Victorian Farmers Federation
Grains Group

Submission to the Senate Rural and Regional Affairs and Transport References Committee

Inquiry into Australian grain networks

August 2014

Table of Contents

VFF Grains Group

The Victorian Farmers Federation (VFF) Grains Group would like to thank the Senate Rural and Regional Affairs and Transport References Committee for the opportunity to provide a submission to the inquiry into Australian grain networks.

The VFF is one of the largest state farmer organisations in Australia, representing over 10,000 members who live and work on more than 6,000 farm businesses across Victoria. The VFF Grains Commodity Group, through its elected Council, has the responsibility and autonomy to determine VFF policy regarding grains industry issues. The VFF Grains Group works actively with all market participants from across the supply chain, including farm input providers, research and development organisations, government departments, bulk handlers, traders, and exporters.

The VFF supports the call for an open, transparent and "efficient grain supply chain from farm-gate to port."

Recommendations

1. The Federal Government should match the Victorian Government's funding to standardise rail lines.
2. Regulated contestability in port access, in the form of a Mandatory Code of Conduct, should continue until objective measurement confirms the establishment of a competitive landscape for farmers' grain.
3. ACCC access provisions, as envisioned by the farming organisations, should be extended to up-country silos.
4. Stocks information should be made available weekly, by grade and by up-country silo, to facilitate pricing which occurs by grade and silo location on an intra-day basis.
5. The Federal Government should facilitate national harmonisation of a Victorian state-based legislation addressing grain trade licences, if such legislation is introduced in Victoria.

Overview

The VFF considers functioning, effective markets to be the key factor underpinning an efficient grain supply chain, both in principle and in practice. To this end, the VFF identifies a number of existing sources of market failure that are currently preventing the efficient operation of the Australian grain supply chain. These are, namely, market power, information asymmetry, issues in grain quality, and industry or public goods. The VFF has outlined its views on these issues in previous submissions to the Rural and Regional Affairs and Transport References Committee of the Australian Senate[1] and the Wheat Industry Advisory Taskforce.[2] The VFF identifies the first two sources of market failure, market power and information asymmetry, as of particular relevance to this inquiry,

[1] The VFF's submission to the Inquiry into the ownership arrangements of grain handling, dated 17 June 2013, can be found here: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Grain_Handling/Submissions [Accessed 4 August, 2014].

[2] The VFF's submissions to the Wheat Industry Advisory Taskforce's various inquiries can be found here: http://www.wheattaskforce.gov.au/Pages/submissions.aspx [Accessed 4 August, 2014]. The submission to the inquiry into stocks information, dated 9 August 2013, is of most relevance to the current inquiry.

directly addressing articles (c) and (d) in the terms of reference (attached in Appendix A). Market power and information asymmetry are addressed respectively in Parts 2 and 3 of this submission.

Additionally, the VFF also considers two further issues to be of relevance to this inquiry. The inefficiency of the Victorian grain supply chain is exacerbated by the currently "disconnected and maintenance-intensive"[3] rail lines, and an efficient rail network underpins an efficient grain supply chain (article (a) in the terms of reference). This issue is addressed in Part 1 of this submission.

The issue of ongoing grain trader insolvencies must also be addressed in order to ensure a functioning and efficient grain network in Australia, and this is examined in Part 4. Grain trader insolvencies have a significant impact on farm-gate returns (article (b) in the terms of reference), with the direct losses from insolvencies estimated at approximately $50 million in recent years. Upon trader insolvency, farmers join the list of creditors, often along with hundreds of other individuals and firms. The direct financial cost and the cost of recovery is significant for farm-gate returns, and the flow-on costs to rural communities are also high.

1. Rail Standardisation

> *"The rail network provides considerable potential to alleviate the strained road network thereby balancing the mode use to provide maximum benefits and to increase the competitiveness of logistics for the region"*[4]

The current freight rail network on the east coast of Australia retains fundamental features from pre-Federation, functioning as a series of essentially disconnected branch lines of varying gauges and low axle load. This causes significant inefficiencies in both freight system and supply chain operation. In addition, there has been significant investment in road transport productivity and infrastructure in recent years, which has led to a freight mode shift from road to rail.

The Victorian Government is currently investigating potential options for rail standardisation in the state, and has committed $220 million over four years for standardisation projects. However, according to the project report by GHD Consulting[5] (commissioned by the Victorian Department of Transport, Planning and Local Infrastructure), the cost of standardisation projects is estimated at up to $393 million to increase lines to a 23mt axle weight. The committed funding is thus insufficient to cover the necessary investment costs, and **the VFF is calling for a matching commitment from the Federal Government.** This is in line with the Government's stated priorities as an 'infrastructure government,' demonstrated by the existing commitment of $300 million for the commencement of work towards the Inland Rail (Melbourne to Brisbane) line.

Investment in rail standardisation as outlined in the GHD report will lead to a mode shift from road to rail, resulting in "safer transport, lower fuel consumption, lower carbon emissions and reduced

---

[3] Juturna Infrastructure, 2014. *Good Instincts*, market briefing paper, April, p.8 (URL: http://www.juturna.com.au/pdf/070414-Good-Instincts-issuu.pdf) [Accessed 11 August 2014].

[4] GHD, 2014. *Murray Basin Region Freight Demand and Infrastructure Study*, project report, July, p.iii (URL: http://www.transport.vic.gov.au/__data/assets/pdf_file/0008/216368/Final-Murray-Basin-report-July-2014.pdf) [Accessed 11 August 2014].

[5] Ibid.

terminal costs."[6] The importance of a shift from road to rail is well recognised. It will increase freight efficiency, reduce road damage and transport and maintenance costs, and improve transport and amenity in regional and rural communities.[7] The minimum increase in efficiency to be gained from standardisation and axle loading increase as calculated by GHD is 15 percent (up to more than 30 percent). Government investment in rail infrastructure, as a public good, will in turn provide significant opportunities "for industry to focus invest in its supply chain on its rail service," bringing further efficiency and cost benefits.[8]

Improving freight efficiency for Australian produce is particularly important in the current international market. Over the past decade, the rate of Australian on-farm productivity growth has been slowing, and international competition is increasing.[9] To maintain the strong position of the agricultural sector, which is currently one of Australia's most competitive sectors,[10] and to capitalise on future opportunities – such as rising demand from Asia – it is essential to invest now in long-term infrastructure. The Minister for Agriculture, The Honourable Barnaby Joyce, drew attention to these issues in his opening address to the Australian Grains Industry Conference in July 2014.[11] He noted the growing international competition that Australia faces, and highlighted the need for increased rail infrastructure to be used in agriculture as well as mining. The Minister also emphasised the importance of forward planning and acting now to build the infrastructure that will be needed for grains networks in 2050.

Recommendation 1

The Federal Government should match the Victorian Government's funding to standardise rail lines.

The Victorian Government has committed $220 million to standardising rail lines in the state. The VFF calls for the Federal Government to fulfil its commitments as an 'infrastructure government' by matching the Victorian Government's funding and investing in a standardised rail network as a key component of an efficient grain supply chain.

2. Market/Monopoly Power

Market power indisputably exists in the Australian grains industry. The Australian grain bulk handling market is dominated by three bulk handlers, with the grain markets in Western Australia and South Australia operating in a monopoly system. A report released earlier this year by the

[6] Ibid., p.iv.
[7] Ibid. See also RACV, 2014. *Regional Victoria: Growing Pains*, report, August.
[8] GHD, 2014. *Murray Basin Region Freight Demand and Infrastructure Study*, project report, July, p.iv (URL: http://www.transport.vic.gov.au/__data/assets/pdf_file/0008/216368/Final-Murray-Basin-report-July-2014.pdf) [Accessed 11 August 2014].
[9] Juturna Infrastructure, 2014. *Good Instincts*, market briefing paper, April (URL: http://www.juturna.com.au/pdf/070414-Good-Instincts-issuu.pdf) [Accessed 11 August 2014].
[10] Business Council of Australia, 2014. *Building Australia's Comparative Advantages*, discussion paper, July.
[11] Presentations from the Australian Grains Industry Conference are available here: http://www.ausgrainsconf.com/australia/presentations.

Australian Export Grains Innovation Centre[12] highlights the extent of the imbalances in market power:

- In Western Australia, **90-95 percent of grain is handled by Cooperative Bulk Handling** (CBH). CBH controls 100 percent of the port throughput, and 48 percent of WA bulk exports.
- In South Australia, **80 percent of grain is handled by Glencore-Viterra**, which similarly controls 100 percent of the port throughput and 46 percent of SA exports.
- Although there is more competition on the east coast, **GrainCorp handles 75 percent of the region's grain, and operates seven of nine bulk grain ports** (estimated to be **80-90 percent of port throughput**). Emerald and Cargill also own significant receival networks in the eastern states.

Each year, approximately 70 percent of the grain produced in Australia is exported,[13] although this varies dramatically between regions (between 85 and 95 percent of grain produced in Western and South Australia is exported, compared with approximately 50 percent of grain produced in the eastern states[14]). As a result, domestic grain prices are largely determined through export price parity.[15] Any market failure caused by monopoly or oligopoly power is therefore systemic, and the resulting inefficiencies have an impact on the entire export supply chain – and, in turn, on the grain supply chain as a whole.

Debunking the competitive ports argument

As outlined above, significant imbalances in market power exist in the operation of Australian ports. According to a GrainCorp media release in April 2013, it "handles ~90% of eastern Australia's bulk grain exports,"[16] and ports in Western and South Australia are controlled through monopoly holdings. Although it has been argued that other port operators may exist in the future, it is clear that the existing operators have significant market power.

Ports are currently regulated under access provisions administered by the Australian Competition and Consumer Commission (ACCC). It is argued, usually by those with an interest in a bulk handling corporation, that increased investment in grain port infrastructure will allow this 'market' to become a competitive marketplace. However, it is clear that customers of port loading infrastructure – which indirectly includes the grain producer, who bears the cost of higher port terminal fees – cannot readily switch between geographically-based port zones. This is especially the case in areas where there are no feasible alternative port loading facilities, such as Rainbow in Victoria. GrainCorp is the sole bulk handling company operating in Rainbow, and also controls the port facilities in Portland, the only feasible destination for Rainbow's grain.[17]

---

[12] AEGIC, 2014. *The cost of Australia's bulk grain export supply*, information paper, January.
[13] Approx. 25MMT of 35MMT total production. Ibid, p.9.
[14] Ibid., p.5.
[15] A more detailed examination of ways in which domestic and export grain prices are linked can be found in the joint response from selected farming organisations to the draft Mandatory Port Access Code of Conduct for Grain Export Terminals, June 2014, p.10 (URL: http://www.daff.gov.au/__data/assets/pdf_file/0004/2397748/combined-farmer.pdf) [Accessed 8 August 2014].
[16] GrainCorp press release, 26 April 2013 (URL: http://www.graincorp.com.au/investors-and-media/media/releases) [Accessed 4 August, 2014].
[17] There is no domestic market for grain produced in Rainbow, and the cost of transport to ports at Geelong or Melbourne respectively is approximately 14 percent and 18 percent higher than the cost of transport to Portland (calculations based

While some competition is evolving with new port loading facilities at Bunbury in WA and Newcastle in NSW, grain producers are largely captive to the existing system. These new competitors are still limited, with restricted access to up-country networks and/or limited rail access in the case of the Bunge port in Bunbury.[18] Most grain producers are geographically bound to one port. Given the majority of Australian grain is exported, producers cannot readily 'switch' between port zones or port loading providers. Similarly, exporters cannot readily switch between ports if they desire the grain or quality from a region with no other port loading facilities.

These geographical restrictions feed back into the market power dynamics, as **growers ultimately pay the price for the market power exerted by bulk handlers**, who act as 'price makers.'[19]

Recommendation 2

Regulated contestability in port access, in the form of a Mandatory Code of Conduct, should continue until objective measurement confirms the establishment of a competitive landscape for farmers' grain.

The VFF reaffirms the recommendations made in the joint response from selected farming organisations to the draft Mandatory Port Access Code of Conduct for Grain Export Terminals.[20]

Debunking the up-country competition argument

Bulk handlers also have a dominant – approaching monopoly – market position in the up-country storage and handling network for grains. In the eastern states, GrainCorp controls the essential network infrastructure required to acquire, accumulate and deliver grain to ports and end-users. According to the company's own press release in April 2013, it "handles ~75% of eastern Australia's annual grain production through direct receivals at…country sites or port terminals."[21]

It is often argued that up-country storage and handling is a well contested market, however it is clear that there are significant power imbalances and challenges to competition in a market in which 75 percent of the supply chain is controlled by one company. GrainCorp operates 70 receival sites across the eastern states, with an additional 200 sites operating on an 'as required' basis.[22] In contrast, the next largest up-country storage and handler on the east coast, GrainFlow (a wholly-owned subsidiary of Cargill), operates 22 storage sites across the east coast and into South

---

on Grain Trade Australia 2013/2014 location differentials, available here: http://www.graintrade.org.au/sites/default/files/file/Vic%20Location%20Differentials%206%20Nov%202013.pdf).

[18] Bobbie Hinkley, 'Bunge facility ready for July,' *Farm Weekly*, 20 June 2014 (URL: http://www.farmweekly.com.au/news/agriculture/cropping/general-news/bunge-facility-ready-for-july/2702394.aspx?storypage=2) [Accessed 8 August 2014].

[19] A more detailed examination of the process by which limited competition in port access negatively affects farm-gate returns can be found in the joint response from selected farming organisations to the draft Mandatory Port Access Code of Conduct for Grain Export Terminals, June 2014, pp.16-17 (URL: http://www.daff.gov.au/__data/assets/pdf_file/0004/2397748/combined-farmer.pdf) [Accessed 8 August 2014].

[20] Ibid.

[21] GrainCorp press release, 26 April 2013 (URL: http://www.graincorp.com.au/investors-and-media/media/releases) [Accessed 4 August, 2014].

[22] AEGIC, 2014. *The cost of Australia's bulk grain export supply*, information paper, January, p.11.

Australia,[23] and does not own port infrastructure. GrainFlow is therefore largely dependent on access to GrainCorp port infrastructure.

Another argument often raised in defence of the competition within up-country supply chains is the increasing use of on-farm storage. There is indeed significant on-farm storage capacity for grain: in the eastern states it is estimated that on-farm storage capacity is equal to approximately 60 percent of annual production.[24] However, presenting on-farm storage as a competitive force in the supply chain is misleading, and is akin to Telstra telling its domestic customers to build their own infrastructure access. Grain producers' competitive influence in the supply chain is limited and they are customers not competitors in the storage space. There are a number of reasons for this:

- The majority of on-farm storage is temporary and is built to store 'harvest overflow.' It is not long-term storage to compete with bulk handlers.
- The domestic market alternative is limited in capacity, with the vast majority of wheat produced being exportable surplus. Only those producers in 'freight advantaged' locations have true access to domestic end-use.
- As a result, the majority of farmers must still access bulk handling infrastructure at some point in the supply chain to export their grain, regardless of whether they build on-farm storage. It is at that point they will pay additional receival fees on top of costs already incurred.
- The majority of farmers are capital-restrained and do not have the capacity to put additional capital at risk to build storage infrastructure. This creates a further market inefficiency through inefficient use of capital to create excess storage capacity.

Barriers to up-country acquisition, accumulation and handling form a barrier to compete at port, although, unlike ports, the ACCC currently does not regulate up-country grains network infrastructure. A Productivity Commission report into wheat export marketing arrangements in 2010 highlighted the importance of "regulatory arrangements [to] enhance efficiency in the transport and storage market by facilitating contestability."[25] The VFF considers access to this essential network infrastructure to be critical in ensuring the capacity for true competition at port terminals.

In summary, increasing access to the up-country storage and handling network will improve supply chain efficiency by reducing market power and increasing competition. It will also help to avoid other market failures – such as the over-use of capital for on-farm storage, which reduces investment in actual grain production and pushes freight onto inefficient road pathways. The existence of market power has flow-on costs to market efficiency and leads to negative externalities, including reduced investment in food production, increased road damage, and potential public safety concerns.

[23] GrainFlow webpage (URL: http://www.cargill.com.au/en/products/GrainFlow/index.jsp) [Accessed 6 August 2014].
[24] AEGIC, 2014. *The cost of Australia's bulk grain export supply*, information paper, January, p.14.
[25] Productivity Commission, 2010, *Wheat Export Marketing Arrangements*, Inquiry Report No. 51, 1 July, p.2.

Recommendation 3

ACCC access provisions, as envisioned by the farming organisations, should be extended to up-country silos.

The VFF reaffirms the recommendations for port access regulation made in the joint response from selected farming organisations to the draft Mandatory Port Access Code of Conduct for Grain Export Terminals, and calls for these to be extended to up-country infrastructure.[26] This would ensure all grain producers and grain buyers can access essential infrastructure to load at port.

3. Information Asymmetry

Information asymmetry, a principal source of market failure, is evident within Australian grain networks. The significant market power held by the bulk handling companies, particularly CBH, Glencore, and GrainCorp, means that they have significantly greater access to stocks information, and in some cases, exclusive access to this information.

Although the 2013 report into wheat stocks information from the Wheat Industry Advisory Taskforce found that there was "no evidence provided of market failure,"[27] it is the VFF's opinion that the asymmetry in wheat stocks information constitutes another source of market failure within the supply chain. The Taskforce's final report did acknowledge that "access to certain types of information can improve transparency and positively affect market efficiencies."[28]

The bulk handling companies claim that they 'own' stocks information, however, the VFF considers that the bulk handlers act as the custodians of grain held in store, and as a result they do not own the rights to information. The VFF considers that **the rights to information belong to the party holding title to the grain**. This means that the rights to information for a set portion of warehoused grain belong to the producer or buyer, including bulk handler, who holds the title to that portion of stock. Where a bulk handler's marketing division does own title to a portion of grain, they own the information regarding that portion, just as other buyers do.

Price discovery and market liquidity

The transparency of stocks information is a fundamental component of supply and demand, and as such it is an essential element for price discovery in any market, not just the grain market. As noted in a recent submission by the Australian Securities Exchange:

> *"The importance of the provision of timely and accurate data on grain production forecasts and stocks cannot be understated… The existence of regional monopolies with inherent information advantages inhibits the development of open markets and challenges efficient price discovery"*[29]

---

[26] Ibid.
[27] Wheat Industry Advisory Taskforce, 2014. *Final Report*, 30 June, p.9.
[28] Ibid.
[29] ASX submission to the House Standing Committee on Agriculture, Resources, Fisheries and Forestry, Wheat Export Marketing Amendment Bill 2012 Inquiry, p.3 (URL:

The issue posed by the current information asymmetry for both industry and government alike is how to overcome this market failure to **ensure a transparent, liquid and competitive market for grain, rather than a market for stocks information.** As Mick Keogh highlighted in a blog post for the Australian Farm Institute,

> *"the [Wheat Industry Advisory] task force appears to have based its analysis on the 'market' for information about grain stocks, rather than* ***the role that the publication of grain stocks might play in maintaining fair grain market competition*** *in the face of potential monopolistic behaviour"*[30]

Mr Keogh also draws attention to the fact that stocks information is regularly published by other nations, including the United States, one of Australia's largest export grain competitors. Quarterly grain stocks reports released by the US Department of Agriculture – covering both on-farm and traders stocks, disaggregated by location, and dating back to 1973 – are easily accessible on the Department's website.[31]

In Australia, grain is priced by grade, by silo location, on a daily or intra-daily basis. Stock on hand information is therefore essential to ensure appropriate pricing and maintain a competitive, transparent and liquid market for grain.

Barrier to efficient market operation

The absence of open access to stocks information is a barrier to competition, as it prevents competitors from acquiring stocks up-country for loading at port or to the domestic market. Similarly, this lack of transparency disadvantages growers as it means that they must make sales decisions based on imperfect information. That is, growers do not have adequate information to decide whether to sell at harvest, when prices may be low, or to hold their grain (paying carry costs) to achieve a higher price. This is an impediment to growers' efficient behaviour in the marketplace, as they are forced to miss potential sales opportunities.

While third-party exporters have access to ports and shipping slots through ACCC access provisions, the inability to see and efficiently compete for and buy grain up-country to load a vessel is a very real barrier to competition for both domestic end-users and exporters. That is, an exporter must put capital at risk and acquire a shipping slot without having the capacity to see what stock is available and accurately estimate a fitting price to bid; in effect, the exporter is pricing 'blind' in the market. This is an impediment to the ability of the exporter to compete, as it increases risk to the exporter.

Similarly, domestic users do not have access to stocks information to see what stock is available to bid for to outturn, thus impeding the ability to compete and increasing risk to buyers.

---

http://www.aph.gov.au/parliamentary_business/committees/house_of_representatives_committees?url=arff/wheat/subs/sub17.pdf) [Accessed 7 August, 2014].

[30] Mick Keogh, 2013, 'Looking for grain market failure in all the wrong places,' *Australian Farm Institute*, 1 August (URL: http://www.farminstitute.org.au/_blog/Ag_Forum/post/looking-for-grain-market-failure-in-all-the-wrong-places/) [Accessed 6 August 2014].

[31] USDA National Agricultural Statistics Service, *Grain Stocks* (URL: http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1079) [Accessed 6 August 2014].

Recommendation 4

Stocks information should be made available weekly, by grade and by up-country silo, to facilitate pricing which occurs by grade and silo location on an intra-day basis.

Regulation requiring information disclosure is required to ensure a transparent, competitive and liquid market and address systematic information asymmetry. **The supply of stock information should be made available to ensure a liquid, transparent and competitive market, as in other markets such as the Australian Securities Exchange and other overseas commodity markets such as those in the United States. This will remove barriers to competition at port and up-country, and will allow more efficient price discovery for the market as a whole.**

4. Insolvencies

In the past three years, seven grain traders/buyers on the east coast have become insolvent or been placed under administration, resulting in direct losses of approximately $50 million:

- LGL Commodities in mid-June 2014 (debts estimated by the administrator at more than $10.3 million)[32]
- Gippsland Mills, trading as Meeniyan Stockfeeds and Cornells Prime Stockfeeds, in May 2014 (debts estimated at $2.1 million)[33]
- Belmark Rural in mid-April 2014 (debts estimated at $10 million; 133 creditors)[34]
- Sapphire (SA) Pty Ltd, a Grain Trade Australia member trading as River City Grain Co. in Victoria, in March 2014 (debts conservatively estimated at $13 million; approximately 200 creditors)[35]
- Convector Grain in June 2013 (debts estimated at $15.3 million; approximately 240 creditors)[36]
- Mid-West Milling in May 2013 (debts estimated at $3.2 million; 120 creditors)[37]

---

[32] *ABC News*, 'Administrator estimates LGL Commodities debts in excess of $10m,' 27 June 2014 (URL: http://www.abc.net.au/news/2014-06-27/grain-administrator/5554312) [Accessed 7 August 2014].

[33] Emma Field and Rob Harris, 'A Tamworth grain company has collapsed and gone into administration, making it the latest in a line of failed grain traders,' *The Weekly Times*, 25 June 2014 (URL: http://www.weeklytimesnow.com.au/business/grain-and-hay/a-tamworth-grain-company-has-collapsed-and-gone-into-administration-making-it-the-latest-in-a-line-of-failed-grain-traders/story-fnker6ee-1226965242207) [Accessed 7 August 2014].

[34] Peter Hemphill, 'Stockfeed business Belmark Rural run by former AWB whistleblower Mark Emons collapses with $10 million debt,' *The Weekly Times*, 22 April 2014 (URL: http://www.weeklytimesnow.com.au/business/grain-and-hay/stockfeed-business-belmark-rural-run-by-former-awb-whistleblower-mark-emons-collapses-with-10-million-debt/story-fnker6ee-1226892286884) [Accessed 7 August 2014].

[35] Peter Hemphill, 'Grain company Sapphire (SA) has collapsed, leaving creditors owed $13 million,' *The Weekly Times*, 30 April 2014 (URL: http://www.weeklytimesnow.com.au/business/grain-and-hay/grain-company-sapphire-sa-has-collapsed-leaving-creditors-owed-13-million/story-fnker6ee-1226899501375) [Accessed 7 August 2014].

[36] Peter Hemphill, 'Riordan Grain has bought the business operations and assets of failed container packer Convector Grain,' *The Weekly Times*, 4 February 2014 (URL: http://www.weeklytimesnow.com.au/business/grain-and-hay/riordan-grain-has-bought-the-business-operations-and-assets-of-failed-container-packer-convector-grain/story-fnker6ee-1226817524181) [Accessed 8 August 2014].

[37] Peter Hemphill, 'Failures left a string of debts,' *The Weekly Times*, 14 May 2014, p.81.

- One World Grain, a Grain Trade Australia member, in October 2012 (debts estimated at approximately $5 million; 30 creditors)[38]

Many of the creditors are farmers, and the insolvencies have a significant impact on farm-gate returns. In addition to these direct losses, the flow-on costs of these insolvencies are considerable, as less money flows into rural communities and upstream businesses. These costs include:

- the multiplier cost to the economy (using a simple multiplier of 2.5 for the $50 million in direct losses, this is estimated to be a further $125 million over the past three years);
- the economic cost of recovery for farms and communities; and
- the emotional and health impacts and the associated costs to those involved.

There is also a documented 'domino effect,' as many creditors are unable to recover from losses incurred by a trading partner's insolvency.[39]

These ongoing insolvencies have significant ramifications for the broader grain market. There is a negative impact on market confidence, including liquidity, borrowing costs, and market efficiency. **There is also a negative impact on competition, as ongoing insolvencies reduce growers' capacity to trade with smaller or newer firms.** The VFF has frequently received feedback from growers indicating that in order to adequately manage their business risk, they are only able to trade with 'the big end of town.' Considering the substantial market power that already exists in the grain supply chain, this is not a desirable or efficient market outcome.

Insufficient protection

The *Personal Properties and Security Act 2009* (PPSA) and associated Purchase Money Security Interests (PMSI) are often referenced when discussing insolvencies. The PPSA, in theory, allows sellers of goods the ability to retain title to the product and the proceeds of sale of goods pending payment by registering a PMSI. In the case of insolvency, a properly registered PMSI has a superior priority to most other security interests (as per date of registration). In effect, this makes a PMSI holder a secured creditor, with priority over unsecured creditors.

However, the PMSI has a number of shortcomings, especially in the grains industry:

- In a number of instances grain trade contracts do not enable growers to retain title – therefore voiding the PMSI.
- While on face-value a PMSI is arguably relatively easy to register online, it is understood that in reality even minor coding 'errors' will render a PMSI invalid, yet the online system does not advise the registrant that the PMSI has been incorrectly lodged.
- Assuming a PMSI has been correctly lodged, and is valid with retention of title, it appears that in the case where physical grain has been out-turned to a third party the grower does not retain a claim over the stock or payment for the grain, but simply becomes a secured

[38] Ibid.
[39] Emma Field and Rob Harris, 'A Tamworth grain company has collapsed and gone into administration, making it the latest in a line of failed grain traders,' *The Weekly Times*, 25 June 2014 (URL: http://www.weeklytimesnow.com.au/business/grain-and-hay/a-tamworth-grain-company-has-collapsed-and-gone-into-administration-making-it-the-latest-in-a-line-of-failed-grain-traders/story-fnker6ee-1226965242207) [Accessed 7 August 2014].

creditor and must stand in line with other secured creditors, such as banks, to try and recover funds from any remaining assets of the company.

Most importantly, the PMSI is not a preventative measure regarding insolvencies. In the case of insolvency, it may increase a grower's status from unsecured to secured creditor, but does not prevent the insolvency event from occurring in the first place and is no guarantee of payment for grain or recovery of funds.

Due diligence: necessary but not sufficient

There is currently limited regulation and oversight in the grain trade, and the VFF has received feedback from growers concerned that in the current market "you only need a laptop and mobile phone to be a grain trader." **Due diligence from growers in dealing with traders and buyers is necessary but not sufficient for protection.** Banks and other institutions with professional credit risk departments are also carrying substantial losses from these insolvencies.[40] Additionally, the Federal Government has recognised the difficulties for small businesses such as farmers in negotiating contracts and business transactions with larger trading partners, because of the inherent power imbalances in these transactions.

The Australian Treasury (on behalf of Consumer Affairs Australia and New Zealand) is currently undertaking a consultation process investigating the possibility of extending consumer protections, such as protection from unfair contract terms, to small businesses. The background paper prepared for the consultation acknowledges that:

> ***"Large businesses may present [small businesses] with standard form contracts and, like consumers they may lack the time and legal or technical expertise to critically analyse these contracts, and the power to negotiate…some contract terms and conditions may unfairly advantage one party, at the expense of the other, with the potential to transfer all or much of the risk in a transaction to one party"***[41]

The VFF considers that this accurately captures the relationship between grain growers and traders/buyers, and indicates the need for certain producer protections. **Currently, farmers incur production risk, market risk, price risk, and costs, and also bear the capital risk of their counterparty's businesses.** It is the VFF's view that standards need to be introduced to provide a more equitable balance for farmers and to improve the professionalism and accountability of the grain trade. This should be achieved through the assistance of government to implement a form of industry self-funded self-regulation such as a licensing scheme and guarantee fund.

Precedents for licensing regimes exist in many other Australian industries and in our largest export competitors, Canada and the United States. Together, Canada and the US have licensing and

[40] Peter Hemphill, 'Farmers and traders are questioning whether NAB is Australia's worst rural lender after a string of company collapses,' *The Weekly Times*, 6 June 2014 (URL: http://www.weeklytimesnow.com.au/business/farmers-and-traders-are-questioning-whether-nab-is-australias-worst-rural-lender-after-a-string-of-company-collapses/story-fnkeqfxg-1226943198496) [Accessed 7 August 2014].

[41] The Treasury, *Extending Unfair Contract Term Protections to Small Businesses*, Consultation Paper, May, p.5 (URL: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/~/media/E53165D4D8B24B4799395680E68FE0B0.ashx) [Accessed 7 August 2014].

insurance schemes in more than 30 states and provinces and many of these have been operating for decades. While these models are not perfect, they act as a preventative measure to insolvencies occurring and therefore increase confidence within the industry. An Australian scheme could incorporate learnings from these existing schemes, building on their strengths. For a more detailed examination of these schemes and more information about the VFF's proposal of a grain trade licensing and guarantee fund system, please refer to the recent discussion paper, *Increasing Professionalism and Accountability of the Grains Industry*.[42]

Recommendation 5

The Federal Government should facilitate national harmonisation of a Victorian state-based legislation addressing grain trade licences, if such legislation is introduced in Victoria.

This would incorporate accreditation of grain traders, and potential underwriting by a self-funded insurance scheme, similar to those existing in the US and other Australian industries.

The VFF recognises that the administration of licensing is undertaken on a state-level, however, it is important that the implementation of a licensing scheme does not disadvantage Victorian traders relative to other domestic traders. As such, it is understood that other states could choose to adopt similar legislation and that parties registered under Victorian legislation could be recognised in other states under the Mutual Recognition Agreement (MRA).[43] If this were established for the grain trade, it could streamline interstate grain trading and offer protection to industry participants around the country. The Council of Australian Governments would play a key role in developing and implementing a coordinated state-based grain trade licensing system, which would be recognised under the MRA.

Conclusion

The VFF considers market power and information asymmetry to be two of the key sources of market failure within Australian grain networks, and they are directly related to the terms of reference of this inquiry. To address market power, ACCC access provisions should continue for port access and should be extended to up-country silos, to ensure all grain producers and grain buyers can access essential infrastructure to load at port. There are significant disparities in the availability of stocks information to market participants, and this has a negative impact on price discovery and the liquidity of the market. Regulation requiring information disclosure is required to ensure a transparent, competitive and liquid market and address this systematic information asymmetry.

Additionally, the currently disconnected rail freight network significantly impedes the efficient operation of grain supply chains and has contributed to a mode shift from rail to road. The VFF is calling on the Federal Government to match state funding to improve rail efficiency through standardisation and increasing axle load capacity and redress this mode shift.

---

[42] VFF Grains Group, 2014, *Increasing Professionalism and Accountability of the Grains Industry*, Discussion Paper, 28 July (URL: http://www.vff.org.au/vff/Documents/Grains/VFF%20Draft%20Industry%20Proposal%20Increasing%20Professionalism%20and%20Accountability%20in%20the%20Grain%20Trade.pdf) [Accessed 7 August 2014].

[43] Council of Australian Governments, 1992, *Agreement relating to Mutual Recognition*, 11 May (URL: http://www.coag.gov.au/sites/default/files/mra_text.pdf) [Accessed 7 August 2014].

Finally, grain trader/buyer insolvencies are an ongoing problem for the industry, with negative effects on market competition as well as devastating impacts on growers, farm-gate returns, small businesses and rural communities. The VFF has previously raised the potential for an industry licensing scheme to help to prevent the risk of insolvencies and to bring increased professionalism and accountability to the grain trade, and here reiterates this position. The VFF recommends that the Federal Government should facilitate national harmonisation of a Victorian state-based legislation addressing grain trade licences, if such legislation is introduced in Victoria.

Appendix A: Terms of Reference

"On 19 June 2014, the Senate moved that the following matters be referred to the Rural and Regional Affairs and Transport References Committee for inquiry and report by 3 December 2014.

Grain export networks, including the on- and off-farm storage, transport, handling and export of Australian grain, with particular reference to:

a. the principles and practices underpinning an efficient grain supply chain from farm-gate to port;
b. grain marketing and export arrangements and their impact on farm-gate returns;
c. competition constraints on grain transport, storage and handling services;
d. the extent to which transport, storage and handling arrangements are transparent and accountable; and
e. any other related matter."