GrainCorp

15 February 2012

Ms Jeanette Radcliffe
Committee Secretary
Senate Rural Affairs & Transport References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: rat.sen@aph.gov.au

Dear Ms Radcliffe,

Inquiry into operational issues in export grain networks

Thank you for the invitation to provide a further short submission to the Inquiry.

GrainCorp, based on its experiences since our earlier submission to the Inquiry of 12 May 2011, would like to provide the following information to update on the operation of the grain chain and emerging developments.

1. ACCC acknowledgement of competitive environment and ample port capacity

Since tendering our original submission, the ACCC has accepted GrainCorp's second Access Undertaking in relation to access to its ports. A number of elements of the ACCC's June 2011 determination should be highlighted.

In particular, the ACCC's determination acknowledged the competitive environment in which GrainCorp's ports operate:

> *The ACCC notes in particular that port terminal capacity is relatively unconstrained on the east coast and that the export of bulk wheat through GrainCorp's port terminals are subject to a number of competitive pressures, including from domestic users, up-country supply chains, from other ports and the threat of customers by-passing GrainCorp facilities. (ACCC Determination 2011, p. 8)*

The determination also highlighted that it is in GrainCorp's commercial interest to provide access to grain exporters at our ports:

> *In regard to the incentive for self preferential treatment, GrainCorp faces a level of competition to its port terminal services that is significant and that is greater than competition to the port terminal services provided in South Australia and Western Australia.*
>
> *In reaching its decision on the 2011 Undertaking, the ACCC recognised that GrainCorp has a degree of market power in relation to its control of its port facilities and an incentive to advantage its activities, and those of its Trading Division, upstream and downstream of the port. However, the ACCC considered that countervailing competitive constraints arise from a number of factors including:*
>
> - *competition in the east coast for up-country supply chain services*
> - *a significant level of competition in the east coast between wheat supplied into the domestic market and export wheat*
> - *some weak competition between port terminals located in sections of the east coast (New South Wales, Victoria and the easternmost parts of South Australia); these competitive pressures are less evident in Queensland, particularly for GrainCorp's facilities at Mackay*
> - *competition from containerised wheat exports*
> - *competition from access seekers prepared to bypass port terminals on the east coast.*
>
> *In summary, the ACCC considered that, while GrainCorp's ports are subject to capacity constraints at peak periods, port capacity on the east coast is adequate overall to meet the demands on it and is less constrained than in other wheat export regions. Further, the vertically integrated monopolist's incentive for self preferential treatment is moderated by countervailing competitive pressures in the case of GrainCorp. (ACCC Determination 2011, p 25)*

GrainCorp has approximately 15 million tonnes of port capacity and last year the company exported 8.1 million tonnes of grain. There is clearly substantial incentive for us to provide access to our port infrastructure, to fill the spare capacity and ensure our assets are being efficiently utilised.

As outlined in our previous submission, the constraint in the export grain supply chain is not port capacity, but available transport capacity. Transport capacity issues are driven by:

- Ongoing underinvestment in rail track, in particular the rural branch line network, limiting operating speeds and payload on certain lines, increasing cycle times and reducing overall operating efficiency.
- Competition for capacity with other commodities – particularly coal – on already congested rail lines.

- Underinvestment by some market players in capacity in a constrained environment. Access to transport capacity is primarily determined by the willingness of a participant to commit to contracts with transport providers – this reduces the risks of purchasing limited available capacity on a spot basis.

Such limitations substantially reduce flexibility of the supply chain network and its ability to respond to changing customer demand.

2. Experience of 2011-12 harvest

The 2011-12 east coast winter crop was smaller than that of the previous year, but still of a substantial size, with GrainCorp to date receiving 10.9 million tonnes of an estimated total crop size of 18 million tonnes. In anticipation of a large crop, coupled with the carry-over from last year's large harvest, GrainCorp invested approximately $13 million into site improvements to facilitate efficient delivery. This included:

- Approximately 1 million tonnes of new bunker storage;
- Road improvements around sites;
- Weighbridge upgrades;
- Improved out-turn onto highways;
- Improvements to general site amenities, including sample stands.

Better weather conditions during the east coast harvest period – which was complete prior to the February flooding in northern NSW and Queensland – also meant the harvest was less logistically complex to process, requiring fewer off grade segregations at storage sites than last year.

Notwithstanding the largest carry-over in company history (6 million tonnes), overall GrainCorp's storage and logistics business handled the delivery of this year's harvest (and an out-turn of approximately 2 million tonnes of grain during the harvest period) smoothly. No significant operational issues were reported, although there were some delays to delivery in areas of Victoria and central NSW caused by complexities stemming from increased local segregations following rainfall.

Over the twelve months to the end of September 2011, GrainCorp exported 8.1 million tonnes of grain, significantly higher than the previous year's total of 3.5 million tonnes exported. We expect to export in excess of that volume this 2011-2012 season, with year-to-date port elevations at 3 million tonnes.

3. Allocation of port terminal capacity

GrainCorp has maintained its 'first in, first served' approach in the allocation of port capacity. We strongly believe this approach is more efficient than an auction system used in WA and to be used in SA. The auction system, particularly with bid premiums being pooled and rebated to customers, drives speculation and gaming that in turn distorts the grain market. This was demonstrated in the recent WA auction for port capacity where bid premiums reached an irrational $100 per tonne and bidders (including ourselves) withdrew with capacity not allocated.

Our shipping stem and the allocation of capacity to customers, using the 'first in, first served' approach has functioned smoothly through the year with no stem-related customer disputes recorded.

There was a significant peak of nominations when the stem opened in July 2011, largely caused by the delay to the stem's opening, as the Port Access Undertaking was not agreed with the ACCC until late June 2011.

Notwithstanding the high level of demand immediately after the stem opened, GrainCorp's system was able to process nominations in the order in which they were received.

It is GrainCorp's preference to open the shipping stem at an earlier date to provide customers more time to plan their exporting requirements. GrainCorp is currently exploring the possibility of bringing forward the opening of our shipping stem to provide our customers with further access certainty and the opportunity to forward plan their export program.

4. Non uniform application of port regulation could undermine Australia's competitiveness

To our knowledge, bulk grain terminals in Australia are the only bulk commodity terminals that are regulated in Australia and the only grain terminals that are regulated in the world. This creates an uneven playing field for GrainCorp, which has made a significant investment in our port assets, both locally and internationally.

In the previous season we estimate that 2.5 million tonnes of wheat was exported by alternative export channels from eastern Australia. Most of these alternative export channels are not subject to regulation, namely:

a) Two new bulk grain terminals: Wilmar and Gavilon acquired an export terminal in Brisbane and Louis Dreyfus constructed an export terminal in Newcastle. Both Gavilon and Louis Dreyfus are large multinational grain companies. We understand these terminals are not regulated given the structure of their ownership.

b) Containers: The export of wheat (and other grains) in containers continues to grow, with eastern Australia now serviced by over 50 grain packers.

It should also be noted that often, the customers using GrainCorp's port terminals can also be our competitors, selling grain from North America and South America to our overseas customers in Asia and North Africa / Middle East from their export terminals in these countries. As noted earlier, these overseas terminals do not have the regulatory constraints that are in force in Australia.

The disparity in regulation in the international grain market will increase next year with the deregulation of wheat (and barley) export from Canada in August 2012. The Canadian Government decided that regulation of port terminals was not required, as it would undermine the incentive for innovation and investment. Any potential competition issues (if they arose) could be adequately managed under current Canadian competition law:

> *The prices of Canadian grains and oilseeds are set by world market supply and demand conditions. The CWB is a small part of world wheat and barley markets and has little influence on global prices. Open markets attract investment, encourage innovation and create value-added processing (Agriculture and Agri-food Canada, http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1311891454058&lang=eng#a10)*
>
> *As recommended by the Working Group, our Government will give market forces every opportunity to work. Contractual arrangements between terminal operators and non-terminal companies are working successfully for other crops. Facility owners are expected to actively seek arrangements for additional grain volume and profitability.*
>
> *The Government is considering a range of options, including working with the value chain to monitor any anti-competitive behaviour or systematic issues, should they arise. The grain value chain also has access to long-standing tools, including the Competition Act and the Competition Bureau, to address anti-competitive behaviour. (Agriculture and Agri-food Canada, http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1323989251887&lang=eng)*

The Productivity Commission in its 2010 Report also noted this asymmetrical regulation and made the following comment on how this could unfairly advantage multi-national grain exporters at the expense of Australian bulk handlers:

> *The Commission notes that it is not necessarily inappropriate for the bulk handling companies to be operating with some level of competitive advantage. The bulk handling companies follow a business model that facilitates the achievement of certain synergies and efficiencies between their marketing and their operating arms. Sharing information might be necessary in order for the bulk handling companies to capitalise on theses efficiencies, and therefore obtain a return on their investment in the supply chain.*
>
> *Indeed, international grain handling companies have adopted a similar business model and are able to benefit from information sharing ...the Commission has not heard any evidence of adverse competition impacts arising from the 'information asymmetry advantage' these companies have. (PC pp. 239-240)*

5. Limitations of port regulation are emerging

GrainCorp supports the Productivity Commission's view expressed in its 2010 Report that maintaining the current transitional arrangements will lead to sub-optimal outcomes:

> *…the Commission is not attracted to heavy handed regulation for port terminals, particularly because of the potentially heavy costs involved. If infrastructure owners and operators are not adequately protected they will have a diminished incentive to invest in facilities. Therefore, to ensure infrastructure is adequately provided and maintained, the Commission considers it is better to err on the side of*

infrastructure owners/operators. *(PC p 203)*

The current regulatory framework not only imposes compliance costs, it constrains our ability to develop a competitive grain supply chain to compete in the international grain market, as it:

- Limits our ability to operate our facilities and provide value add services to improve the efficiency and effectiveness of the grain supply chain for both growers and overseas customers;
- Limits our ability to offer differentiated and tailored services and the pricing of our port services;
- Reduces our incentive to invest in our port terminals to improve its capacity and provide new services to our customers through long terms arrangements.

The following illustrations demonstrate some of the limitations emerging from port regulation.

a) Poorer service to overseas customers

The increase in global demand for grain creates an unparalleled opportunity for Australian grain growers. We are forecasting that the trade in wheat will double by 2050 and Australia, given its quality wheats and location, is well positioned to participate in this growth.

However it is concerning to note that many consumers in South-east Asia and North Africa / Middle East have issues with wheat from Australia and are increasingly turning to Canadian and US-origin wheat. This view was reinforced by comments made in the recent Grain Grower's Report, *"What the world wants from Australian wheat"* (April 2011) regarding variable wheat quality, delays and lack of support from Australia.

We believe a reduced level of service and support for export wheat is partly due to the 'one size fits all' approach of port regulation that reduces our ability to flexibly manage our port terminals and to differentiate our product offering to meet the requirements of our overseas consumers. This impacts Australia's reputation as a quality and reliable supplier of wheat.

b) Northern NSW floods

The grain supply chain is very complex as its deals with organic product, with variable supply and quality, from a large number of locations. To optimise the supply chain, a commercial and flexible approach is required. However, under port regulation it is not possible to prescribe operational solutions to allow us to efficiently manage this complexity in a flexible and commercial manner.

The recent floods in Northern NSW continue to cause transport disruption and constrain our ability to accumulate grain at our Newcastle port for our customers. These issues have been caused by rail lines being damaged by wash-aways between Moree and Narrabri and Walgett and Narrabri.

To reduce disruption, GrainCorp has had to move beyond the parameters of the port protocols to temporarily increase capacity at other ports to handle affected ships from Newcastle. While the ACCC was cooperative in this process, we are limited in our ability to best manage our infrastructure to address this situation. Further, we continue to be exposed to the risk of legal action or regulatory scrutiny given the restrictive parameters of port regulation, as the ACCC is unable to provide GrainCorp with complete assurance they would not pursue remedies for any breach in these circumstances, despite our efforts veing aimed at providing port access to customers in time of an emergency.

c) Increased grain supply chain costs

The constraint of port flexibility by current regulation has led to inefficient behaviour that in turn has increased costs. In addition to direct and indirect compliance costs of around $1 million a year, we estimate that supply chain costs have increased by over $10 million a year from increased use of road transport, as customers seek greater delivery flexibility.

The current regulation does not allow long term planning and investment decisions to reduce supply chain costs, as demonstrated by correspondence from one our export customers:

> *We would like to see the stem opened for bookings for 3 - 5 years in advance so our business has the certainty to make medium to long term business decisions knowing that we have some certainty….. The present one year system limits our ability to plan both our long term marketing and logistics strategy.*

d) Ships failing survey

A related supply chain issue that increases costs is the relatively high incidence of ships failing survey. Under the current port regulation, customers do not have a liability to other customers adversely affected by survey failure, and GrainCorp only has limited ability to manage the adverse consequences.

As an illustration, in the period 1 October 2011 to 31 January 2012, 14% of vessels at port failed survey due to the condition of their cargo hold or residue remaining from previous cargoes. The failure of a vessel at survey can delay loading and disrupt following vessels on the stem. It also impacts the up-country supply chain, with other customers not being able transport grain to the port. These costs can be considerable to GrainCorp and other customers in terms of vessel demurrage and take-or-pay rail transport capacity not being used.

To minimise some of these impacts in the interim, GrainCorp supports the recommendation of the Federal Export Certification Reform process, which will enable AQIS Authorised Officers to undertake inspections of grain ships while they are at anchor and prior to them reaching the berth.

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6. Proposed deregulation of ports

On 23 September 2011 the Government announced its response to the recommendations made by the Productivity Commission, following the inquiry into Wheat Export Marketing Arrangements.

GrainCorp supports the Government's decision to reduce the regulation of port access.

As an organisation, GrainCorp is working constructively with stakeholders on the development of a voluntary code to replace the Access Undertaking and transition to the deregulation of port terminals.

The Government's decision will also ensure port access for the export of bulk wheat continues to be governed by general competition law and brought into line with the level of compliance that applies to other non-agriculture and agricultural commodities.

We believe this decision will benefit all participants in the Australian grain chain by enhancing the competitiveness of Australian wheat exports.

We are grateful for the opportunity to provide this update on our original submission. Should you require further information on any of the matters raised, please contact GrainCorp's Director of Government and Communication Mr Angus Trigg on (02) 9325 9132.

Yours sincerely,

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