construed as a sign of a capacity constraint as the capacity available was dictated by what CBH chose to offer and this did not reflect the capacity available as demonstrated by the previous year's shipping program.) However, for the second quarter it is estimated that there is still a significant proportion of acquired capacity still to be shipped. At an estimated 400,000 tonnes still to be shipped, this is a potential cost to exporters of around \$10 million. It is further estimated that there is significant capacity acquired by exporters in the auction process that is yet to be shipped in the third and fourth quarters. It is likely given international market conditions that a proportion of this capacity will remain unused emerge as the season progresses. The losses to the export sector will be substantial.

While exporters have incurred considerable cost through the issues outlined above, growers have also been adversely impacted. If exporters have shipping slots purchased that they are unable to fill and without an effective secondary market, one response will be to discount sales in order to fill the slot as a preferred option to forfeiting the full cost of the shipping slot.

The system operating WA will potentially transfer risk to the farmer through removing liquidity in the market and encouraging greater use of marketing tools such as pools.

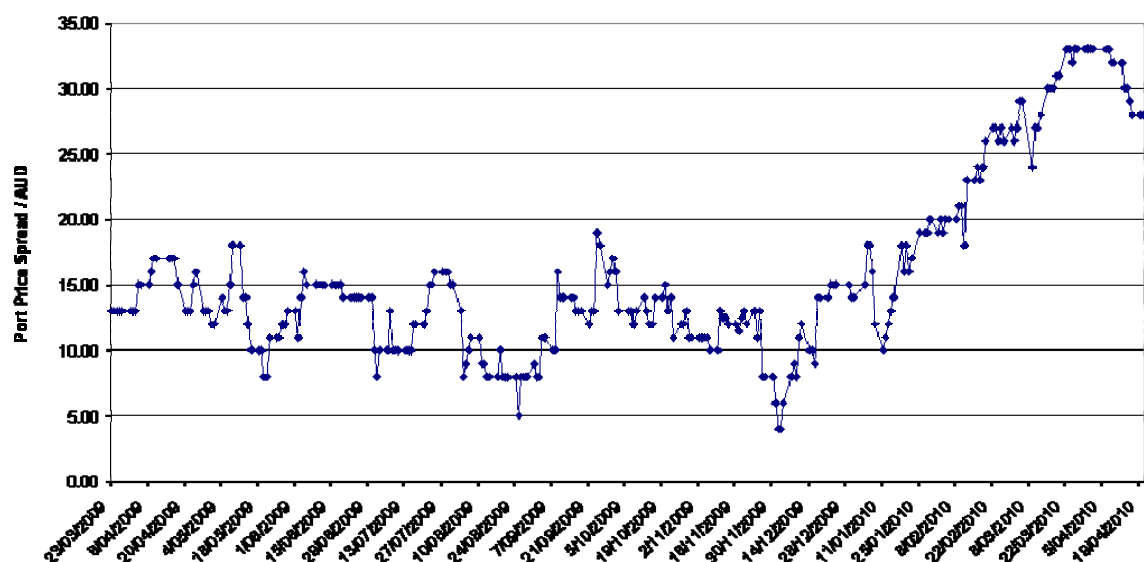
- *The auction system has created problems for exporters and the Australian wheat industry*

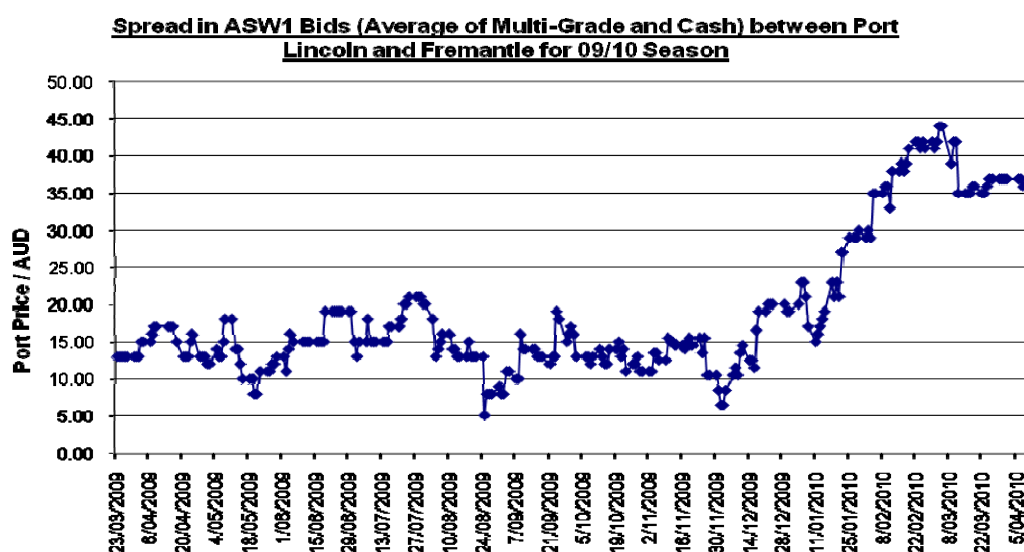
For example, analysis of the spread between Fremantle and Port Lincoln ASW and APW prices illustrates the impact of the auction system that has artificially created a market distortion. The graphs below show that between February 2009 and 30th November 2009, spreads traded in a range of AUD5-20.00 per tonne with the average being approximately AUD12.00 per tonne. At AUD12.00 per tonne it is merely a reflection of the execution difference (fobbing and freight) between WA and SA. In other words, the market was trading the estimated cost of execution between the two states as the grain market is efficient.

On the 23rd October the first official WA auction occurred in which the trade bid for 15 day shipping slots up to 12 months in advance for sales they did not necessarily have. From the 30th November 2009 (one week after the auction) the spread went from a low of AUD6.00 per tonne to near AUD45.00 per tonne on ASW and AUD33.00 per tonne on APW. There were adequate supplies in both states, there were no quality issues and no barriers to shipping out of SA and thus, the market should have been pricing grain in line with the most cost effective pathway to the global market.

The conclusion drawn, therefore, is that the spread is being caused by an 'artificial' factor such as the auction system and risk of losing the non refundable fees (approximately AUD25.00 per tonne) associated with this.

Spread in APW1/APW2 Bids (Average of Multi-Grade and Cash) between Port Lincoln and Fremantle for 09/10 Season





- *The auction system is not a model that AGEA would like to see adopted by other bulk handlers*
- *There has not been an effective secondary market under the CBH system, or under any of the models*

The inability to move slots and the requirement to deliver against the Grain Express or Direct Access nomination limits the effectiveness of the secondary market. In AGEA's view the primary market has not been effective evidenced by the number of auctions where there have not been any bids, much less the secondary market.

For example, in the first auction where 70% of 'core' capacity was offered, not all of this was sold. The last three auctions have had very limited activity indicating soft demand as shippers are aware that the market is long slots that have no option other than to sell at a discount. Given the inflexibility of the system, exporters have identified that the risk versus reward is not providing an incentive to participate in the market.

- In case of CBH, the secondary market has not operated effectively because of the rules of the auction system e.g. the fact that the traded capacity must retain the supply chain option originally nominated. In case of GrainCorp and Viterro, there is not provision for a secondary market although, in some instances, there has been more operational flexibility
- The first come, first served model used by other bulk handlers has had some issues but have, in general, had less impact on exporters. This model could work if there was equal access for direct access supply chains and the ability to swap or roll forward slots

In relation to the requirement to give early notice in regard to use of Grain Express or direct access (and subject to preceding comments on the auction system), AGEA recommends that this should be changed to nomination of Grain Express/Direct Access 22 days prior to ship nomination.

There are significant impediments to use of alternative supply chains to Grain Express due to the CBH charges and nomination period (refer to section below regarding charges).

Grain express

Request for information - page XLI

The Commission is seeking further information in regard to the efficiency of Grain Express, the degree of contestability and impediments to other supply chains developing.

AGEA has previously commented that Grain Express has had a significant adverse impact on the efficiency and cost of the wheat industry supply chain in WA. The major issues relate to the lack of flexibility and lack of transparency. There is no ability to measure the efficiency and cost effectiveness of the services provided and no visibility on the individual cost components. There is no flexibility to organise alternative arrangements in the event of non delivery.

Exporters are essentially forced to use Grain Express as the terms of auction process requires exporters to nominate within five days whether or not they are using Grain Express or direct access.

The CBH charging structure also acts as a significant impediment to direct access. Under the current CBH charges using Grain Express incurs a total cost of \$27.10 per tonne comprising the receival fee of \$10.00 per tonne and export outturn charge of \$17.10 per tonne.

Direct Access incurs the same cost if drawn from a totally separate supply chain, however, if exporters need to draw supplies from CBH storage sites to 'top up' or complement their direct purchases, then the total cost increases to \$35.60 per tonne comprising the receival fee of \$10.00 per tonne domestic outturn fee of \$8.50 per tonne and export outturn charge of \$17.10 per tonne.

In effect, exporters are forced to use Grain Express as they cannot afford the risk of having to 'top up' direct supplies from the CBH system.

(The impediment to direct access does not apply only to WA. For example, in SA only grain from approved storages can be delivered to Port. Approved storages are defined as GTA approved storage and handling operators. The Access Undertakings state that direct access cannot be reasonably denied if drawn from a system utilising an industry accepted hygiene system. If an exporter has a quality assured supply chain that is not GTA approved, this can be refused access at the port and will, therefore, be treated as a grower receival and incur the receival fees associated with this.)

AGEA believes that Grain Express is clearly anticompetitive and concentrates interior freight negotiations solely with CBH. AGEA believes that this will lead to lower prices to growers in the longer term as it will reduce competition in road and rail services. While Grain Express is allowed to operate, it will greatly restrict the ability of any party to build any competing infrastructure or transport capability.

AGEA provided initial support to CBH for Grain Express when it was proposed in 2008 in good faith and in an effort to ensure a smooth transition to a deregulated market. This support was given on the basis of commitments by CBH that by giving them control of the supply chain, they would take on responsibility for performance against the service outcomes identified and would be accountable for non performance.

These commitments have not been delivered on and in effect, the reverse has occurred where if there is a cost saving CBH keeps this and if there are additional costs, these are passed on to exporter. CBH is not accepting any responsibility or accountability in provision of services.

AGEA would not give support for Grain Express today and strongly recommends that the ACCC acts to remove the Exclusive Dealing Notification (N93439) lodged by CBH enabling Grain Express to operate.

AGEA believes that to enable supply chain efficiencies and reduced costs to be achieved, that it is critical there is the flexibility to draw grain from CBH and/or private storages and move the grain to port in the most cost effective manner. There must be transparency and exporter control over costs and movement of grain.

The lack of a non-discriminatory pathway and opportunity for wheat from private third party upcountry facilities to be delivered into the port terminal facilities controlled by BHCs, is preventing alternative transport and storage arrangements from being developed and stifling innovation in development of specialty supply chains.

Other findings/recommendations

Draft finding 6.1

This finding indicates that up-country storage facilities do not exhibit natural monopoly characteristics and that there is no case to consider changing arrangements regarding third party access to up-country storage facilities.

This may be true if the market was not distorted by the arrangements such as Grain Express and Export Select in place regarding movement of grain from upcountry to terminal. These arrangements are promoting monopoly style features. As outlined above the charging practices and rules around terminal access are effectively impeding the development of alternative supply chains including investments in up-country storage and transport infrastructure.

Any future investment in up-country activities will be significantly influenced by the continuation of restrictive practices in movement of grain to terminal, port terminal protocols and bulk handling company charging practices.

Draft finding 3.1

The Commission is seeking further information in relation to pools.

AGEA agrees that there is an opportunity to provide greater transparency in relation to pools, in particular, to improve the information to growers and other pool participants. Pool operators should strive to improve transparency and to encourage clear disclosure with regard to prices including the basis of pricing, what is included, what is excluded and what charges apply.

Aspects that would assist to improve transparency in pools include:

- publishing all fees and charges associated with any products or services in a transparent and clear manner
- posting pool estimates net of management and administration fees and/or net of estimated finance and compulsory underwriting costs
- regularly updating changes to estimated returns by posting updates at regular intervals
- having in place the necessary skills, payment systems, risk systems/procedures and resources in place to effectively manage pools

Further investigation may be required to establish the appropriate level of oversight required in relation to pools. A mechanism to deliver this oversight currently exists via ASIC if it is deemed that more formal oversight is required.

Quality – comments top page XXXIX of the draft report

In a competitive market, Australian wheat quality standards will be maintained through competition to export grain which will force exporters to meet, or exceed, the standards that overseas buyers require to maintain market share; and through developing new, often niche, markets that will lead to increased differentiation. However, there will always be buyers who prepared to pay less for lower quality grain and it is important that the industry's self-managed system ensures the 'brands' associated with specific qualities and standards of wheat are maintained. In a competitive market, buyers of Australian wheat can, and will, determine the supplier who best meets their demands for quality, supply and value; and will regard those suppliers more favourably than others who supply an inferior product or service.

While there has been significant profile given to quality issues in container shipments, these have generally been isolated and are likely to be sorted out by the market.

However, AGEA recognises that there are a range of issues that need to be addressed in order to maintain and protect the integrity of the Australia's reputation as a supplier of quality wheat to a wide spectrum of markets and believes that the industry needs to work to develop a self-regulatory approach to address quality integrity and to provide exporters with certainty around outturn of grain.

There are some specific issues within the supply chain that AGEA believe need to be addressed to allow quality to be better managed in a deregulated market:

- access to bulk handling facilities by exporter's nominated Superintendent Company to carry out services associated with quality and quantity determination which are fundamental to successful trade; and can be necessary to comply with contracts that are standard in international trade. This is standard custom and practice throughout the world. These companies require access to those parts of the bulk handling facilities where samples need to be taken, such as belt loaders, warehouses or silos and to where weight determinations are made
- ability to have exporters' (receiver/owner/vessel) shipping agent appointed and not be forced to use bulk handlers (shippers) agent
- greater integrity in management of quality from farm to port including guaranteed outturn against quality specifications and/or the ability for exporters to access stock of equivalent quality purchased. As the industry transitions to a fully competitive environment, the industry's quality management activities will evolve to requirements of the market and the industry

As indicated in AGEA's original submission we see that it is important that the industry maintains and enhances the key tools of quality i.e.

- Classification i.e. the process for translating market signals into targets and categories that enable the development and production of wheat varieties that meet customer requirements
- Quality standards which are an important tool for communicating with buyers

- Monitoring i.e. there may be benefit for the industry in random sampling/checks of exported grain to provide information in relation to conformance with grades shipped. This could be 'soft' monitoring e.g. technical reports or 'hard' monitoring e.g. testing of grain shipments

Draft finding 8.1

Wheat classification has played an important role in translating market signals into wheat breeding and classification targets to enable the facilitation of the ongoing development and production of wheat varieties that meet the requirements of key markets.

Classification of wheat varieties should continue as an important component to underpinning the quality of the Australian wheat crop. There also needs to be a process in place to capture market signals and communicate these to breeders and growers.

AGEA believes that capacity exists within the existing industry structures to provide the administration and coordination of these activities without the need for a new body. AGEA believes that Grain Trade Australia could take on the management / administration of the wheat classification process, with supporting funding from parties such as GRDC in relation to the technical support that the activity requires.

Draft recommendation 7.1

AGEA believes that availability of, and access to, information on stocks is important for the industry. Information should cover all major grains. It is important for the Government as well as industry to have access to stocks information. The Government should continue to require reporting on stocks and this should be delivered through an independent agency such as ABS or ABARE. AGEA sees that this could become a function of a smaller and refocused WEA.