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25 May 2011

Committee Secretary
Ms Jeanette Radcliffe
Senate Standing Committees on Rural Affairs and Transport
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Ms Radcliffe,

Re: Operational Issues In Export Grain Networks

JK International Pty Ltd is pleased to have the opportunity to put forward a submission for the Senate Committee to consider.

We would also be more than happy to meet with yourself or members of the Committee if further information is required.

Yours sincerely

Sandeep Mohan
General Manager
JK International Pty Ltd

Contents

Terms of Reference.....	3
Introduction.....	4
Executive Summary.....	5
JKI response to Select Committee Terms of Reference	7
(a) any risks of natural, virtual or other monopolies discouraging or impeding competition in the export grain storage, transport, handling and shipping network, and any implications for open and fair access to essential grains infrastructure;..	7
(b) the degree of transparency in storage and handling of grain and the appropriateness of any consequent marketing advantages;	9
(c) equitable access to the lowest cost route to market, including transport options;.....	9
(d) competition issues arising from the redelivery of grain;.....	11
(e) the absence of uniform receipt, testing and classification standards and practices and any implications for growers and/or for Australia’s reputation as a quality supplier;	11
(f) equitable and efficient access to the shipping stem; and.....	13
(g) any other related matters.....	15
Conclusion.....	16

Operational issues in export grain networks

Terms of Reference

Operational issues arising in the export grain storage, transport, handling and shipping network, with particular reference to:

- (a) any risks of natural, virtual or other monopolies discouraging or impeding competition in the export grain storage, transport, handling and shipping network, and any implications for open and fair access to essential grains infrastructure;
- (b) the degree of transparency in storage and handling of grain and the appropriateness of any consequent marketing advantages;
- (c) equitable access to the lowest cost route to market, including transport options;
- (d) competition issues arising from the redelivery of grain;
- (e) the absence of uniform receipt, testing and classification standards and practices and any implications for growers and/or for Australia's reputation as a quality supplier;
- (f) equitable and efficient access to the shipping stem; and
- (g) any other related matters.

Introduction

JK International Pty Ltd (JKI) was formed in 1978 and has been involved in the global trade of agri-commodities since that time. What started as a small family operation, trading containers of mung beans to the UK, now has the company at the forefront of soft commodity supply to the Indian Sub-Continent, the Middle East and North Africa whilst still supplying product to niche markets in North America and Europe.

JKI is involved in the supply chain from producer to consumer and as a result has an intimate knowledge of the various issues which arise throughout the purchase, shipment and marketing process.

Executive Summary

JKI believes firmly in free and fair trade along with the development of a fully deregulated grain market in Australia. However, JKI supports where necessary the imposition of regulations or trade rules which will enshrine competitive neutrality and the efficiencies within the supply chain for Australia's grain exports.

Unlike many other countries the Australian grain handling industry was built on the back of a couple of different models which could be describe as cooperative in nature. Essentially a State by state approach to the construction of grain receival sites and export ports to receive and export grain, that which was first delivered to "up country" silos. These cooperative structures where either owned or existed under State Legislation that supported quasi State Ownership in the case of Queensland, New South Wales and Victoria or indeed farmer ownership in the case of South Australia and Western Australia.

However, it is fair to say in all cases Government support in the construction of rail assets to service the transport of grain from country points to export ports had a huge hand in the development of the industry. As time wore on, Governments seemed less interested in maintaining or supporting such structures and encouraged moves towards corporatization and industry consolidation. Further developments in the case of Graincorp included the takeover of GEB (Victoria) and BGQ/Grainco (Queensland) and public listing and Viterra ended up with the aggregated assets which were ABB and SACBH.

Therefore the "Three Sisters" have, through consolidation, ended up with natural monopolies based on historic access to a State based and sponsored "line company" elevator system. Which in and of itself, was and still is, immune to any handling competition within the State and now region they are domiciled in. Such a system in its purest form did allow for an industry to be scalable in the face of fluctuating crop outcomes and minimized potentially wasteful expenditure on storage asset infrastructure. The problem has occurred where these same regional "line companies" are also seeking to compete with grain marketers and traders using their natural (and previously State sponsored) monopolies to increase barriers to entry and increase costs to other market participants.

When the Federal Wheat Marketing Act was changed to remove the single desk from AWB Limited, the Government's aim was to have free and fair exports of wheat (and other grains) from Australia. If it was the Government's intention to maintain a regulatory environment then they would have simply restructured AWB or had another body execute single desk responsibilities. It is clear that the Federal Government wanted to open up competition right through the supply chain and onto bulk vessels.

The reality, however, is that whilst there was much time taken to produce voluminous documents that would enshrine the prospect of true competition through to the FOB (loaded onto vessel) point, unwittingly the Federal Government have created three regional commercial monopolies. We are convinced that it was never the intent of Government to have "The Three Sisters" Viterro, CBH and Graincorp (BHC's) develop into commercial monopolies of the type we continue to see grow in power and anti competitive behaviour in Australia.

The fatal flaw in all the thousands of papers written which were designed to protect and indeed enhance competition was the lack of adherence to simple market economy principles.

Such concepts as competitive neutrality and the foundation facets of market economics such as the opportunity for profit and the balancing threat of loss across all market participants seems to have been missed in all of the documentation! It is true that all Australian grain market participants have at the very core, some opportunity to make a profit. However, only part of this same community (the BHC's) stand to be threatened by loss through the purchase of shipping stem. The fundamental imbalance around this core principle is where the industry currently turns.

It is with the above comments in mind we contribute to the Senate Inquiry into the Operational Issues in Export Grain Networks and trust that the Committee will do all in their power to ensure the principles of competitive neutrality and free trade are enshrined.

JKI's response to Senate Committee's Terms of Reference

JKI will address, where appropriate, the issues outlined in the Senate Committee's specific Terms of Reference, point by point.

(a) any risks of natural, virtual or other monopolies discouraging or impeding competition in the export grain storage, transport, handling and shipping network, and any implications for open and fair access to essential grains infrastructure;

JKI believes that the foundation of the Australian grain market is not structured to support vigorous competition;

The "Three Sisters" enjoy regional monopoly positions as follows, Queensland, New South Wales and Victoria – Graincorp, South Australia - Viterra and in Western Australia – CBH. In essence the "Three Sisters" through their supply chain integration and absolute control of export ports essentially dominate and use their natural monopolistic positions to reduce competition and increase barriers to entry.

There is collective agreement within the Australian Grain Trade that the BHC's have unfair advantage in the context of shipping stem allocation and knowledge of all grain stocks and quality.

The reality is that whilst the Seaboard Terminal Access Undertakings were largely designed to manage access to ports for wheat exports; the bastardisation of the intent of this situation is negatively impacting the export of all crops not just wheat. At the core of this matter are the allocation of shipping stem by the BHC's and the subsequent purchase of such stem by the BHC's and the broader grain trade. (The issue of shipping stem will be discussed below against point (f)).

The fact that the BHC's have the opportunity to manipulate stem availability along with having the ability to purchase stem without "real" cost; and they have perfect stock information makes it harder for other market participants to purchase and ship grain. As more confusion surrounds stem availability and the broad cost of accessing stem continues to mount, the logical outcome of all of this is to reduce grain

purchase activity in aggregate or at a minimum attempt to price these risks into those prices shown to farmers on a daily basis for all commodities.

JKI believes the uncertainty surrounding shipping stem for wheat is putting the future of smaller crops in peril in Australia. Crops such as peas, lentils, chickpeas and faba beans are all an important part of the grain farmer's armoury when it comes to managing price outcomes and agronomic issues. Should prices and demand for these commodities continue to erode relative to world price and demand, then ultimately the farmer will stop producing them. This, in turn, will have an economic impact on Australia as the reality of a tightening in crop rotation cycle delivers a smaller export offering and lowers wheat, barley and canola quality and yields.

The key to a vigorous and competitive marketplace is clean port access, fairness and equity in the provision of shipping stem across all market participants and transferability of shipping stem and a secondary market (outside of the BHC's) for delivering the ability to trade stem. We have made recommendations on this matter in point (f) below.

The other major issue impacting the development of a free and fair market in Australia is the fact that not all market participants are operating with the same information base. In fact the BHC's have an unfair advantage in that they alone know where every tonne of stock that's in their system is along with what the quality of that stock is and who owns it. Because there are now no ring fencing provisions in the legislation, The BHC's are free to act with impunity with such knowledge. In the grain business knowledge is power, and the BHC's have both in spades.

JKI proposes as a solution either one of the following recommendations be put into effect;

1. That robust and appropriate and ring fencing be re-applied to the BHC's activities;
2. That the BHC's cease and desist from trading grain and revert to being a handling company; or
3. That all stock and quality information for all market participants be made available.

(b) the degree of transparency in storage and handling of grain and the appropriateness of any consequent marketing advantages;

As per point (a) above JKI believes no-one should have an unfair advantage when it comes to stock knowledge. Therefore as per previous recommendations it is our belief that either everybody knows the entire data set or no-one should have access to information other than what stock they own themselves.

Unlike free market systems in some of our competitor trading origins, the Australian BHC's do not allow transparency of stocks by quantity, quality and location within their handling systems. However, the exception to the above is that component of the BHC's business that trades grain does have access to this information. Even with any discussion about reinstating Ring-Fencing provisions there would be no one in the Australian grain trade that would believe the BHC's Trading Businesses wouldn't have access to and use this information.

It is JKI's recommendation that;

- (1) this information should be collated on a regular basis by an independent party (ABARE) and distributed in a commercially timely manner to registered Grain Exporters. Or
- (2) that the BHC's divest themselves of their Trading Operations.

(c) equitable access to the lowest cost route to market, including transport options;

JKI believes with the advent of a more constructive approach to the allocation, purchase and the full transferability/tradability of shipping stem a much more efficient usage of infrastructure would ensue. Private storage operations as well as road and rail transport assets would be beneficiaries of a more flexible and efficient port shipping stem system.

Exporters do not have total control over the many logistical variables they face when moving agricultural goods from local farms to overseas customers. Therefore when

planning is interrupted by unforeseen circumstances or an inefficient supply chain then costly bottlenecks build very quickly.

Australia used to lead the world when it came to cargo assembly and the efficient export of grain to world markets. Since deregulation supply chain costs (road, rail, country receipt and storage, export elevation and punitive charges) have all expanded exponentially relative to competing origins. The risks and costs of executing Australian grain today are driving our company to do more and more business outside of Australia.

Governments need to make decisions on the future of rail infrastructure investment and maintenance. Unfortunately grain does not rank in the volumes that minerals do and consequently receive only tacit interest. Unfortunately this means the entire supply chain bottlenecks between up country sites and the export port locations.

If it is Government's intention to allow more grain to move on road transport then it must address the major structural inefficiencies that exist in the road transport industry. Issues surrounding inconsistent application of various Government policies surrounding weights which can be carried, the configurations which can carry the grain (B-Double/Road Train/AB Triple) and the lack of a practical approach to managing driver log books and driving times. All of these inconsistencies between states drive up the cost of moving goods.

It almost goes without saying that the parlous state of major roads and highways leading to export ports leave transport assets with varying level of damage and reduced service intervals which in turn increases costs. The provision in all areas suitable areas for drivers to rest and to "drop" trailers off would increase efficiency and reduce the impact of driver fatigue and frustration.

Governments can and need to do more in the area of sponsoring the development of Regional Shipping Container Parks and supporting them with rail commitments which would see an improved secondary export path. Such an approach would improve supply chain competition with the BHC's, allow for innovation and the development of niche markets and keep more heavy trucks out of major city/export path routes.

JKI Recommends;

- (1) That the Productivity Commission along with the Council of Australian Governments be tasked to produce and practically implement a functional integrated National Transport and Export Logistics Strategy that fundamentally improves the industry's ability to seamlessly move product into export positions.

(d) competition issues arising from the redelivery of grain;

The delivery of grain ex farm, ex private storage or ex country receival points into port locations has proven to be a growing problem. With limited re-investment in BHC's country assets (particularly on the east coast) freight costs have continued to increase because of breakdowns at site, poor site access, confusion of grain availability, insect infestation, personnel issues etc etc.

There is no incentive for BHC's as a general comment to increase expenditure in their up country assets because they know that by keeping their costs down up country, they will dissuade any significant new up country investment. Similarly they know, that in the end they get the lion's share of any grain because it must come through their export terminals regardless of the grain origin. Therefore they are also free to differentiate their port receival charges depending on grain origin (ex farm, competitor facility or their own facilities). This approach is designed to ensure more grain comes through their "system."

(e) the absence of uniform receipt, testing and classification standards and practices and any implications for growers and/or for Australia's reputation as a quality supplier;

JKI believes there are times when the BHC's work practices and opening times do not deliver best logistical outcomes for the industry. Nor does it deliver the most efficient supply chain to the marketplace. JKI has experienced commercial disadvantage due to inconsistent application of product receival standards and inability to capture market peaks due to insufficient storage and segregation allocation.

The BHC's should always be, when receiving grain using best in class procedures, technology and training to ensure the sanctity of grain quality. Grain quality is one of the pillars of any grain contract and is the key to clean contract execution.

Buyers, sellers and producers must have confidence in the BHC's being ready and prepared for those events which impact grain quality.

The BHC's along with buyers, sellers and producers must be engaged in the development of standards using an industry approach (Grain Trade Australia) that ensures not one particular market segment has undue influence.

The BHC's largely operate outside of the National Grains Standards when it enforces on its export customers a limited liability in respect to delivered quality outcomes. The key to this point is that the BHC's must be accountable for outturning grain within the specifications of the GTA standards. In the 21st Century, all care and no responsibility is unacceptable.

Grain quality management and outcomes are critical to successful arbitrage and contract execution. The BHC's are able to manipulate quality outcomes without guaranteeing outturn on one hand but then on the other, able to "steal" that quality over the minimum specifications to "blend up" their own poorer quality stock. Because only the BHC's have perfect quality by site knowledge, they are in the box seat to arbitrage quality and origin.

In summary as per point (a) above; JKI proposes as a solution either one of the following recommendations be put into effect;

1. That robust and appropriate and ring fencing be re-applied to the BHC's activities;
2. That the BHC's cease and desist from trading grain and revert to being a handling company; or
3. That all stock and quality information for all market participants be made available.

(f) equitable and efficient access to the shipping stem;

JKI believes that this point is where the industry in Australia turns and as such delivers a major impact on the competitive foundation of the local grain industry.

JKI believes that unlike the rest of the trade there are no disincentives for the BHC's to speculate on shipping stem. For example if JKI wants to buy a shipping stem in South Australia for 2011/2012 crop marketing year, we must consider the cash flow, p&I and risk implications of buying shipping space so far out into the future. If we choose to go ahead and nominate to Viterra for one or more shipping stems, we must then pay to Viterra a non-refundable AUD5/mt for the privilege.

The angst which JKI has with this system is twofold. Firstly, as the BHC's receive stem nomination from exporters, given there exists no ring fencing, the perception exists that the BHC has the opportunity to "cherry pick" its own requirements before accepting any third party nominations. Secondly and as already explained earlier, exporters must pay AUD5/mt non-refundable fee for each nomination however the BHC in reality does not. For the BHC, it is at worst an accounting journal entry, in that it has zero implications on the aggregated BHC's bottom line.

Therein lies the rub, with no threat of loss or any negative impact on their cash flows, BHC's are largely free to speculate wildly on the stem. Having accessed the stem for no real cost, the BHC tightens up the supply of same, forcing other market participants to move much earlier than necessary and in aggregate start a stampede for space and access.

This then provides an economic windfall for the BHC! This is all based around a flawed principle of the BHC suffering no penalty financially for "getting it wrong." The rest of the trade however has spent "real" money in volume for space for which a crop may or may not come.

This move or this ability by the BHC's to manipulate firstly what stem will be made available and secondly the allocation of same to themselves at no real cost, fundamentally changes the basis for farm gate competition. Put plainly, if JKI doesn't think a stem will be available it won't buy grain from farmers. If we purchased grain

without a stem it would result in large carry costs, some of which would be paid to the BHC! Therefore the BHC has ample motives to restrict stem availability as they become a direct beneficiary from these additional cost imposts on exporters.

Alternatively we may have to sell the grain at a discounted price to someone who does have stem. If for example the "cost" to FOB grain in SA is approximately AUD40pmt and the true FOB market is say AUD140/mt then the track (or delivered port) market should be somewhere around a AUD100/mt. However, this spread has widened out considerably at times, as traders who cannot get port access take the decision to liquidate their position rather than be forced to bear additional carry costs.

Equally for those who have purchased a stem, but who don't own any grain or have no ability to ship the goods in the slot they have purchased, there exists no mechanism for this stem to be "traded." This is largely prohibited by the BHC's (which is clearly anti-competitive), however the trade works around this by transacting purchase and sales contracts to sell product on the track market and then buy back the FST grain. This transaction requires an inefficient and cumbersome transfer of grain and money to another party. Viterra for example receives a further AUD0.25 per tonne fee for the privilege! Clearly these restrictions of trade are seen by many as just another income source for the BHC.

It should be very clear that JKI has no issues with any market participants speculating on stem. Our issue is that there should be regulation put in place to ensure competitive neutrality where it pertains to the allocation and operations in respect to booking shipping stems in the Australian grain business.

If Viterra for example want to lock up 1 million tonnes of stem, then they should be expected to do so on an equally competitive footing and therefore pay to a third party regulator (not to themselves), AUD5 per tonne for the right to do so.

Therefore we would propose the following;

- a. That a regulatory framework be established to allow a third party body to be put into place to receive and allocate stem; and
- b. That under the regulatory framework established above, that shipping stem be freely traded and transferable without the involvement of the

BHC's. (albeit market participants would need to have storage and handling contracts with the BHC's); or

c. That the BHC's divest their Trading Operations entirely.

Such an outcome would fairly price shipping stem in the present or into the future ensuring the best and most efficient use of and access to strategic assets.

(g) Other matters

JKI believes that the storage and handling agreements which must be constructed between the BHC's as service providers and JKI as the service purchaser remain overtly legalistic and always strongly in the favour of the BHC.

For example Viterra's insistence that they maintain a lien over our stock to guarantee payments for service regardless as to disputes that may exist between the 2 companies puts them in a very strong (and unfair) negotiating position. Equally the BHC's do not offer or stand behind any load rate or cargo assembly guarantees as part of their service package, even though by their action or inaction they can directly impact the logistics path and therefore how fast cargo is accumulated or how quickly a vessel loads.

Conclusion

JKI believes that when the wheat export market was deregulated it was never the intention to enshrine export power in the hands of the Bulk Handling Companies. The Federal Government along with the States are seeking a fully competitive market that best utilises the agronomic potential of our environment along with those infrastructure investments that are critical in converting agricultural output into cash. This goal is best served by a system that has at its core the notion of competitive neutrality and sound adherence to market economic principles.

This is not the situation right now and until such balance is restored it is our considered judgement that competition for grain will reduce in Australia and new entrants will be dissuaded from becoming involved. Such an outcome will see the smaller crops get smaller and once scale economy has been lost; there will be a secondary diminution of competition and price for same. This will ultimately deliver poor agronomic flexibility and options to producers which in turn will lead to a drop off in both yield and quality and increase disease risks in the major crops of wheat, barley and canola.

At this point it is worth reinforcing that the BHC's have "ended up" in this position due to inaction and limited foresight by State and Federal Governments, they have assumed natural monopoly positions due to various deregulation and corporatisation strategies supported by Government.

The grain trade requires a system which allows exporters greater flexibility, without prohibitively restrictive port access practices and cost imposts from the BHC's. Equally Governments across Australia must work with the Australian Grain Industry to improve supply chain efficiencies where they are being impacted by Government policies which do not allow for the fluid movement of grain from country receival sites to export ports. If this can be achieved it will lower barriers to entry, increase farm gate competition, and be income positive to those participants directly involved in the supply chain, the BHC's themselves and the Australian economy overall.