# SUBMISSION

Senate Standing Committees
on Rural and Regional Affairs and Transport

# WHEAT EXPORT MARKETING AMENDMENT BILL 2012

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# EXECUTIVE SUMMARY

GrainCorp supports the Wheat Export Marketing Amendment Bill 2012.

The Australian wheat export industry has made substantial positive progress since deregulation. The reforms contained in this Bill are the logical next step to improve the competitiveness of Australian wheat exports and ensure the sector can capitalise on rising demand for grain from developing countries.

The limitation of existing regulation is not that port access must be provided to third parties. The limitation is that the application of regulation effectively dictates how port elevators operate, reducing the efficiency of the supply chain and hindering international competitiveness of Australian wheat.

As a result of the competition at all points along the grain supply chain, GrainCorp already has strong commercial incentives to provide third parties with access to our facilities, without the need for regulation. The high fixed cost structure of operating the country and port network means our business model depends on high volume throughput of grain – it is therefore in our interests to act to attract grain to our network.

The operation of the existing regulation is constraining our competitiveness as an Australian agribusiness, as in an average year around one-third of the export wheat crop is already departing eastern Australia via unregulated channels such as containers or unregulated ports.

The current regulation also reduces Australia's export competitiveness by imposing a "lowest common denominator" approach to the provision of port elevation.

The Bill offers a number of benefits that will overcome these limitations and improve the competitive position of Australian export wheat by:

- Allowing flexibility and innovation along the supply chain, through operations and tailored services that meet the changing requirement of overseas consumers;

- Encouraging further investment in the wheat supply chain, by allowing participants to make longer term commitments for port elevation services;

- Reducing compliance costs and red-tape, which ultimately disadvantage grain growers; and

- Ensuring ongoing safeguards for market participants.

A number of other matters that are not directly related to the provisions of this legislation have been raised in the public discussion of the Bill. GrainCorp supports open discussion of issues of interest to the industry. However, we emphasise that it is important that the benefits of the Bill are not held hostage to the discussion of separate issues:

- <u>Reputation of Australian export wheat</u>: As a bulk exporter with a significant investment in supply chain assets in Australia, GrainCorp agrees that quality assurance and supply chain reliability is a high priority.

While there have been periodic claims about a decline in the quality of wheat exports, there is little evidence to suggest these claims relate to bulk wheat exports. Since July 2008, GrainCorp has loaded over 420 wheat vessels. Based on a review of our records, none of these vessels failed to meet the contracted quality specification under our agreements with our export customers.

Wheat that passes through GrainCorp's system is subject to a strenuous quality control system. GrainCorp submits that the perception that export wheat quality has declined is primarily due to the variability of grain quality shipped in containers – usually by small unregulated container packers who have limited quality systems – and by seasonal factors such as those caused by the extreme wet weather in the 2010-11 harvest.

The industry is already self-regulated, through commercial contracts and existing industry bodies, including Grain Trade Australia and Wheat Quality Australia and there are positive signs these arrangements are maturing. The industry is in the best position to manage quality and should be encouraged to address remaining quality control issues of its own accord.

The reputation of Australian wheat has also been affected by supply chain reliability, given the lack of flexibility, innovation and investment in the grain supply chain. This is particularly an issue in the rail network, which can be addressed by the enactment of the Wheat Export Marketing Amendment Bill 2012 and increased investment in rail.

- Stocks information disclosure: The provision of additional stocks information would not improve the efficiency of the grain market, nor would it improve grower returns. The key consideration of an efficient market is price discovery and the grain market already has clear and efficient price transparency, with many prices being offered by buyers, exporters, merchants, end users and others. This level of price transparency and information disclosure enables all participants to offer and bid appropriately for grain. Further, a substantial amount of information is already made available to the grain market by GrainCorp and other organisations.

  While remaining open to discussion of workable and equitable solutions that have a clear market benefit, GrainCorp is concerned that no clear case has been made for the provision of additional stocks information. Further, the primary beneficiaries of such a move would be the large multinational grain traders, who already enjoy a substantial information advantage from their international operations.

  GrainCorp acknowledges it does generate certain information in the course of operating its business; however this information is proprietary, in the same manner as that generated by any other business. It has been generated through our investment of over $1 billion in country and port assets and forced disclosure would represent the removal of property rights. Further, the ACCC and Productivity Commission have consistently found that GrainCorp does not have the ability to leverage any substantive market position in grain trading or downstream processing from the information it generates.

- Auction system: GrainCorp does not agree with proposals to introduce an auction system across Australia for the allocation of port capacity. The 'first in, first served' approach has worked well in eastern Australia.

GrainCorp

# SECTION 1: GRAINCORP'S POSITION ON THE LEGISLATION

## 1.1 Support for legislation

GrainCorp supports the Wheat Export Marketing Amendment Bill 2012 (the 'Bill').

The reforms contained in the Bill are the logical next step to improve the competitiveness of Australian wheat exports, following the process of deregulation which commenced in 2008. The Bill will deliver benefits for all participants in the Australian grain industry and Australian agribusinesses, including GrainCorp.

The transitional access arrangements that currently apply to the bulk grain port elevators were understandable as part of a phased transition from the single desk to a deregulated export wheat market. However the benefits of the access test are diminishing and these arrangements are now adding cost, as the Productivity Commission pointed out in its recent report on the industry.[1]

To our knowledge, Australian bulk grain port elevators are the only grain terminals regulated in this manner in the world. Port terminals that service other export commodities (such as coal and iron ore) are not subject to the same constraints.

This creates an uneven playing field for Australian growers and Australian agribusinesses, including GrainCorp, which has made a significant investment in port assets and related grain infrastructure.

Australia's wheat industry has made tremendous progress over the three years since the removal of the single desk. In 2010-11, over 18.5 million tonnes of wheat was exported by around 20 active exporters to 52 countries. Seven exporters were responsible for shipping over 1 million tonnes each.

The opportunities for our industry are set to grow, with global population growth and increasing demand for protein in developing countries expected to drive a doubling in the international trade of grain in the next decades.

To take advantage of this opportunity, our grain industry requires the most flexible and efficient grain chain possible. It would also benefit from a national champion such as GrainCorp, which has made a significant investment in the Australian grains industry.

## 1.2 Why this legislation is required

**The limitation of the current regulation is not that access must be provided to third parties, as GrainCorp has a significant commercial incentive to provide access regardless of regulation. The limitation is that application of regulation effectively dictates how port elevators operate, reducing the efficiency and international competitiveness of Australia's supply chain.**

Existing port access regulation imposes a rigid "one-size-fits-all" and "lowest common denominator" approach to the allocation and management of third party access to ports. This in turn endangers the competitiveness and reputation of Australia's grain industry, by limiting operating flexibility, innovation and investment in the Australia's grain chain.

[1] Productivity Commission Inquiry Report: Wheat Export Marketing Arrangements, p.2

The risks of persisting with a highly regulated and cumbersome port access regime are:

- Lower prices paid for Australian wheat by overseas consumers, who may also source wheat from alternative regions if they cannot get wheat from Australia in an effective and flexible manner; and
- Reducing Australia's ability to compete with other export countries that are seeking to increase their market share. For example, the USDA predicts Black Sea Port countries may overtake the USA's market share of wheat within the next decade.

This Bill offers a number of benefits and will improve Australia's competitive position in the global wheat market through:

**a) Improved supply chain flexibility to respond to customer needs**

A port protocol, under the current regulation, cannot be written in a way that accommodates all operational scenarios in a complex grain chain. At present, any changes in the port protocol to improve the operation of port elevators involve a cumbersome six-month plus consultation process.

This is a severe constraint in servicing overseas consumers in a demanding environment whose requirements often change. Inflexibility at the port elevators can cause major inconvenience.

Regulation limits our ability to flexibly sequence the receival of grain and vessels into our port terminals in an optimal manner to reduce overall ship delays and consequential vessel demurrage.

The impact of this inflexibility is particularly marked when unforeseen events arise. For example, when rail access to GrainCorp's Newcastle port was disrupted by the flooding in northern NSW in February 2012, GrainCorp needed to add alternative capacity at other ports to assist affected customers to transfer ships. This move required acting outside our Access Undertaking.

While the ACCC were cooperative in the process, they made it clear they could not sanction any move by GrainCorp or give us immunity from prosecution. GrainCorp took a commercial decision we viewed as in the best interests of the industry to add alternative capacity and transfer ships, notwithstanding the legal risk to our company.

**b) Greater certainty for those participants with a long term commitment to Australian wheat**

Current regulation does not allow GrainCorp to enter into long-term agreements with export customers who wish to plan ahead and lock in their grain chain arrangements for several years into the future. The mismatch between the forward planning time necessary for business certainty and that available under current access arrangements is becoming increasingly pronounced.

For example, many large export customers have multi-year rail contracts of a 3-5 year duration, while under the current regulation the shipping stem is opened only annually before the start of each harvest season, meaning that exporters cannot plan and invest with certainty beyond very short periods. Furthermore, any decision to invest in new rail capacity generally involves a 10-15 year time horizon.

These discrepancies are a disincentive for long term planning, investment in export marketing and promotion and investment in rail and other supply chain capability. This is an issue that is increasingly affecting the reputation of Australian wheat and makes the Australian grain industry more vulnerable to short-term factors and volatility.

**c) Encourage more investment in supply chain infrastructure**

Current regulation acts as a significant disincentive for market participants to invest in improving port performance. Any investment in additional capacity at a regulated port is immediately effectively "nationalised" and is open to all market participants, removing any ability to enter into a commercial arrangement with a customer to secure a return on this investment.

No organisation will invest if they do not retain property rights over that investment or if regulation takes away its right to use the property or investment.

For example, under the current regulation an export customer cannot enter into an agreement with GrainCorp to increase silo capacity at a particular port by, say 20,000 tonnes, to help them service an international contract, as this additional silo capacity must automatically be made available to all users of the port.

**d) Encourage more innovation**

Regulatory constraints around ports prevent the ability for any innovation by exporters and bulk handlers to improve services to meet international customer demands. Furthermore regulation limits the ability for exporters to differentiate their service offering.

For example, under the current regulation GrainCorp cannot enter into specific agreements to tailor specific services to meet the need of its overseas consumers or other wheat exporters. This results in a "lowest common denominator" service across the entire industry.

**e) Reduction in cost and red-tape**

Compliance with the extensive requirements of existing regulation involves significant diversion of resources, which leads to decreased efficiency of service delivery. The lengthy and cumbersome process required to make any changes to access arrangements also place significant burdens on GrainCorp and other users of our port facilities.

These inefficiencies and costs ultimately disadvantage grain growers as well as bulk handling companies and grain exporters.

## 1.3 Non-uniform application of port regulation is inequitable

GrainCorp urges the committee to be mindful of the importance to Australian business of a level playing field in the application of port regulation. It is important that the implementation of this legislation does not unintentionally provide loopholes for new port operators or other market participants that would disadvantage businesses currently subject to this regulation.

There are a number of areas of inconsistency in the current legislation that adversely impact Australian agribusinesses like GrainCorp, often to the benefit of larger, international competitors who have not made a substantial investment in the Australian grain chain.

The following are areas of inconsistency are of particular concern in eastern Australia.

A significant volume of wheat – an estimated 2.5 million tonnes last season (around 30% of exports) – is departing eastern Australia via alternative export channels that are not subject to regulation. These include:

- Containers: The export of wheat in containers continues to grow, with eastern Australia now serviced by over 50 grain packers, none of whom are subject to current constraints.
- Unregulated terminals: Two new bulk grain terminals run by large multinational grain companies that we understand are not subject to Access Undertakings due to the structure of their ownership:
    - Wilmar and Gavilon acquired an export terminal in Brisbane.
    - Louis Dreyfus constructed an export terminal in Newcastle.
    - It is not clear whether the regulation would apply to the planned new bulk export terminal at Newcastle, approved by Newcastle Port Authority, which is reportedly sponsored by a number of international companies.

Further, the overseas terminals owned by GrainCorp's international competitors do not have the regulatory constraints that are in force in Australia, endangering our ability to compete as global demand for grain increases.

## 1.4 New arrangements will continue to offer substantial protections

The Wheat Export Marketing Amendment Bill will allow a reduction in the level of administrative red tape for exporters of Australian grain.

Importantly, under the new arrangements, there will continue to be a number of safeguards to ensure a competitive environment remains in place for the continued benefit of the Australian grains industry. These protections include:

- A voluntary code of conduct for all bulk export port operators that will include a dispute resolution system.
- Port access would remain subject to the robust safeguards of Australia competition law (in particular, Part IIIA of the Competition and Consumer Act).
- The highly competitive environment in eastern Australia would ensure GrainCorp remains incentivised to act in a commercial manner, in order to provide access to third parties and maximise grain throughput.

GrainCorp does not agree with proposals for the creation of an industry ombudsman, which would place additional cost burden on government. The substantial controls outlined above also make such a move unnecessary.

Furthermore, the grain industry is already efficiently and effectively self-regulated, with Grain Trade Australia (GTA) playing an important role in developing grain standards, trade rules and contracts across the industry, while also providing cost-effective arbitration services.

## 1.5 Need for focus on provisions of the legislation

GrainCorp is concerned that the significant benefits of this legislation are being endangered by the addition of issues that are not directly related to the provisions of the Bill.

Such matters that have been raised include the compulsory provision of additional information, the introduction of auctions, and calls for an Ombudsman.

GrainCorp supports open debate of issues of interest to the industry, however this legislation – and the opportunity for more efficient ports and more internationally competitive Australian wheat – should not be held hostage to separate discussions.

## SECTION 2: RECOMMENDED AMENDMENTS TO IMPROVE OPERATION

GrainCorp makes the following recommendations to avoid unintended ambiguity and inconsistency in the legislation and thereby improve its operation.

| Clause | Comment / Recommended change |
|---|---|
| General<br>*Applicability* | For fairness, it is important that all wheat bulk port terminals are included under the same regulatory framework, or the result would be a two-tiered regulatory system. The legislation needs to be more explicit that:<br>• Existing ports (Wilmar/Gavilon in Brisbane and Louis Dreyfus in Newcastle) should not be exempt from the conditions that apply to GrainCorp and other port operators.<br>• New or future port terminal operators are covered by this legislation. |
| Section 9 (4) (c) (vi)<br>*Access Test: Continuous Disclosure rules* | Some requirements in this Section 9 (4) (c) are inconsistent with existing Access Undertakings. As required by our Access Undertaking, GrainCorp's shipping stem already provides a significant amount of information, much of which is also contained within the Bill, that is:<br>• Assigned load date and unique booking reference number<br>• Exporter and vessel name<br>• Date and time nomination was received<br>• Date and time nomination assessment was completed<br>• Loading status (accepted, underway or complete)<br>• Date completed.<br>The Bill would require GrainCorp to show the estimated time of departure as required in Section 9 (4) (c) (vi). The provision of this information would provide an additional compliance burden, for no added transparency gain. GrainCorp already discloses time of loading completion, which allows performance to be monitored. Estimated departure times are naturally subject to considerable variation, estimates would therefore need to be synthetically generated. |
| Section 9 (4) (c) (xi)<br>*Access Test: Continuous Disclosure rules* | For avoidance of doubt, this clause should be clarified to state the "date" that loading was completed, as opposed to the "time".<br>GrainCorp already discloses the date of loading completion. To require disclosure of the "time" loading is completed (for example, 2.19pm on 18 April 2012) would add additional complexity and cost, for no benefit, and would be inconsistent with the existing Access Undertaking. The time of loading completion is irrelevant as vessels often have to wait for the tide, tug assistance, or harbourmaster clearance before departing. |
| Section 24<br>*Vesting of assets of WEA* | It is recommended that the funds made available by the winding up of WEA are made available to non-profit organisation(s), such as Grain Trade Australia, that have the objective to improve and promote Australian wheat quality. |

## SECTION 3: GRAINCORP'S COMPETITIVE OPERATING ENVIRONMENT

There is no economic or competition-based reason to regulate bulk wheat terminals, given the level of competition that exists along all stages of the grain chain. It is inconsistent that non-wheat port terminals are not regulated, when many of these commodities exhibit less competition than the wheat industry.

GrainCorp is aware of parties calling for the retention of the current regulation on the basis that GrainCorp is a regional "monopolist" or "oligopolist". This claim is not true, either in structure or in market practice.

GrainCorp has a commercial imperative to provide 'open access' to its infrastructure. This is the case because the company:

1. Operates in a highly competitive and variable market. GrainCorp is not in a position to purchase all of the grain received and handled within the company's network, nor willing to assume the risk associated with owning or trading this quantity of grain;
2. Has a high fixed cost structure (labour and depreciation) to operate its country and port network, and its business model depends on high volume throughput. GrainCorp therefore has the incentive to attract and retain as much grain throughput as possible; and
3. Has excess storage and elevation capacity and is reliant on grain volumes from other grain exporters. GrainCorp's country storage utilisation is less than 50% and port elevation utilisation is less than 35%. Thus the greater the number of purchasers and storers of grain within GrainCorp's network, the higher the likelihood that growers will chose to deliver their grain to GrainCorp silos and in turn increase the utilisation and profitability of our assets.

The lack of monopolistic power can be further demonstrated by the company's level of return on equity ('ROE'). GrainCorp's average ROE in the past five years has ranged from -5% to 13% (with a weighted average of 5%). This is less than the average ROE for ASX200 companies.

The competitive environment along every step our grain chain was confirmed by the ACCC in its acceptance of our Ports Undertaking determination in 2011:

> *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 up-country supply chains, from other ports and the threat of customers by-passing GrainCorp facilities.*[2]
>
> *....Further, the vertically integrated monopolist's incentive for self-preferential treatment is moderated by countervailing competitive pressures in the case of GrainCorp.*[3]

GrainCorp cannot influence the price of grain and does not have exclusive control in the supply of grain supply services. This is because the company operates in:

[2] ACCC: GrainCorp Operations Ltd Port Terminal Services Access Undertaking: Decision to Accept, 2011, p. 8

[3] ibid, p. 25

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- **A highly competitive global grain market** in which we have no influence on wheat prices, given our small size; and
- **A highly competitive local grain market** comprising a large number of participants with contestability at each point of the grain chain: (i) up-country silos, (ii) export port facilities, and (iii) grain marketing.

## 3.1 International competition

The price of wheat in Australia tracks the international price of grain ('export parity'), as eastern Australian wheat exports represent less than 3% of the global trade of wheat. Accordingly GrainCorp must compete with wheat supplied from Canada, USA and Eastern Europe and has no ability to influence wheat prices.

The competitiveness of the global grain market is the primary reason why regulatory constraints are not imposed on grain port elevators in other counties. For example with the forthcoming deregulation of export wheat from Canada, the Canadian Government came to the view that regulation of its port terminals was not required in a deregulated market as:

> *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.*[4]

## 3.2 Up-country competition

Since the first round of wheat deregulation, there has been significant investment in grain storage by bulk handlers, merchants and growers.

In eastern Australia, there is a large number of competing country storages for grain, with in excess of 40 million tonnes capacity. This is equivalent to the ability to handle average grain production 2.5 times over (see Figure 1).

Figure 1: Estimated eastern Australia country silo capacity

| Operator | QLD | NSW | VIC | TOTAL |
|---|---|---|---|---|
| GrainCorp | 3,475,438 | 11,967,700 | 5,071,500 | 20,514,638 |
| *GrainCorp Share* | *56%* | *50%* | *126%* | *51%* |
| Cargill | 416,800 | 1,412,400 | 808,100 | 2,637,300 |
| Emerald | | 550,000 | 400,000 | 950,000 |
| Viterra | | | 120,000 | 120,000 |
| Merchant/Enduser | 495,500 | 3,577,650 | 994,100 | 5,067,250 |
| On Farm | 1,832,953 | 6,212,837 | 3,196,707 | 11,242,497 |
| **Total Capacity** | **6,220,691** | **23,720,587** | **4,015,200** | **40,531,685** |
| Average production | 3,000,000 | 9,500,000 | 4,500,000 | 17,000,000 |
| **Capacity / Production** | **2.1 x** | **2.5 x** | **0.9 x** | **2.4 x** |
| **Farm / Production** | **61%** | **65%** | **71%** | **66%** |

[4] *(Agriculture and Agri-food Canada, http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1311891454058&lang=eng#a10)*

While GrainCorp's share of country storage is around 50%, the competing storage capacity could in theory handle the whole average harvest storage and receival task of 17 million tonnes in eastern Australia. Competing country storages for grain in eastern Australia include:

- Cargill and Emerald, with a storage and handling capacity of over 4 million tonnes;
- Over 11 million tonnes of permanent on-farm storage; and
- A large number of merchants (operating storages in many rural towns) with 5 million tonnes of capacity, which is linked to the provision of road transport services and / or farm inputs.

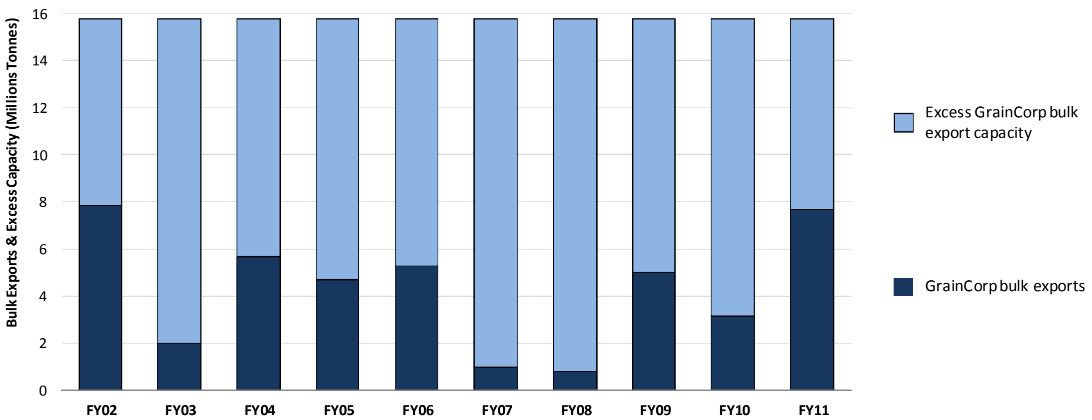
## 3.3 Competing export facilities

GrainCorp has substantial excess elevation capacity at our ports, with 16 million tonnes of capacity available for nomination and an actual capacity that exceeds this level.

As Figure 2 below shows, even in the years of "bumper" harvests, only just under half our available port capacity is used across the year.

To secure an adequate return on investment for our port assets, GrainCorp has the strong incentive to act in a commercial manner to provide the maximum elevation capacity to other grain exporters to attract grain to our export facilities.

Figure 2: Excess capacity at GrainCorp ports




GrainCorp's published nominated port elevator capacity can be less than its actual capacity, as available rail and road transport capacity into the port elevator is taken into consideration to minimise port block-outs. However, GrainCorp will increase nominated capacity if there is an expansion of supporting transport capacity by industry participants, as demonstrated by our announcement on 4 April 2012 to increase nominated capacity by 600,000 tonnes at three ports.

Furthermore, GrainCorp also faces competition in port elevation in eastern Australia from a large number of competing export facilities for grain that include:

- 50 container packers with an annual capacity of over 5 million tonnes;
- Bulk terminals, including Melbourne Port Terminal (owned by Emerald/Sumitomo), Newcastle (Louis Dreyfus) and Brisbane (Gavilon/Wilmar); and

- A planned new bulk grain terminal, Newcastle Agri-Terminal, planned for Newcastle.

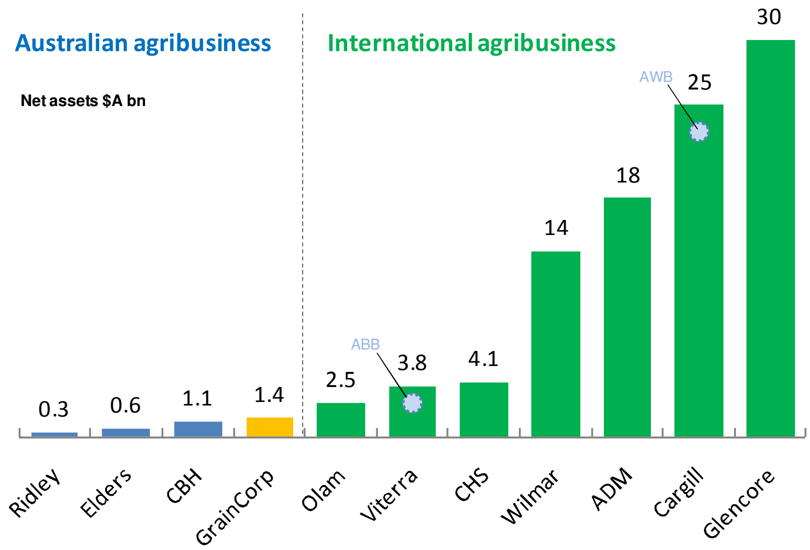
## 3.4 Grain trading competition

Most wheat in Australia is accumulated and traded by multinational grain traders who sell to each other and on to either domestic or overseas consumers. These multinational traders have extensive international grain trading and handling capability in other countries, combined with established relationships with overseas consumers.

GrainCorp has no ability to exercise market power in the purchase of grain, as it faces vigorous competition from established multinational grain traders such as Cargill (who acquired AWB), Viterra (who acquired ABB), Glencore (currently acquiring Viterra), Toepfer (owned by ADM), Louis Dreyfus and Bunge. The market is now also served by new multinational grain traders such as Noble, Gavilon, Wilmar and Olam.

The relatively small size of GrainCorp against those multinational grain traders operating in Australia is illustrated in Figure 3 below.

Figure 3: International competitive market




The considerable countervailing power held by multinational traders involves both local wheat prices and access to infrastructure:

- If GrainCorp were to reduce the price it offered for wheat to growers; multinational traders, who have superior access to the global grain markets, could simply trade around GrainCorp at higher prices; and

- If GrainCorp were to deny access to infrastructure to multinational traders, who have superior supply arrangements into certain markets and consumers, we will suffer a loss of grain throughput volumes and earnings.

## SECTION 4: REPUTATION OF AUSTRALIAN EXPORT WHEAT

GrainCorp notes that the basis for referral of this Bill to the House Standing Committee on Agriculture, Resources, Fisheries and Forestry was *"concern that Australia will lose its place as the premium supplier of wheat to our two biggest competitor countries Canada and the USA, both of which have quality assurance processors with exports."* This issue was also the subject of discussion in the recent Senate Committee's Inquiry into Operational Issues in Export Grain Networks.

GrainCorp agrees that the quality assurance, along with supply chain reliability, is a high priority to ensure the competitiveness of Australian wheat into the global market. As a bulk exporter with significant investment in supply chain infrastructure and assets in Australia, we have a keen interest in safeguarding the international reputation of our wheat.

GrainCorp believes the grain industry is in the best position to manage quality through industry organisations (such as Grain Trade Australia) supported by commercial contracts. Accordingly GrainCorp notes the comment made in the Senate Rural and Regional Affairs and Transport Committee's recent Report on Operational Issues in Export Grain Networks:

> *The committee would encourage the industry in its endeavours to continue to develop and apply objective standards for grain…. Grain Trade Australia is to be commended for its work in developing accreditation processes in collaboration with industry.*[5]

Since the removal of the bulk wheat export monopoly, there have been periodic claims about a 'decline' in the quality of wheat exports, however there is little evidence to suggest these claims relate to <u>bulk</u> wheat exports.

**Since July 2008, GrainCorp has loaded over 420 wheat vessels. Based on a review of our records, none of these vessels failed to meet the contracted quality specification under our agreements with our export customers.**

It is important to note that GrainCorp has a contractual obligation to out-turn grain against its receival standard, where it is required to pay the owner of the grain for the value of any downgraded grain. This provides the commercial imperative for GrainCorp to manage grain quality at all points in its supply chain. For example, in occasional instances where we have identified that a cargo was not going to meet specification, we discharged and reloaded to ensure that the contracted specification was met.

The perception of a decline in export wheat quality is attributable to the following factors:

1. <u>Deterioration and variability of grain quality shipped in containers</u>, usually by small container packers that do not have sophisticated assets and quality systems. There is evidence to suggest that grain exporters and overseas customers are now becoming more selective in their choice of container packer to ensure the contracted grain specification is met.

2. <u>Grain exporters shipping bulk wheat much closer to contracted quality specification to the overseas customers than previously occurred</u>. While this has required some adjustment for international end-users, feedback suggests they are adjusting to the new environment.

[5] Senate Rural and Regional Affairs and Transport Reference Committee, Operational issues in export grain networks report, p.94

GrainCorp and other exporters are increasingly dedicating resources to technical support for customers to facilitate this adjustment. It should also be noted the Australian standards under which grain is received and classified is frequently not used in specifications contracted by the overseas consumer. Thus, each export parcel usually requires a blend of different grades to meet the minimum contracted standards. In a competitive export market, grain exporters cannot afford to over-deliver grain against the contracted minimum quality specification.

3. Recent seasonal factors have affected wheat quality, for example, the severe wet weather experienced in the 2010-11 harvest caused significant quality downgrading and loss in milling performance of much of the wheat crop in SA and the East Coast.

## 4.1 Quality issues and containers

The majority of anecdotal feedback around variable wheat quality has been focused on wheat exported in containers – not wheat exported in bulk. This issue with containers was explored in some detail in Grain Growers' recent report: *What the World Wants from Australian Wheat*.

> *The quality of wheat shipped in containers [is perceived by customers as] being less reliable and less consistent than bulk shipped wheat. This applies to a range of important wheat standards and is threatening the overall reputation of Australian wheat.*[6]
>
> *A small proportion of containerised trade that does not meet acceptable standards is undermining the reputation of Australian wheat. This has the potential to have a widespread and significant negative impact.*[7]
>
> *[South East Asian] buyers expressed major concerns with the container trade from Australia. It is considered that quality variation within and between shipments is destroying the reputation of Australian wheat....Bulk cargoes provide better consistency than containers.*[8]

It is important that the benefits of this Bill – including more efficient access to bulk port terminals – does not become entangled in separate concerns involving containers which are not regulated. If there are concerns about quality assurance issues these should be focused on the container export market.

## 4.2 Quality assurance of bulk grain from GrainCorp's facilities

Wheat that is shipped in bulk through GrainCorp's up-country silos and port terminals pass a strict screening and quality assurance process that is independently audited by NCSI to a standard set by the International Organization for Standardization.

### Quality control at up-country silos

Our approach to quality control is underpinned by a network of five technical laboratories that provide an advanced grain and oilseed quality testing service. Each laboratory is National Association of Testing Authorities (NATA) certified (ISO17025, ISO9001:2008) and tests against a

[6] Grain Growers: What the world wants from Australian wheat, 2011 p. 4
[7] ibid, p.7.
[8] ibid, p. 10

range of international standards, including USDA methods. Our quality control process includes the following checks and balances:

1. Testing of all deliveries to up-country sites: The sample stand at each GrainCorp silo samples every truck delivery using trade certified equipment and trained personnel. GrainCorp provides grain assessment training to all sample stand staff prior to harvest. Our training courses cover all aspects of grain assessment, including instrument operation, interpretation of standards, visual assessment and dispute resolution.

2. Composite testing post-receival: Composite samples from silos are sent to our network of technical laboratories and further analysed by trained staff using calibrated equipment. These tests include:

    - Falling number testing;
    - Food safety testing;
    - Audited varietal testing;
    - GM testing (primarily for canola segregations); and
    - Free fatty acid test (for oilseeds).

3. Reference testing: As part of our NATA certification, results from up-country silos are checked against technical laboratory results to ensure the testing and data is accurate. All anomalies are investigated and corrective action is taken if necessary.

4. Additional reference testing: Technical laboratories also conduct more complex tests on composite samples that cannot be performed at up-country locations. These include tests for flour and dough rheology, mycotoxins, chemical residues. These results are published in our Crop Report available on our website to all exporters.

5. Post-receival testing: Export wheat is also tested on out-loading to port, on arrival at port, during vessel loading and after loading on representative samples.

### Quality control at port terminals

Prior to acceptance of a vessel, GrainCorp carries out a risk assessment using Australian and importing country regulatory information as well as commercial specifications.

- Cargos that have quality requirements outside GTA grade specification are assessed and export customers are notified where the cargo may be in doubt prior to accumulation, and

- Export customers with nominated cargos that will fail to meet importing country requirements for pesticide or quarantine requirements are advised prior to acceptance.

During loading, an export vessel is subject to a range of independent controls and audits:

- AQIS inspectors are in place during loading to inspect the status of the wheat by using automatic sampling systems. This inspection includes checking for Australian regulatory requirements (including insects and other food safety requirements). It also includes checking against the importing country regulatory requirements for quarantine issues, endorsing fumigation declarations and other importing government requirements.

- Representative samples of all cargoes are collected and routinely tested during vessel loading to determine that the cargo is meeting specification. During loading, these samples are analysed by trained laboratory staff using calibrated equipment. Port operations, including laboratory operations, are independently audited by NSCI and form part of our ISO9001:2008 Quality Assurance program.

- During cargo accumulation, export customers are kept updated on the cargo received against specifications. If there is a requirement to adjust the quality of stock being received from country locations, this is advised to the export customers so that they can adjust their accumulation and loading plans to meet specification or renegotiate with their buyer if required.

- Representative samples collected during this process are also provided to independent cargo superintendents who analyse these samples independently and provide their results to facilitate payment between the buyer and seller of the grain. Cargo superintendents are usually accredited by the Grain and Feed Trade Association (GAFTA) or are referenced directly by the cargo contract.

- Representative samples are also collected and provided to the National Residue Survey (DAFF) who tests each cargo for the presence of chemical residues. Chemical issues with bulk exports have been extremely low from the GrainCorp export system.

### Technical support for overseas consumers

GrainCorp provides a range of technical support services to buyers of Australian wheat, including production of an annual crop report for eastern Australia. This report contains quality and technical data on the grain and is made available to export customers, end users and publicly on our website. This report includes all of the information for GrainCorp port zones that had previously been provided by AWB Ltd in their National Crop Report prior to deregulation.

GrainCorp has provided approximately 3.5 tonnes of representative wheat samples to exporters to provide to their own customers so they are able to carry out their own testing.

We are also developing our ability to provide technical support to consumers of Australian wheat, including technical exchanges, to ensure better understanding of the characteristics of wheat from eastern Australia on a season by season basis. This service is supported by our recently acquired Wheat Milling and Baking laboratory in Toowoomba and is supported by a team of wheat quality experts in flour milling, baking and noodle making in Australian and international production systems. Similar services are provided by other exporters who have this capability in Australia and overseas.

### Industry organisations already oversee wheat quality

Regulation of export wheat quality would crowd out private investment and innovation in the development and marketing of wheat quality. Additional regulation would be costly and would only add limited value as:

- The grain industry is self-regulated through commercial contracts: Grain Trade Australia already plays an important role in standardising grain standards, trade rules and contracts across the industry for the trade of grain. Contractual disputes on grain quality are arbitrated by GTA, if these contracts reference GTA.

  Grain Trade Australia is also developing a revised Industry Code of Conduct to provide additional comfort to growers and buyers that purchase grain from GTA members.

- Development of wheat standards is self-regulated: Wheat Quality Australia is an independent organisation that governs the classification of wheat varieties from plant breeders to facilitate the development and identification of high quality wheat. This information is used by GTA in the setting of receival standards and by exporters in promoting the wheat performance to overseas consumers.

Grain Trade Australia is funded by membership fees from grain traders and Wheat Quality Australia is 50% funded by contribution from bulk handlers and grain traders through Grain Trade Australia (the other 50% is from the Grains Research and Development Corporation).

## 4.3 Supply chain reliability

Our research with overseas grain consumers has highlighted concerns expressed by major customers, particularly in Indonesia and Malaysia, regarding reliability of supply and delays to delivery. The following are extracts of feedback from a report commissioned by GrainCorp:

> *[Major Indonesian customer is] concerned about Australian wheat supply logistics. This includes the movement of wheat to the port and port access. They have been very frustrated with shipping arrangements for Australian wheat and they have experienced a lot of delays. This is a major concern to their security of supply.*
>
> *[Major Malaysian customer is] concerned about logistics and rail access in Australia. There is a sense that Australia will have trouble moving wheat fast enough to meet shipping schedules. Forward booking of shipping slots resulting in penalties, this adds cost and creates problems with continuity of supply.*

There are two core areas for focus to improve supply chain reliability:

1. Managing the complexity of our supply chain; and
2. Increasing investment in rail track.

### Complexity of supply chain

The distinguishing feature that adds additional complexity to Australia's wheat supply chain when compared with that of our international competitors is:

- Overseas, exporters buy and trade wheat when it is accumulated at port, versus;
- In Australia, exporters can buy and trade wheat at up-country silos and separately procure supply chain services to transport and ship their grain.

Our supply chain involves managing significant complexity with a large number of grain exporters, each having different grain accumulation and shipment requirements, using the same grain supply chain.

This complexity is made more difficult given the inherent characteristics of the grain chain compared to the supply chain for other bulk commodities. This complexity increases the execution risk, namely:

- A mismatch between the demand for grain for shipment and grain availability due to:
  - Wheat must go through a cycle of fumigation to protect the grain from infestation. Grain must go 'under gas' for up to 28 days (including treatment and venting time) every 2 to 3 months.
  - Many grain exporters often own small parcels of a grain or grade at a silo that cannot load a full train load.
  - The outloading of grain can be limited by rain (as it is a food product) and availability of mobile equipment, road transport and rail transport delays.
- Compressed schedules to accumulate grain for a shipment due to:
  - The need to allocate port storage to segregate grain for a number of export traders.
  - Increasing demand for complex cargo blends to meet customer quality specifications.
  - Increasing use of less efficient road transport to accumulate grain into the port.

To manage the increasing complexity following deregulation we have been required to:

- Open 40% more silos for grain outloading every day, increasing operating costs and placing pressure on fumigation to manage insect control.
- Actively transfer grain ownership between silos and between customers, requiring significant forward planning, particularly during peak periods.

Regulation of port terminals make the complexity of the grain supply chain more difficult to manage. It is vital that port access is deregulated to enable GrainCorp to manage this complexity flexibly and to meet customer requirements in a cost effective manner.

### Investment in rail track

GrainCorp submits that the single largest priority for government and industry in improving the image and reputation of Australian wheat must be improving the performance of rail transport.

Rail is crucial to export efficiency and the ability to move large volumes of export wheat to the world market in a timely manner. The average ship for bulk wheat export can be loaded with around 18 trainloads, as opposed to nearly 900 B-double truck movements.

GrainCorp, and other grain companies, have made substantial investments in above rail operations, to make them more productive. Over the past three years we have lifted the productivity of each of our trains by nearly half; from 180,000 tonnes per annum to over 250,000 tonnes per annum. We have also over this time improved our supporting silo performance by lifting average train loadings at our silos by 50%.

However further productivity improvement in above rail operations, which is privately owned and funded, is being constrained by lack of investment in the regional rail track network. For decades there has been significant underinvestment in the below-rail infrastructure and a gradual tipping of the balance of Government funding support in favour of road.

As a result, the inefficiencies caused by weight and speed restrictions on many rail lines are pushing more grain off rail and on to local roads. This is negatively impacting the grain industry by:

1. Increasing the relative cost of rail to road transport. We believe that our rail cost is at least $10 per tonne higher than best practice – a significant cost burden on the grain industry.

2. Unnecessarily pushing more grain volumes onto road with also consequential negative community and social impacts. Over the past four years, GrainCorp has seen the volume of grain moved by road into our port terminals triple to over 3 million tonnes per annum.

To help us maximise the efficiency of our exports, the rail priorities for governments around Australia should be:

- Encouraging further investment in above-rail resources by guaranteeing the security of the grain branch network. When a rail line is closed we typically see most of this grain moved by road direct to the port or other markets. It is pleasing to note that some state Governments have increased investment in the rural network – but more focused Federal commitment to this issue is required.

- Increasing the weight payload on grain lines. Most rail lines have a limit of 76-82 tonnes per wagon – compared to normal industry practice of 90 tonnes per wagon in Australia and over 100 tonnes per wagon in other countries. This would allow the grain industry to invest in larger wagons that can carry up to 50% more grain and significantly reduce transport costs.

- Improving track capacity and relieving congestion on the main thoroughfares into ports, where competition from other commodities like coal is pushing grain onto the road. For example, we can only move 9 trains per week from South East Queensland into Brisbane, significantly limiting the volume of grain that can be moved by rail. Priority areas include:
    - Increasing line capacity from Maryborough to Geelong with additional crossing loops;
    - Increasing line capacity from Werris Creek into Newcastle; and
    - Increasing line capacity or a new rail line from Toowoomba to Brisbane.

## SECTION 5: INFORMATION DISCLOSURE

GrainCorp is aware of calls for disclosure of additional stocks information that have been made in the public discussion of this Bill.

In regards to the regulation and compulsion of information disclosure, GrainCorp notes the report of the Senate's Rural and Regional Affairs and Transport References Committee's Inquiry into Operational issues in export grain networks:

> *The committee therefore will not recommend at this time that the government should intervene further in this area. It notes that in relation to access to port facilities that the government intends that a voluntary code of conduct will be developed by the industry and implemented by 30 September 2014. That code of conduct will include continuous disclosure rules.*[9]

GrainCorp already makes available a significant amount of public information to the market. GrainCorp remains open to discussion of workable, reasonable and equitable solutions that have a clear market benefit.

GrainCorp believes the current level of information disclosure enables all participants to offer and bid appropriately for grain. The compulsion to release more information would not benefit grain growers, but simply give further advantage to multinational grain traders, who are already privy to superior global grain information, to detriment of Australian agribusinesses.

Any proposals would require disclosure of all stocks held, not just the grain in GrainCorp's system, as only around 50% of grain is stored at GrainCorp silos after harvest. This would require a cumbersome and costly process to disclose stocks by all grain handlers and traders at all facilities, including on-farm storage that stores up to 30% of the grain production.

This would involve significant costs for government or a regulator for an unclear benefit as:

- The primary beneficiaries of a move beyond the existing disclosure would be the multinational grain traders operating in Australia, as outlined above. The information generated by these companies is not disclosed to growers and participants in Australia.
- The net benefit to growers from such a change is not clear. Growers can currently elect to disclose their grain stock information to the market that suits their individual marketing purpose. The fact that the vast majority of growers prefer to withhold their information indicates a preference that this ability to choose be maintained.

### 5.1 The grain market already has efficient price discovery

The provision of additional information would not improve the efficiency of the grain market – nor would it improve grower returns.

The key consideration of an efficient market is price discovery and, given the level of competition and contestability in eastern Australia (as outlined in Section 3) the grain market enjoys timely and efficient price transparency:

[9] Senate Rural and Regional Affairs and Transport Reference Committee, Operational issues in export grain networks report p.63

- Grain prices are offered to growers by a large number of grain buyers every day. We estimate prices are offered by over 100 grain buyers that include grain exporters, merchants, container packers and domestic end-users. Most grain offers by buyers on any one day are usually within a range of $5 per tonne.

- Growers have access to benchmark grain prices to develop their selling strategy through a large range of channels. In eastern Australia benchmark local grain price information can be sourced from the ASX futures, CLEAR grain exchange, web sites of grain traders and grain broker information in subscription reports (such as Profarmer) and farmer newspapers.

- Access to expert advice. Growers can also obtain advice on selling for their grain (or execute the sale of their grain) from brokers, farm consultants and merchants. We estimate there are over 50 grain brokers, farm consultants and merchants servicing growers in eastern Australia.

## 5.2 Information and support already provided by GrainCorp

GrainCorp already provides substantial information to the market that is not provided by many of our competitors. This information includes:

a) Weekly grain receivals during harvest and monthly wheat country stocks (to the Australian Bureau of Statistics);

b) Posted cash prices at GrainCorp silos;

c) Daily shipping stem volumes by port and grain type and weekly disclosure of stocks at port;

d) Total grain metrics (from our investor publications);

e) Quality reports to owners of grain at a particular site of the average grain quality at that site, by grade, pest control and other data for assist customers with their grain execution; and

f) Annual crop report on the eastern Australian harvest that provides information on grain properties, end use performance and major varieties included in grades.

GrainCorp also provides a tool for growers to ‘opt in’ their warehousing information into the public domain. This allows growers to disclose their grain stock to the market, if they wish to do so, through CLEAR. CLEAR is an independent grain exchange owned by the NZ Stock Exchange.

Through CLEAR, growers and buyers can anonymously post cash offers and bids for grain from warehousing. GrainCorp has no visibility or control over these transactions. As part of this process growers can show their grain stocks by grade and site against an offer price.

Furthermore a large amount of additional public information is available to market participants:

- Grain production forecasts by region, provided by regular government reports (ABARES) and regular private reports (Australian Crop Forecasters);

- Grain pricing information, provided by a large range of sources such as silo cash prices, CLEAR bids and offers, broker and market reports and ASX futures. This information is provided real time through the internet and email update; and

- Grain stock information, provided by regular government reports (ABS).

## 5.3 GrainCorp proprietary information

GrainCorp acknowledges that it does generate certain information in the course of operating its business, as does any company. GrainCorp, as a commercial company operating in a competitive and contestable market, uses this information to improve its service offering to attract grain from growers and to sell grain to its domestic and overseas consumers.

However, the high level of competition in the Australian market – with multiple buyers competing for grain at each point – means that GrainCorp owns only around 20% of the grain held in our up-country silos and 35% of the grain that is exported through our ports.

As with any other business that generates information from their operations, this limited information should remain with GrainCorp for the following commercial reasons:

- This information has been generated through GrainCorp's investment of over $1 billion in its country and port assets and through the provision of proprietary services such as warehousing[10]. Accordingly, this information is 'private property' and the forced disclosure of this information would represent the removal of property rights.

- Each participant in the grain chain has access to proprietary information, this is particularly the case for multinational grain companies that have established systems to collect international information that impact global grain prices. The forced disclosure of additional information will create an unequal playing field for GrainCorp to compete against multinational grain traders (and other grain participants) who are not required to disclose their proprietary information.

This position was acknowledged by the Productivity Commission in its report:

> *Indeed, international grain handling companies have adopted a similar business model and are able to benefit from information sharing...*
>
> *The global wheat market is highly competitive. Any market power the bulk handlers might enjoy at home could not be effectively passed on in global markets where they are price takers. Lifting costs for rival exporters would potentially lead to reductions in Australian wheat exports and in throughput at port terminals.*

GrainCorp has neither the incentive nor the ability to leverage substantive competitive advantage for its marketing arm from its storage and handling facilities, as our information is incomplete:

- 40-50% of grain in eastern Australia is stored outside our network;

- 80% of grain is acquired and sold by traders through private contracts;

- We have no information about the trading position (long or short) of grain owners in our network;

[10] It should be noted that GrainCorp offers warehousing to growers on favourable terms including free storage for up to two months and deferment in receival storage fees until sale (which is usually paid by the grain buyer).

- We have no information on the destination of the grain until an outloading order is placed; and

- The information is generally out of date as stored grain is usually transferred up to two times, undertaken online with no involvement of GrainCorp personnel.

The ACCC has reviewed GrainCorp's business on five separate occasions, in relation to transactions and port access, and has consistently concluded GrainCorp does not have the ability to leverage any substantive market position in grain trading or downstream processing:

> *The main constraint was that the ownership of grain within GrainCorp's facilities was not fixed …… This means that GrainCorp would not be able to target grain within its system because the ownership of that grain could change.*
>
> *In terms of access to storage, a large amount of grain entered GrainCorp's system in the name of growers or traders …… Therefore GrainCorp would not know who the grain was destined for when it entered GrainCorp's storage facilities.*[11]
>
> And:
>
> *Further, the ACCC considers that the need to require measures such as those proposed by stakeholders or ring fencing rules to ensure competitive neutrality is not strong in the case of GrainCorp. In forming this view the ACCC has had regard to the legitimate business interests of GrainCorp to itself manage its port terminal facilities and the interests of access seekers to obtain access to GrainCorp's port terminal facilities on a non-discriminatory basis.*[12]

Finally, the claim that GrainCorp should provide more information because the company was previously owned by the Government ignores the fact GrainCorp was privatised over 20 years ago. Over the past two decades the shareholders of the company have recapitalised the business to fund substantial investments in the acquisition of storage businesses, construction of new facilities and the upgrading of old facilities.

[11] See ACCC summary at http://www.accc.gov.au/content/index.phtml/itemId/476569/fromItemId/751043

[12] ACCC: GrainCorp Operations Ltd Port Terminal Services Access Undertaking: Decision to Accept, 2011, p. 31

## SECTION 6: AUCTION OF PORT ELEVATION

GrainCorp does not agree with proposals to introduce an auction system across Australia for the allocation of port capacity. The 'first in, first served' approach in the allocation of port capacity is more efficient and has worked well in eastern Australia, with port access fairly and efficiently allocated.

However, as outlined in Section 1, more efficient arrangements could be put in place (e.g. long term access agreements with customers) if the current regulation was removed.

In regards to the need for auctions in eastern Australia, GrainCorp notes and supports the majority finding in the recent Senate Committee Inquiry into operational issues in export grain networks:

> *The committee considers that the extension of that system to all Australian ports at this time would not necessarily improve the competitive position of exporters in the eastern states.*[13]

The auction system used in WA and planned for SA, particularly with bid premiums being pooled and rebated to customers, drives speculation and gaming that in turn distorts the grain market.

This position is supported by an economic analysis conducted by the ACCC's Dr Darryl Biggar:

> *The auction mechanism may not, in certain circumstances, come to an outcome at all. In other circumstances, the auction will reach a conclusion but the outcome of the auction will not reflect an efficient allocation of scarce port capacity.*[14]

This point 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. This issue was also analysed by Dr Darryl Biggar:

> *As a consequence of the rebate mechanism, participants in the auction do not care very much about the overall* level *of prices in the auction. Rather, the parties care primarily about the* relative *price of high-priced slots relative to low-priced slots.*[15]
>
> *....at this point the auction mechanism is not necessarily allocating capacity to those who value it most highly, but to those with the deepest pockets or the greatest ability to bear risk. This may not be an effective allocation, and may not be consistent with a level playing field, or the promotion of competition.*[16]

GrainCorp also has other concerns that an auction system would negatively impact the efficient export of grain from eastern Australia:

1. An auction system is not necessary as there is excess port elevation capacity;
2. The current 'first in, first served' system of allocation is working in eastern Australia, as noted by the ACCC;

[13] Senate Rural and Regional Affairs and Transport Reference Committee, Operational issues in export grain networks report p.35
[14] Biggar, D – Analysis of the proposed Viterra port capacity auction mechanism, 7 March 2012 p.1
[15] ibid p.2
[16] ibid p.4

3. Auctions, and the likely consequential secondary market for port elevation capacity, would drive gaming and speculative behaviour. This will in turn lead to attention being diverted from trading and exporting grain, to trading elevation capacity bookings as a new line of business. The result would be:
    - An additional layer of complexity in exporting grain with less planning and flexibility, increasing uncertainty for customers seeking supply of grain from eastern Australia;
    - An increase in unexecuted port elevation bookings as grain exporters could 'hoard' capacity, particularly in peak months; and
    - Increased costs in executing export sales with exporters generating a port elevation trading margin. This higher cost will be passed back to growers in the form of lower grain prices.

## CONTACT INFORMATION

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