

Review of the *Grain Marketing Act 2002*  
Economic Regulation Authority  
PO Box 8469  
Perth Business Centre  
PERTH WA 6849

## **AWB Limited Submission to the Review of the Grain Marketing Act 2002**

### **Background**

The AWB Group is Australia's biggest agribusiness group of companies, with interests in commodity trading, rural services, finance, supply chain operations, livestock, and real estate. The group operates in all agricultural sectors and also has global operations in the United States, Asia, South America, the Middle East and Europe.

Until recently AWB managed Australia's bulk wheat exports under the single desk arrangements set out in the 1989 Commonwealth Wheat Marketing Act. AWB continues to be the major exporter of wheat from Australia. AWB's involvement in the Australian grains industry extends to domestic grain trading, exports of grains other than wheat, investment in supply chain assets such as storage facilities and grain export terminals, financing grain acquisitions and the provision of risk management advice and service to buyers and growers of wheat.

### **Review of the WA Grain Marketing Act**

AWB welcomes the opportunity to contribute to the WA Government's review of the WA Grains Marketing Act.

AWB's view is that there are several significant shifts underway in global and domestic grain markets which, if supported by the right policy settings, could provide opportunities for significant investment in and development of the Western Australian grains industry.

These include:

- Changes to the Commonwealth Wheat Marketing Act (1989). The new Federal Government has a stated policy of abolishing the current arrangements in favour of a more competitive wheat export model, which is likely to see increased competition in the export wheat market, as opposed to the previous system which was dominated by a single seller.
- Consolidation at all levels in the Australian grains industry. From farms to bulk handlers, marketers and logistics providers, all sectors in the grains industry have

been engaged in a consolidation phase which is to a significant extent being driven by the unwinding of statutory arrangements and the increasing commercialisation of the industry. New business models are also emerging as industry participants attempt to capitalise on their strengths and more efficiently utilise their capital. Foreign investors are looking at Australian agribusiness as an increasingly attractive investment, and several new alliances in the grains industry have recently been formed between local companies and international trading houses.

- Shifts in global supply and demand for grains. Grain prices are currently at record highs. Prices have tended to be volatile in the past, but largely on the back of fluctuations in supply. Whilst the current situation is in part driven by supply shortages, there is also new demand for grains which stems from two seemingly sustainable sources – the rise in incomes and subsequent dietary changes in the developing world, particularly India and China, and the growth in demand for biofuels.

AWB has been a participant in the Grains Licensing Authority-managed permit process for prescribed grains. AWB's view is that the system would be improved if access to permits for the export of prescribed grains was made easier for applicants. There are opportunities for a company such as AWB, which already exports wheat from WA and barley and canola from other Australian states, to provide the same grains to its customers from a Western Australian origin. These opportunities are not just about price. For example, improved supply chain efficiency through the sale of combination cargoes (eg wheat and canola) to customers who require both commodities could be achieved. The current system does not appear to favour the capture of those opportunities as it is too narrowly focussed on premiums and core markets.

A template for the type of improvements to the GLA system which could be made can be found in the National Competition Council's report <http://www.ncc.gov.au/pdf/AST7As-001.pdf>.

AWB believes that the review of the Grain Marketing Act would not be complete without also considering supply chain issues, in particular the operation of both the rail network and the storage and handling of grain exports. It is AWB's view that there needs to be fair and open access to all logistics facilities and that the current regime does not provide that. As grain markets move increasingly towards deregulation policy makers need to be mindful that there are not unintended consequences. An example in the grains industry could be increasing competition in the grains export market, but seeing that competition restricted through the lack of competition among grain export terminals.

To gain a better understanding of these issues, AWB commissioned the WA Chamber of Commerce and Industry to compile an independent study of the impact of wheat market deregulation in Western Australia, which is attached for your



AWB LIMITED ABN 99 081 890 459  
380 La Trobe Street, Melbourne, Victoria 3000, Australia  
GPO Box 4562, Melbourne, Victoria 3001, Australia

Telephone 03 9209 2000  
Facsimile 03 9670 2782  
[www.awb.com.au](http://www.awb.com.au)

---

consideration. Whilst the report focuses on the wheat industry, the principles and findings of the report are equally relevant to the prescribed grains covered under the WA Grain Marketing Act.

AWB would be pleased to provide further information of assistance to the Review.

For assistance please contact:

Paul Ryan  
AWB Industry Relations Manager – WA  
Level 8/8 Bennett St  
East Perth 6004  
Telephone: 08 9318 8290



# Implications of Wheat Marketing Deregulation

A Report Commissioned by  
AWB Limited

March 2007



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

# Table of Contents

<b>About CCI .....</b>	<b>3</b>
<b>Introduction.....</b>	<b>3</b>
<b>Executive Summary.....</b>	<b>3</b>
<b>Key Findings .....</b>	<b>7</b>
<b>Overview of the Wheat Industry .....</b>	<b>9</b>
<b>A Brief History.....</b>	<b>9</b>
<b>Economic Profile.....</b>	<b>10</b>
<i>Wheat Production.....</i>	<i>10</i>
<i>Wheat Markets.....</i>	<i>11</i>
<b>Industry Profile.....</b>	<b>11</b>
<i>Production.....</i>	<i>11</i>
<i>Transportation, Storage &amp; Handling.....</i>	<i>12</i>
<i>Sales &amp; Marketing.....</i>	<i>15</i>
<b>Regulatory Environment .....</b>	<b>17</b>
<i>History.....</i>	<i>17</i>
<i>Commonwealth Wheat Marketing Act 1989.....</i>	<i>18</i>
<i>Bulk Handling Act 1967.....</i>	<i>20</i>
<b>Supply Chain Analysis .....</b>	<b>21</b>
<b>Industry Dynamics.....</b>	<b>21</b>
<i>Production.....</i>	<i>22</i>
<i>Distribution.....</i>	<i>23</i>
<i>Sales and Marketing.....</i>	<i>23</i>
<b>Key Issues .....</b>	<b>24</b>
<i>Market Power of CBH.....</i>	<i>24</i>
<i>Market Power of AWB.....</i>	<i>28</i>
<b>Implications of Reform.....</b>	<b>31</b>
<b>Reform Options.....</b>	<b>31</b>
<i>Deregulation.....</i>	<i>31</i>
<i>Partial Deregulation – Licensing Systems.....</i>	<i>31</i>
<i>Single Desk.....</i>	<i>32</i>
<b>Supply Chain Implications of Reform.....</b>	<b>32</b>
<i>Deregulation.....</i>	<i>34</i>
<i>Partial Deregulation.....</i>	<i>35</i>
<i>Summary.....</i>	<i>36</i>
<b>Facilitating Competition.....</b>	<b>37</b>
<b>Issues for Review.....</b>	<b>37</b>
<i>Supply Chain Transparency.....</i>	<i>37</i>

## Implications of Wheat Marketing Deregulation

A Report Commissioned by  
AWB Limited



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

<i>Pricing Structures</i> .....	38
<i>Vertical Integration</i> .....	39
<b>Avenues for Review</b> .....	<b>40</b>
<i>Economic Regulation Authority</i> .....	40
<i>COAG Competition and Infrastructure Reform Agreement</i> .....	41
<i>Access Arrangements</i> .....	42
<b>Appendix A – Standard Service Agreements</b> .....	<b>46</b>
<b>Appendix B –Competition Policy</b> .....	<b>49</b>
<b>National Competition Policy</b> .....	<b>49</b>
<b>National Reform Agenda</b> .....	<b>50</b>
<i>Competition and Infrastructure Reform Agreement</i> .....	52
<b>References</b> .....	<b>54</b>
<b>Endnotes</b> .....	<b>56</b>

**Implications of Wheat  
Marketing Deregulation**

A Report Commissioned by  
AWB Limited

**Disclaimer**

*This report has been prepared by CCI Economics for the exclusive use of AWB Limited. It has been prepared on the basis of publicly available information at the date of publication, including information supplied by AWB Limited. CCI Economics does not accept liability for any claim that may arise from any person acting on this information.*

*For further information on this report, please contact:*

*John Nicolaou  
Chief Economist  
Chamber of Commerce and Industry WA  
Ph: (08) 9365 7587*



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

## **About CCI**

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

CCI exists to serve its members and the broader business community as the State's leading representative for commerce and industry, dedicated to the pursuit of a competitive and responsible free enterprise economy for the benefit of all individuals in our society.

## **Introduction**

The Federal Government is currently undertaking an inquiry into the future wheat marketing arrangements for the 2007 crop and beyond.

It is not the purpose of this report to examine the single desk marketing arrangements or the possible reform options that are currently being considered by the Wheat Export Marketing Consultation Committee. Rather, the report's purpose is to examine the competitive environment that exists across the wheat industry supply chain, and analyse the impact of the possible reform options on the competitive environment.

This analysis will be undertaken with reference to Western Australia, as the largest producer of wheat in Australia, and from where the majority of Australia's wheat exports originate.

## **Executive Summary**

Western Australia's wheat industry is the largest in Australia, and is recognised as one of the most efficient and competitive not only in Australia but across the world. However, by virtue of its relatively small population base, the majority of the wheat that is produced in WA is exported overseas rather than consumed domestically.



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

This has therefore made Western Australia a critical part of the AWB's national wheat pool which it markets overseas as part of the Government-mandated single desk arrangements. While AWB currently maintains an exclusive right to market wheat overseas without a permit, it does not own or control any storage, handling and transportation infrastructure in Western Australia. The storage and handling system, including port terminals, is owned by CBH, and land transport is coordinated through rail and road operators.

The CBH Group has evolved into a strong and diverse organisation over many years in Western Australia, with the foundations of this growth built around protection originally provided under the *Bulk Handling Act 1967*. This allowed it to invest in a substantial storage and handling infrastructure network, establishing CBH in a very strong position of supply chain control, where there are high barriers for entry by potential competitors. Through its subsidiary, the Grain Pool, the CBH Group has also developed a strong marketing focus as the main licence holder to export barley, canola and lupins from the State, and more recently its wheat marketing products through AgraCorp. More recently, it also obtained a special licence to export 500,000 tonnes of wheat to its Asian flour milling investment in Indonesia.

In a similar manner, AWB has grown into a strong and diverse organisation with the assistance of the protection afforded under the single desk. This has allowed AWB to undertake strategic investments around the world, as well as establish a presence in other related businesses.

In the context of the WA market, however, the size and scale of AWB is moderated to some extent on the grounds that it does not control key grain storage, handling and transportation infrastructure networks. This has been confirmed by its regulator – the Wheat Export Authority – which found that AWB appears unable to use its market power to significantly influence country storage and handling costs in WA.

Given the nature of the wheat market in Western Australia (and similarly in other States), the discussion over future deregulation of the wheat export marketing arrangements must be cognisant of the implications that this would have on the competitive dynamics within the wheat industry.

This report has found that reform to wheat marketing arrangements – either through partial or full deregulation – could have anti-competitive implications for the wheat industry overall. These concerns need to be investigated by Government when making its decision on reform to wheat marketing arrangements.

While the objective of reforming wheat marketing arrangements is founded on National Competition Policy (NCP) principles, which have been committed to by



all Australian governments, the potential for such reforms to lessen or restrict competition across the supply chain would be inconsistent with such principles.

The overall outcome of any changes to the wheat industry should be that there is a truly competitive environment in all aspects of the industry – not just in relation to one specific part of the supply chain (that is, wheat marketing).

The report has found that if the single desk is removed and wheat exporting is deregulated, this would mean that AWB would become one of a number of grain accumulators seeking to purchase grain for export. It could be argued that the familiarity of growers with the AWB, and the fact that many growers are shareholders in the privatised entity, would mean that AWB would continue to remain a competitive force in relation to the marketing of wheat for export.

However, given the extent of CBH's operations in the wheat supply chain, and in relation to other grains, this represents a competitive threat to AWB's core business of marketing wheat, and an opportunity for CBH to further grow its business.

Deregulation of wheat marketing could, however, trigger other reforms to the grain market more generally. In this regard, a review of the current arrangements under the Western Australian *Grain Marketing Act 2002* can be triggered if the national wheat single desk is removed. This in turn could present an opportunity for AWB to compete in the coarse grain market.

Notwithstanding the control that CBH has over the key storage and handling infrastructure in Western Australia, there are a number of key issues which require further consideration in order to help facilitate competition in the wheat industry.

An important aspect in facilitating competition will be to review the ways in which CBH can control the supply chain, such as through the standard service agreements that CBH requires its customers to accept. Through their control over the supply chain, and because of the structure of the standard service agreements, CBH is provided with both informational and operational advantages, which are not available to other market participants.

CBH has also recently introduced a differential pricing structure which provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport).

While such a pricing structure makes sound business sense for CBH, there is a concern that such a pricing structure will provide CBH with further competitive advantages in a deregulated market that allows it to also become a marketer of wheat. It will mean that CBH will have the opportunity to control their own stocks



and effectively charge their marketing division a cheaper price on account that the stock will be fed through the CBH supply chain.

In a deregulated environment, it is expected that CBH will become a more vertically integrated business and, by expanding into wheat marketing, this will provide it the opportunity to complete its supply chain link from the grower right through to its overseas flour mills.

Concerns with vertical integration across the supply chain stem from the power it provides the infrastructure owner to offer preferential pricing to its affiliates at the expense of independent competitors. At worst, such power can lead to the denial of access to external parties. This may result in higher prices and/or inefficient restrictions on output.

While it is important that the implications of the current wheat marketing arrangements on the wheat industry more generally need to be understood, there are also ways in which competition could be facilitated – both in the context of the current environment and, more importantly, in a partially or fully deregulated wheat marketing environment.

In Western Australia, the Economic Regulation Authority (ERA) exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda agreed to by the Council of Australian Governments (COAG) in February 2006.

This becomes especially important given that the *Bulk Handling Act 1967* does not contain any provisions for review of the legislation.

As part of the New National Reform Agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. Essentially, the agreement notes that ports should only be subject to economic regulation where a clear need exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power. The agreement also stipulated that each jurisdiction would review the regulation of ports and port authorities, and the handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with National Competition Policy.



On the basis of the COAG agreement, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.

Given the monopoly aspects of CBH's facilities, another avenue that could be pursued to ensure fair market access to such facilities is to have them "declared" under Part IIIA of the *Trade Practices Act 1974* (TPA). The resulting development of an access regime would provide certainty on the terms and conditions on which CBH would provide access. Importantly, this would require the development of transparent costing and pricing policies, and would ensure that prices are set by an independent arbitrator.

However, the Part IIIA process is time consuming and costly, and it is not clear whether all the infrastructure owned by CBH would satisfy the criteria for it to be declared an essential service. However, this has never been tested.

## Key Findings

The key findings from the report are detailed below.

1. Because reforms to wheat marketing arrangements could have anti-competitive implications for the wheat industry overall, it is important that this is investigated by Government prior to making any decision on reform to wheat marketing arrangements.
2. The lack of transparency across the supply chain has provided bulk handling companies like CBH with both informational and operational advantages, which will be exacerbated upon deregulation of the wheat marketing arrangements.
3. The application of differential pricing to traders for port outloading will be likely to provide CBH with further competitive advantages in a deregulated environment. While it is unclear whether such a pricing structure breaches the TPA, this should be investigated.
4. As CBH becomes more vertically integrated and therefore increases its market power, this will have implications for other competitors that utilise its services.
5. In Western Australia, the ERA exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda.



6. On the basis of the *Competition and Infrastructure Reform Agreement* signed by COAG in February 2006 as part of the New National Reform Agenda, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.
7. Seeking to have the infrastructure owned by CBH declared an essential service for the purposes of Part IIIA of the TPA represents a legal avenue for access, if it is deemed that access cannot be obtained on “reasonable” terms and conditions at “fair” prices.

**Implications of Wheat  
Marketing Deregulation**

---

A Report Commissioned by  
AWB Limited



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

# Overview of the Wheat Industry

## A Brief History<sup>1</sup>

The industry had its beginnings over 200 years ago when Governor Phillip, realising the need to make the colony self sufficient in food, established a 40 acre government farm at Parramatta.

By the end of 1790, 200 bushels (approximately 5.4 tonnes) of wheat had been harvested, all of which was saved for seed. With the opening up of Liberty Plains (now two of Sydney's western suburbs, Homebush and Strathfield) by free settlers, the colony had 6,000 acres under wheat by 1799.

With the settlement of Victoria, South Australia and Western Australia during the 1830s and 1840s, cultivation of wheat expanded rapidly.

Assisting the expansion of the wheat industry into large scale operations were the inventions of the scrub roller, the “stump jump” plough and the header harvester. Between them, these machines allowed for the clearing and preparation of large tracts of land and harvesting of the bigger crop. The opening up of the inland country railway network in the 1880s greatly improved the efficiency of crop transportation.

Complementing these mechanical advancements was research into new wheat varieties more suitable to the Australian environment and mechanical harvesting, and more resistant to disease. In later stages, growth of the Australian wheat industry was supported by changes in many farm management activities, including the introduction of mixed farming, crop rotation, application of fertilisers, improvements in cultivation techniques, and, since the 1940s, the use of tractors.

The improvement of bulk grain handling systems, development of chemicals to combat diseases, pests and weeds, and the further development of higher yielding disease resistant wheat strains are some of the off-farm activities that continue to make important contributions to the industry.

Since the loss of the United Kingdom market in the 1960s, researchers have sought to create wheat varieties which meet the end-use requirements of Middle Eastern and Asian customers. Australian wheat enjoys an excellent reputation for quality in international markets and the hard white varieties are particularly suited to the production of food products in East Asia, such as instant and fresh noodles.

While tailoring these products for the Australian and international end-markets, researchers had to also ensure that the wheat was high yielding and suitable for the differing environmental conditions experienced across the wheat belt from Queensland to Western Australia.



Initially, wheat breeding and research was limited by the available genetic material. However, from the early-1970s to mid-1980s there was a rapid increase in the availability of new, high yielding varieties to Australian growers.

Wheat growing areas are determined by soil type, soil fertility, topography and rainfall. Rain should predominantly fall during the winter and spring months and needs to be of an annual average between 400 and 600 millimetres per year at a minimum. Suitable conditions prevail on mainland Australia in an area west of the Great Dividing Range known as the wheat belt which stretches from Central Queensland through New South Wales and Victoria and on to South Australia in the form of a narrow crescent, continuing into the south west of Western Australia. In addition, a small area of land in Tasmania is used for growing wheat.

Over time, Western Australia's wheat industry has evolved considerably, and today it has the most area under wheat and the biggest crop of any State in Australia.

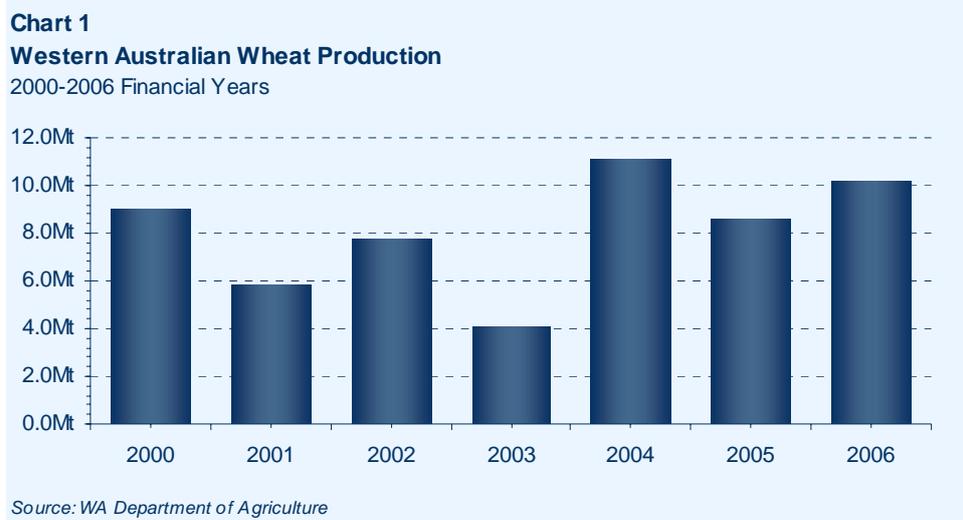
## Economic Profile

### Wheat Production

Wheat production is Western Australia's largest agricultural crop, with wheat production averaging 8.2 million tonnes per annum over the five years to 2005-06, with an average value of \$1.8 billion. In 2005-06, 9.5 million tonnes of wheat were produced, representing an increase of 10 per cent from the previous year (Chart 1).

Overall, wheat production accounts for almost 30 per cent of the total value of agricultural production, and around 60 per cent of total grain production in Western Australia.

The major wheat growing areas in Western Australia were the central (Kwinana)



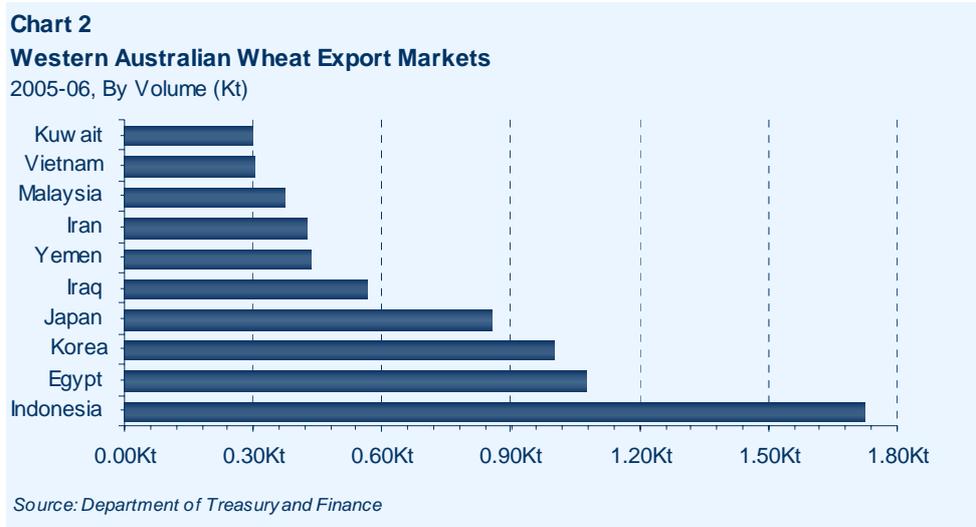
region, which produced approximately 50 per cent of the total wheat production, the northern (Geraldton) region, which produced 27 per cent of total production, the southern (Albany) region, which produced 14 per cent of total production, and the Esperance region, which produced nine per cent of total production.

**Wheat Markets**

There are two flour mills in Western Australia, with the majority of the production of flour used for domestic purposes. Overall, domestic demand is relatively small in Western Australia, with the majority of wheat produced exported overseas. The Department of Agriculture and Food estimates that approximately 87 per cent of all wheat produced in Western Australia is exported<sup>2</sup>.

In 2005-06, the total value of wheat exported was \$1.6 billion. Wheat exports represent an important export for WA, accounting for 40 per cent of total agricultural exports, and 4.4 per cent of total exports.

Western Australia’s top 10 wheat export markets in 2005-06 are detailed in Chart 2 below. Indonesia was the State’s largest wheat export market in 2005-06, followed by Egypt, and South Korea. These three markets accounted for almost half of all Western Australia’s exports in 2005-06.



**Industry Profile**

**Production**

Western Australian wheat producers are some of the most efficient in the world. As with most areas across Australia, there has been significant consolidation of farms in Western Australia, with the total number of grain growing farms falling by 50 per cent since the late 1970s<sup>3</sup>.



This was highlighted in a recent report by ACIL Tasman, which found that Western Australian growers are:

*“becoming larger, reaping scale economies, becoming more specialised, more reliant on wheat income, experience less variation in yield and total production, and are increasing total factor productivity more rapidly”<sup>4</sup>.*

### **Transportation, Storage & Handling**

The wheat supply chain in Western Australia is integrated across transport modes and involves a range of storage and handling facilities. The network extends seamlessly from farm gate to port, ensuring Western Australia’s wheat market is one of the most efficient and competitive in the world.

The rail system serving the grains industry comprises both narrow and standard gauge track, with the majority of grain handled on the narrow gauge network. On 16 February 2006, the above rail operations of Western Australia’s rail network owned by the Australian Railroad Group were sold to Queensland Rail, and Babcock and Brown acquired the WestNet Rail below rail business and assume responsibility for the standard gauge and narrow gauge rail infrastructure leases in WA.

The rail network plays a critical role in the transportation of wheat to port facilities for export. In Western Australia, freight rates for the use of the rail network are established under an industry contract negotiated with CBH, AWB, the Grain Pool, the Western Australian Farmers Federation, and the Pastoralists and Graziers Association.

Grain is also transported via the road network, with the Department of Agriculture and Food estimating that about 40 per cent of all grains delivered to ports for export transported by road<sup>5</sup>.

There are four major grain ports located strategically around Western Australia. These port facilities are used for storing, loading and unloading grain. These facilities are all owned by CBH. The facilities are considered to be world class, and have the lowest storage and handling charges of all other ports in Australia.

There are almost 200 strategically located storage facilities across the southern part of Western Australia, with CBH estimated to receive 85-90 per cent of the State’s grain crop per annum (with the rest stored on farm either for domestic use or kept for seed). Around half of grain produced is directed through Fremantle Port, although the regional ports of Albany, Geraldton and Esperance also play an important role in the export of grain from Western Australia and their transport links are also significant.



## CBH Group

The CBH Group is a vertically integrated group of companies which stores, handles and markets grain. However, its primary function continues to be the storing and handling of grains.

The company comprises of CBH Grain Operations, Grain Pool Pty Ltd, AgraCorp Pty Ltd and Bulkwest Engineering Pty Ltd.

- **CBH Grain Operations** manages the grain supply chain from farm to ship.
- **Grain Pool** holds the main licence to export barley, canola and lupins in bulk out of Western Australia.
- **AgraCorp** markets and trades a range of other grains including wheat, triticale and oats.
- **Bulkwest Engineering** services a range of rural, Australian and international customers providing innovative design, manufacturing and turn-key storage and handling construction solutions.

The CBH Group also invested strategically further down the supply chain. In 2004, the CBH Group established a joint venture company, **Pacific Agrifoods**, with partners The Salim Group, to invest in the Asian value chain and to grow value for the Western Australian grains industry. Through Pacific Agrifoods, the CBH Group holds a stake in five flour mills in Indonesia and Malaysia and a grain terminal and flour mill in Vietnam.

CBH has also directly invested in the **Eastern Pearl Flour Mill** in Indonesia, which is the fourth largest flour mill in the world, with an annual production capacity of 840,000 tonnes.

It should also be noted that on 22 December 2006, the CBH Group was granted a **wheat export licence** from the Wheat Export Authority and the Federal Minister for Agriculture, Hon Peter McGauran MP, to export 500,000 tonnes of wheat to its Asian flour milling investment in Indonesia. This application followed the transfer of the power of veto that originally was held by AWB Limited to the Federal Minister for Agriculture. This decision has effectively expanded CBH's operations to now include the export of wheat.

To store and handle grain, the CBH Group has developed almost 200 strategically located terminal and country receival points across the south-western part of the state, with a total storage capacity of over 19 million tonnes.



The main grain types stored and handled across the state include wheat, barley, lupins, oats, field peas, canola, chick peas and faba beans. Other grains handled in smaller quantities include triticale, rye and albus lupins.

Western Australian grain is transported by rail or road from country receival points into four port facilities located at Geraldton, Kwinana, Albany and Esperance. Each country receival point is located within a zone. There are six zones – Geraldton, Kwinana South, Kwinana North, Kwinana East, Albany and Esperance. Each zone is further divided into areas, with offices located at Avon, Corrigin, Katanning, Koorda, Lake Grace, Merredin, Morawa and Wongan Hills.

The **Geraldton grain terminal** port facility was established by the CBH Group in 1937, and the most recent upgrade was completed in 1994 where construction of fourteen 10,000 tonne steel silos with separate road/rail discharge hoppers and the installation of computerised equipment created a modern and highly efficient facility.

Grain is delivered by road and rail from 23 receival points within the Geraldton zone. During the annual harvest, the Geraldton grain terminal becomes one of the busiest receival points in the world, with growers delivering between 20,000 and 30,000 tonnes of grain per day. The terminal currently has a grain storage capacity of just over one million tonnes and a ship loading speed of 2,000 tonnes per hour.

The **Kwinana grain terminal** is Western Australia's primary grain export facility, shipping more than half of the state's export grain and with a total storage capacity of more than one million tonnes. The terminal was opened in 1976 and receives grain from nearly 120 country receival points throughout the Kwinana zones. Grain is transported by rail to the terminal at Kwinana, which has a current storage capacity of more than one million tonnes.

The **Albany grain terminal** was built in 1956 and has been upgraded and extended several times to provide for increasing volumes of export grain. In 1984, a major upgrade added ten 10,000 tonne concrete silos and a 120,000 tonne horizontal storage structure. In 1995, an 113,000 tonne capacity horizontal annexe was added.

In 2006, the Albany grain terminal received a further \$130 million upgrade to increase operating efficiencies and create greater storage capacity. The latest upgrade has resulted in the full integration of all storages and transformed the terminal into a state of the art, world class facility with the construction of ten 6,000 tonne storage cells for grain. The current storage capacity is over 470,000 tonnes. Grain is received by road and rail from the 41 receival points in the Albany zone.



The **Esperance grain terminal** was built in 1962 to cater for increasing volumes of grain produced in the Esperance region. Steady growth in production for the region led to a \$68 million upgrade in 2000. The current storage capacity of the terminal is now more than 240,000 tonnes. The majority of grain is received by road from the CBH Group's 15 receival points in the Esperance zone. Only two receival points, Grass Patch and Salmon Gums, are connected by rail to the terminal.

The CBH Group parent entity is exempt from income tax by virtue of Section 50-40 of the *Income Tax Assessment Act 1997*. This exemption comes by virtue of its establishment "for the purpose of promoting agricultural production", but this is "provided that it is not carried on for the profit or gain of its individual members".

Under the *Bulk Handling Act 1967* (see page 20 for further details), CBH is permitted to build up reserves and does not make distributions of these reserves to shareholders.

### **Sales & Marketing**

In Australia, the sales and marketing of wheat for export overseas is undertaken by AWB (International) Limited (AWBI), a subsidiary company of AWB Limited (AWB).

AWBI is the Government-mandated exclusive exporter of Australian bulk wheat under the Single Desk marketing system. This Single Desk allows AWB to offer the National Pool, which is open to all of Australia's 30,000 wheat growers. Both AWBI and AWB Limited have a constitutional mandate to maximise net returns to those who deliver wheat to the AWB National Pool. The AWB National Pool markets, on average, \$4 billion worth of Australian wheat annually to around 100 customers in more than 40 countries worldwide<sup>6</sup>.

Operating the AWB National Pool requires managing the wheat supply chain from over 700 receival sites across the Australian wheat-belt right through to international customers.

#### *AWB Limited*

AWB, AWBI and AWB (Australia) Limited (AWBA) were established under amendments to the *Wheat Marketing Act 1989* which effected the privatisation of the Australian Wheat Board. On 1 October 2003, AWB was restructured to separate AWB's wheat export related operations from its commercial activities for credit rating purposes and the acquisition of Landmark. As a result, AWB now has a number of operating subsidiaries.

In general terms, the roles of the major companies in the group are set out below<sup>7</sup>:



CHAMBER OF COMMERCE  
AND INDUSTRY  
WESTERN AUSTRALIA

- **AWB**, as the holding company, is responsible for joint venture investments and projects and earning a return on shareholders' funds. It is also the vehicle for the voting interest of growers in the conduct of the AWB National Pool and the services provided to it.
- **AWBI** is responsible under the *Wheat Marketing Act 1989* for operating the AWB National Pool with the objective of maximising and distributing net returns to growers who sell grain to the pools, and manages the export of bulk wheat through the Single Desk system as well as exercising the statutory power of approval of other bulk wheat exports.
- **AWBA** is responsible for domestic wheat and other grain trading as well as the export of other grains. Its activities also extend to other commercial ventures such as chartering and AWB Seeds.
- **AWB Services Limited** provides, on a fee for service basis, the management and business infrastructure required to support AWB Group operations, including asset management and staff.
- **AWB Harvest Finance Limited** provides growers delivering to the AWB National Pool with a suite of financing alternatives. It also manages foreign currency and interest rate exposures for AWBI's pooling activities.
- **AWB Commercial Funding Limited** provides working capital finance and manages foreign currency and interest rate exposures for the commercial subsidiaries of AWB.
- **AWB Riskassist Limited** provides risk management services to growers participating in the Basis Pool, in particular, providing a service to manage foreign currency and commodity risk.
- **AWB GrainFlow Pty Ltd** operates AWB's supply chain and logistical services and provides modern bulk grain handling facilities to growers. AWB GrainFlow Pty Ltd owns 21 grain centres throughout Victoria, New South Wales, South Australia and Queensland.
- **Agrifood Technology Pty Ltd** provides analytical services to assist AWB's marketing program. Agrifood Technology Pty Ltd generates a commercial return by providing world class analytical and laboratory services to external clients in the food and feed related industries.
- **Landmark Operations Limited** is the principal operating entity for Landmark in Australia (excluding Queensland).

AWB's corporate structure consists of two classes of shares:



- *A Class shares* – which are shares that can only be issued to current wheat growers (that meet the definition of a grower in the AWB constitution), cannot be transferred and are automatically redeemed when the A Class shareholder ceases being a wheat grower. A Class shares are not entitled to receive any dividends, however, they do carry other important rights giving A Class shareholders control of AWB, including giving A Class shareholders the ability to elect a majority of the Board of directors of AWB.
- *B Class shares* – these are the shares which are quoted on the Australian Stock Exchange (ASX). B Class shares carry rights to receive dividends and the right to elect a minority of the Board of directors of AWB. They can be freely traded between wheat growers and non-growers, subject to no shareholder owning more than 10 per cent of the B Class shares on issue. B Class shares commenced trading on the ASX on 22 August 2001.

AWB's evolution from a marketer of wheat to a conglomerate under which a number of subsidiaries operate, has meant that today AWB is one of Australia's top 200 companies (as listed on the ASX).

## **Regulatory Environment**

### **History**

In 1915 the Commonwealth Government set up a wheat pooling scheme to assist wheat growers and to ensure appropriate management of this vital foodstuff during World War I. It was administered by an Australian Wheat Board, comprising the Prime Minister and a Minister from each wheat growing state. Under the scheme, returns from each season's wheat crop were pooled (over time and across markets) and shared fairly among all growers for the duration of the World War I.

After the first Australian Wheat Board ceased operations in 1921, regional wheat pools continued, often managed by farmer cooperatives.

At the beginning of World War II, the Australian Wheat Board was established as a statutory authority under National Security (Wheat Acquisition) Regulations to handle all matters connected with wheat disposal during World War II. Following the war, legislation was passed to establish the peacetime Wheat Board in 1948. The purpose of the board was to ensure that the wheat industry operated in an environment of price stability and orderly marketing and was responsible for the receipt and sale of virtually all wheat produced in Australia.

In 1984 the domestic feed market for wheat was effectively deregulated and growers could sell, under a permit system, to anyone they chose. This was the first step in the deregulation of the Australian domestic wheat market and was designed to benefit the industry by injecting greater flexibility and competition.



In 1989, the domestic wheat market was completely deregulated and since that time has operated without any specific government regulation. At the same time, the Commonwealth government established the Wheat Industry Fund, a compulsory levy on wheat sales, to create a sufficient capital base for the privatisation of the Australian Wheat Board.

In July 1999, the Wheat Board ceased to operate as a government controlled statutory authority and became AWB Limited, a grower-owned and controlled corporation with a dual-class share structure. At this time, all government financial assistance for the Wheat Board, such as underwriting its borrowings, ended. AWB Limited became a public company in 2001, when B-class shares (issued to holders of the units in the Wheat Industry Fund) were listed on the Australian Stock Exchange and today it is one of Australia's top-100 largest public companies.

Through a subsidiary company, AWBI, AWB Limited continues to be the sole exporter of bulk wheat from Australia (under the Single Desk system). Using the Single Desk system – established under the *Wheat Marketing Act 1989* – AWB Limited has a formal obligation to maximise returns to wheat growers from the national pool through being the only exporter of Australian wheat. The Single Desk system aims to capture value through price premiums, reducing supply chain costs, risk management and giving growers access to buyers in over 40 countries.

A government regulator, the Wheat Export Authority (WEA), was established by the Commonwealth Government to monitor and report on AWBI and to manage the system that allows exports of wheat in containers and bags outside the Single Desk.

### **Commonwealth Wheat Marketing Act 1989**

Until 1998 the Wheat Marketing Act prohibited the export of wheat by anyone other than the Australian Wheat Board without the board's consent. In addition, the Act guaranteed the board's borrowings until July 1999 and provided for the accumulation of the Wheat Industry Fund to eventually replace the statutory guarantee.

In 1998 the Act was amended to facilitate the establishment of a grower owned and controlled company, AWB Limited, and its export pool subsidiary, AWBI, to assume responsibility for wheat marketing and financing from July 1999. The amendments also:

- established the WEA to control the export of wheat and to report to the Australian Government minister for Agriculture before the end of 2004 on the performance and conduct of the AWBI;



- conferred on the AWBI the power to export wheat without the WEA's consent; and
- exempted anything done by the AWBI in exporting wheat from Part IV of the *Trade Practices Act 1974*.

The power of the WEA to control the export of wheat is constrained. The amended Act requires the WEA to consult the AWBI before consenting to the export of wheat; for proposed exports in bulk, the WEA cannot consent without the AWBI's approval.

In early 2000, the government commissioned a three-member committee to review the Act against the Competition Principles Agreement (CPA) under National Competition Policy (NCP). The committee recommended that:

- the government retain the single desk until the 2004 review required by the Act;
- the 2004 review incorporate NCP principles and be the final opportunity to show a net community benefit from the arrangements; and
- the government convene a joint industry–government forum to develop performance indicators for the 2004 review.

The committee also recommended that the WEA trial for three years a simplified system of consents for the export of wheat in bags and containers by other exporters.

The government responded on 4 April 2001, stating that it would retain the single desk but would not conduct the 2004 review under NCP principles. The Minister argued that the latter decision is necessary to avoid further uncertainty in the industry and for wheat growers. The government agreed to the development of rigorous and transparent performance indicators to ensure the 2004 review accurately measures the benefits to industry and the community.

In June 2002, the National Competition Council (NCC) assessed that the government had not met its obligations under the CPA arising from the *Wheat Marketing Act*, because the review did not show that retaining the wheat export single desk is in the public interest. Rather, the review found that allowing competition is more likely to be of net benefit to the community.

This position was reiterated in subsequent NCP assessments in 2003, 2004 and 2005.



On 7 December 2006, Federal Parliament passed legislation to remove AWB of its wheat export veto, handing it to the Federal Agriculture Minister for six months. Following this decision, Agriculture Minister Peter McGauran approved two applications for export permits, allowing Wheat Australia to export 300,000 tonnes to Iraq, and CBH to send 500,000 tonnes to its Indonesian flour mills.

### **Bulk Handling Act 1967**

The *Bulk Handling Act* was enacted in 1967 to regulate the bulk handling of grain by Cooperative Bulk Handling Ltd (CBH).

The passage of the *Bulk Handling Amendment Act 2002* repealed major restrictions on competition in the *Bulk Handling Act 1967*. CBH no longer has the sole right to receive grain in bulk and to handle, transport and deliver bulk grain in Western Australia. Ministerial approval is no longer required for installation and alteration of grain handling and storage facilities, and the Treasurer will no longer issue government guarantees in respect of moneys borrowed by the Grain Pool Pty Ltd, the Company formed out of the merger of Cooperative Bulk Handling Ltd and the Grain Pool of Western Australia.

CBH is still controlled in part by statute under the *Bulk Handling Act 1967*. The Act is administered through the Western Australian Department of Agriculture and Food.

Under this Act, CBH must allow any person to utilise any bulk handling facilities it owns at ports, but is free to determine the appropriate fee for using these facilities.

Following these changes, the NCC assessed that the Act was deemed to comply with the obligations under the CPA. In its 2003 Assessment, the NCC stated that:

*“The Council assesses that Western Australia has met its CPA clause 5 obligations arising from the Bulk Handling Act. The continued requirement that CBH accept all grain tendered to it is most unlikely to restrict competition as it does not prevent new entry into the bulk handling and storage services market and, as CBH is free to determine its charges and the location and standard of facilities, it does not in practice prevent CBH from responding to new entry, actual or threatened, through, for example, changes to its service prices or its receival site network.*

*In relation to port facilities it is open to anyone not satisfied with CBH’s voluntary terms of access to invest in alternative facilities or to seek to have CBH’s facilities declared under Part IIIA of the TPA.”*



# Supply Chain Analysis

## Industry Dynamics

Prior to examining potential reform options to the wheat industry, it is important that an assessment be undertaken on the wheat industry supply chain. By examining the supply chain, this can assist in determining the competitive environment, and the implications of any reform options on the competitive environment.

At its broadest level, the wheat industry supply chain can be broken down into wheat growers (production), transport, storage and handling (distribution), sales and marketing, and final consumers.

These sectors (other than final consumers) will be examined separately, by looking at the external environmental and industry factors which impact on the dynamics of the wheat industry.

Broadly speaking the wheat industry is subject to similar external environmental factors, which have a significant influence on the profitability of the industry.

In relation to the *natural environment*, wheat producers are clearly influenced by climatic and weather conditions, as well as other factors such as soil quality. These factors directly impact on wheat producers, but also indirectly impact on the rest of the supply chain to the extent that the amount that is required to be transported and stored, and marketed is reduced.

*Economic factors* also influence the production of wheat, although the demand for wheat globally is seen to be a relatively inelastic commodity, and therefore have relatively stable levels of demand.

*Technological advances* have played a significant role in relation to wheat production, through the introduction of more efficient harvesting techniques and other varieties of wheat which are more suitable to WA conditions, as well as advanced transportation and storage techniques, which have more efficiently brought supply to market.

In relation to *government influences*, these are generally minimal at the production stage of the supply chain, although government assistance is sometimes provided in times of stress (such as drought). Government also provides indirect assistance to wheat producers through its taxation environment. Government, however, has played a more significant role in the other key elements of the supply chain.



- In relation to the distribution sector, CBH has benefited from the initial protection it was afforded under the *Bulk Handling Act 1967*, as it enabled CBH to invest in a substantial storage and handling infrastructure network.
- In relation to sales and marketing, government policy in relation to the marketing of wheat through a single desk has obviously benefited AWB.

The influence of government in relation to the market power gained by CBH and AWB will be explored further on page 24.

It is also important to examine the industry-related factors that impact on each sector. A common approach to assessing the industry environment is Porter's Five Forces Model<sup>8</sup>. This model focuses on the five forces that shape competition within an industry: (1) the risk of entry by potential competitors; (2) the degree of rivalry amongst established companies within an industry; (3) the bargaining power of buyers; (4) the bargaining power of suppliers; (5) the closeness of substitutes to an industry's products.

Overall, it can be said that the stronger each of these forces, the more limited the ability of established companies to raise prices and earn greater profits.

### **Production**

Analysing the production industry with reference to these five forces, it can be concluded that there are competitive elements with producers (growers), although competition is constrained by certain characteristics to the extent that:

- *barriers to entry exist* with respect to the production of wheat due to the land and capital investment requirements;
- there is a *high degree of market power* amongst WA wheat producers collectively when compared to wheat producers in other states and in other countries, due to more efficient production techniques and scale advantages;
- there is a *moderate degree of bargaining power on the part of customers*, on account that while WA producers compete on a global stage, they represent a large share of the total market, and their product is marketed through a single desk, which also increases market power;
- as the first step in the supply chain, it can be seen that the *degree of bargaining power of suppliers is high*, to the extent that wheat producers require the services of CBH (and the rail operators and AWB) to get their product to market (which is primarily export markets); and
- the *threat of substitutes is considered to be low*, due to the fact that wheat is a staple and therefore essential commodity for most countries around the world.



Based on the above analysis, it can be concluded that while wheat producers have a strong position in a globally competitive environment, the degree to which they can raise prices and earn greater profits is influenced to a large extent by CBH (as the supplier of storage and handling infrastructure) and AWB (as the single desk operator).

### **Distribution**

With reference to the five forces framework, it can be concluded that there currently exists a high degree of market power with CBH, although this is mitigated to some extent by virtue of the fact that AWB maintains a government-mandated monopoly position with respect to the marketing of wheat overseas. In this regard:

- there are *high barriers to entry*, with CBH having developed a significant storage and handling infrastructure network substantially under the protection of the *Bulk Handling Act 1967*, which is unlikely to be easily replicated;
- there is a *high degree of market power* to the extent that CBH is a monopoly provider of storage handling services in Western Australia;
- there is a *moderate degree of bargaining power on the part of customers*, on account that while there are limited alternatives to using CBH's services, AWB is also a monopoly provider through the government controlled single desk arrangements;
- the *degree of bargaining power of suppliers is high*, to the extent that CBH requires the use of Western Australia's rail network, with the above rail owned by Queensland Rail and the below rail network controlled by Babcock and Brown; and
- the *threat of substitutes is considered to be low*, due to the fact that CBH is an integrated transportation and service provider.

### **Sales and Marketing**

With reference to the five forces framework, it can be concluded AWB is afforded a high degree of market power, although this market power is mitigated to some extent by the monopoly power that exists with CBH in the transportation and handling of wheat prior to export (in the Western Australian context). In this regard:

- there are *high barriers to entry*, given that the government-mandated single desk arrangements preclude anyone else marketing wheat overseas. This has allowed AWB to build up strong relationships and networks across Australia and around the world;



- there is a *high degree of market power* to the extent that AWB has the legislated single desk monopoly in the marketing of wheat for export in Western Australia (and nationally);
- there is a *low degree of bargaining power on the part of customers*, on account that all wheat has to be marketed through AWB;
- the *degree of bargaining power of suppliers is relatively high*, to the extent that CBH maintains a monopoly through its storage and handling infrastructure in Western Australia. In relation to growers, their degree of bargaining power is also relatively high, on account that all current wheat growers, as A Class shareholders, maintain a degree of control over AWB; and
- the *threat of substitutes is considered to be low*, on the grounds that the only alternative to using AWB's service is to market wheat to the domestic market, which is very small in comparison to total wheat production in WA.

## **Key Issues**

What the previous section highlights is a wheat industry that is heavily influenced by the market power on the part of CBH (as the monopoly provider of storage and handling infrastructure), AWB (as the single desk marketer in Australia), and to a lesser extent the rail operators in Western Australia.

Such an industry structure has evolved on the back of a high degree of government involvement. Therefore, if there were to be changes made in the context of wheat marketing arrangements (which is currently being considered by the Wheat Export Marketing Consultation Committee), then this could have significant flow-on effects to the current competitive balance in the wheat market.

The market power of both CBH and AWB are explored further below.

### **Market Power of CBH**

Under the protection originally provided under the *Bulk Handling Act 1967*, CBH has been able to invest in a substantial storage and handling infrastructure network with a storage capacity of greater than 19 million tonnes, comprising of just under 200 receival points with four port terminals strategically located at Kwinana, Geraldton, Albany and Esperance which is strongly linked with the rail network. This has placed CBH in a very strong position of supply chain control, where there are high barriers for entry by potential competitors.

The major issue with the Act is that pricing of access and services are completely discretionary, and CBH have used this to their advantage.



Although CBH have not increased grower receival charges (i.e. charges direct to growers), storage and handling charges paid by AWB have increased significantly over the last four years.

AWB analysis of CBH charges highlights a significant increase in storage and handling costs, especially in relation to Time Based Storage (TBS) charges. Analysis indicates that over the four year period from 2003-04 to 2006-07, storage and handling charges in WA increased by 52 per cent, while TBS costs increased by 84 per cent. According to AWB, attempts to have CBH review their charges have been unsuccessful.

While it is recognised that CBH provides the cheapest storage and handling charges on a per tonne basis in Australia, it is the rate of increase in CBH charges over recent years (which far exceeds increases by other bulk handlers) that has been of concern to AWB in that it does not appear to be linked to normal inflationary pressures.

It could also be argued that CBH should have lower costs relative to other bulk handlers due to the benefits from being exempt from income tax, the fact that it does not have an obligation to provide dividends to shareholders, and its scale advantages relative to other bulk handlers.

The extent to which CBH controls the supply chain is reinforced through the standard service agreements that CBH requires its customers to accept<sup>9</sup>. While further details are provided in the Appendix A, the following points are worth noting regarding the supply chain control bulk handling companies like CBH are afforded:

1. **Stock Information** – Such information is not available to others, and allows CBH to determine the relevant stock holdings of competing traders, knowledge of what growers are delivering to warehousing, and what supplies of critical grades are available prior to market knowledge.
2. **Site Level Information** – Having access to the quality profiles of the individual bins and bunkers at a storage site allows CBH to be able to arbitrage stock within grades. This superior knowledge (combined with the ability to control the supply chain) allows CBH a greater capability than other traders to blend different grades to a customer specification.
3. **Ability to Move Client and Competitor Stock** – CBH is authorised to move stock, and can do so without notifying the grower. Because the value of the grain to a trader is in its position in the supply chain, this means that if it is moved by CBH, the trader could lose value either through position or through the cost of the freight rate that CBH chooses to charge.



4. **Differential Pricing** – CBH recently introduced differential pricing, which essentially provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport). Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest price.
5. **Operational Advantages** – CBH will be able to move its stock to port in preference to competitors, therefore gaining priority in vessel loading.

Concerns over CBH's market power are not confined to the wheat market and AWB.

Box 1 below represents an extract from the Grain Licensing Authority 2005-06 Annual Report, noting the market power that CBH has in relation to its charges it sets for the Grain Pool (GPPL) and Special Export Licence Holders (exporting grains other than wheat).

**Box 1: Extract from Grain Licensing Authority 2005-06 Annual Report**

CBH introduced a number of policies, fees and charges that appear to be different for the Main Export Licence Holder (GPPL) in comparison to Special Export Licence Holders (SEL) for prescribed grains.

While CBH is a grower owned company it is still controlled in part by statute under the *Bulk Handling Act 1967*. It would appear that CBH are required to allow any person to utilise any bulk handling facilities it owns at ports, but it is free to charge whatever fee(s) it determines.

The uneven application of charges by CBH on GPPL Ltd and SEL's may be justified in some instances. For example where there are clearly greater costs involved in dealing with the requirements of the SEL's. However in a number of instances there does not appear to be justification for some of the policies, fees and charges that CBH has put in place.

A number of SEL's have been in contact with the GLA stating that they believe that they are being unfairly treated by CBH in comparison to the GPPL, a wholly owned subsidiary of CBH. If this is the case, then it is hindering the intended operation of the Act and limiting the competition for prescribed grain on the cash market and lowering prices available to growers.

There is little doubt that the first two years of operation of the GLA have resulted in a significant lift in the cash prices for barley and canola in Western Australia (WA), resulting in better returns for growers who chose to sell for cash.



What is currently not clear is the difference in cost of dealing with an external exporter compared to the GPPL. While it is understandable that costs would be lower for a subsidiary there is no transparency as to how the costs differ and if they are justifiable.

Given that CBH currently holds a natural monopoly on storage and handling in WA, principally through its control of facilities at the four ports, this matter has been referred to the Treasurer, to determine whether the matter warrants intervention under the provisions of the Part IIIA of the *Trade Practices Act 1974*. This matter has been noted by the Department of Agriculture and Food and Treasury, and a Working Group has been formed to look at the issue.

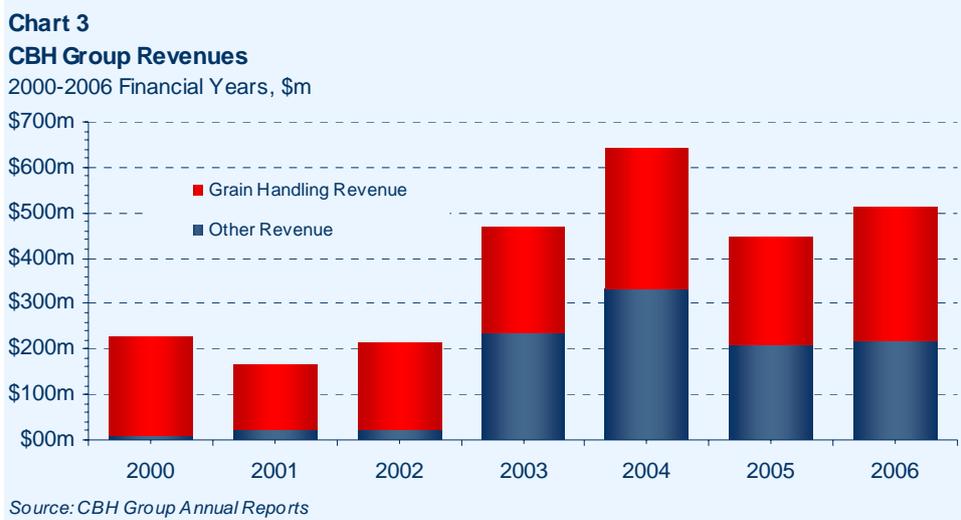
*Source: Grain Licensing Authority 2005-06 Annual Report*

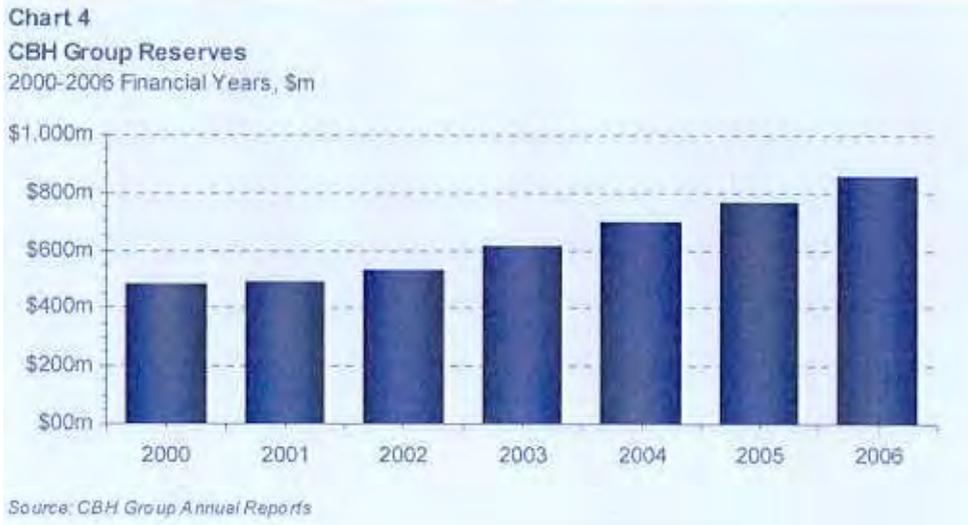
The extent of CBH's market power is clearly reflected in its strong financial position. While the profitability of CBH is to a large extent dependant on the grain harvest in any one year, it has still managed to generate strong results.

In relation to profitability, CBH Group reported a net profit after tax of \$87.3 million for 2005-06, an increase of 42.8 per cent from the previous year. While profitability levels are dependent on the grain harvest, on average since 2001, profits have increased by 56 per cent per annum.

Revenue growth has been similarly strong, with reported total revenues of \$512.9 million in 2005-06, an increase of 14.9 per cent from the previous year. Since 2001, total revenues have increased on average by 23.5 per cent (Chart 3).

CBH Group reported net assets of \$915.8 million in 2005-06, an increase of 11.8 per cent from the previous year. On average, net assets have grown by 11.3 per cent per annum since 2001.





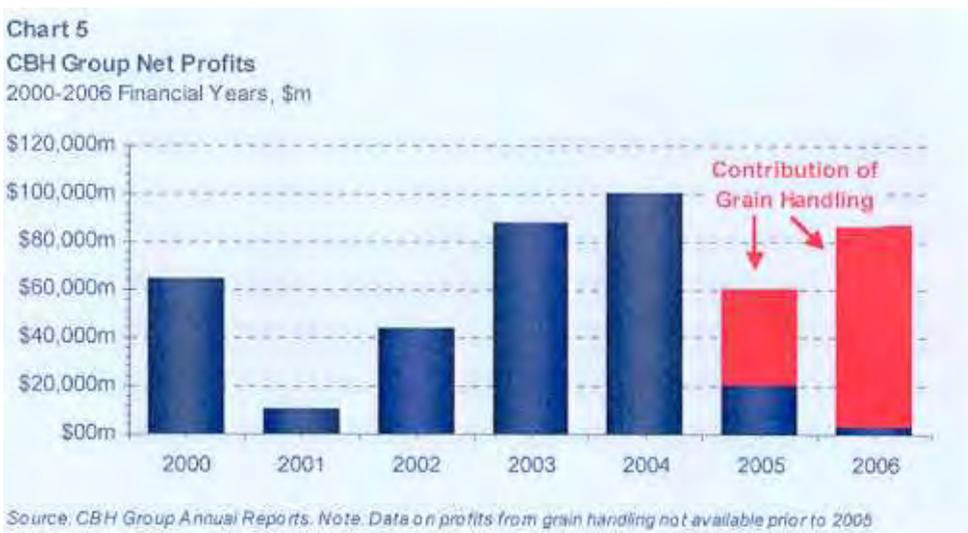
Because the *Bulk Handling Act 1967* allows CBH to build up reserves, but at the same time prevents these reserves from being distributed to shareholders, this has meant that it has built up \$860 million in reserves (see Chart 4).

While CBH Group has a number of business operations, their core business continues to be grain storage and handling. The strong financial performance of CBH Group, by and large, is a reflection of the strong performance of its grain handling business operations.

While diversification has reduced its reliance on grain handling for revenue, in 2005-06 grain handling revenues still contributed 57.3 per cent of total Group revenue, and made up almost all of the Group's net assets. In 2005-06, the grain handling business net profits represented 95.9 per cent of total Group net profits.

#### Market Power of AWB

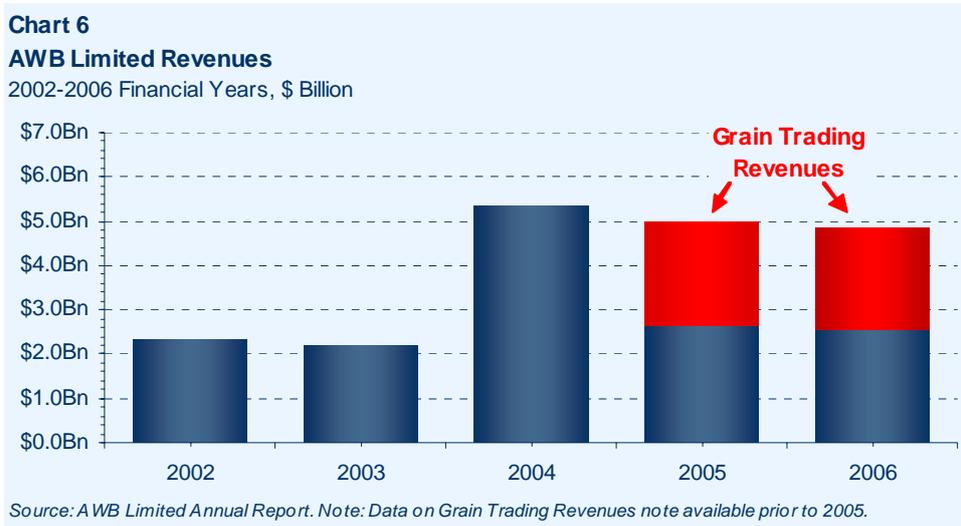
AWB has a number of subsidiaries under its group structure. Its segment performance detailed in its annual reports highlights a diversified organisation,



with its finance and risk management, pool management services, rural services (Landmark), grain acquisition and trading segments in particular making a significant contribution to the overall performance of AWB.

In its 2006 Annual Report, AWB reported total revenues of \$4.9 billion, which helped generate a net profit of \$58.1 million in 2005-06. Both financial measures were down from the previous year, as a result of the effects of drought on the grain harvest.

The most significant segment of AWB is its grain acquisition and trading segment (primarily the international trading business operated by AWBI), which accounted for 47.1 per cent of total revenues (amounting to \$2.3 billion) and 38.5 per cent of net profits (amounting to \$22.4 million) in 2005-06 (Chart 6).



The single desk provides AWBI with a high degree of market power in relation to the marketing of wheat overseas. This has allowed AWB to undertake strategic investments around the world to boost its performance in this area, such as through the opening of offices in new cities (e.g. Sao Paulo), and strategic investments in grain storage and handling infrastructure in India<sup>10</sup>.

While this positions AWB well in relation to its export marketing role, its overall market power in Australia (and more specifically Western Australia) is diluted to some extent on the grounds that it does not control key grain storage, handling and transportation infrastructure networks.

In this regard, the 2006 Annual Report highlights that of AWB's \$5.5 billion in assets, only two per cent represent supply chain assets. The majority of its assets are instead tied up primarily in rural services (Landmark), finance and risk management, pool management services, and grain acquisition and trading segments.



The extent of AWB's market power was highlighted in the Wheat Export Authority's (WEA) performance monitoring of AWB which is required under the *Wheat Marketing Act 1989*.

The 2006 report<sup>11</sup> analysed the prices paid by AWB for storing and out-turning grain with the major bulk handling companies as well as with one private grain handling organisation.

The WEA compared the cost of receiving, segregating and storing grain for 12 months and out-turning to rail (for country bulk storage sites). The analysis found that AWBI pays more per tonne to AWB Grainflow and GrainCorp than other storage and handling providers. Of note is that AWBI pays the same as any non-AWBI traders to GrainCorp, more than the non-AWBI traders to CBH and less than non-AWBI traders to ABB Grain.

Based on this analysis, the WEA found that AWBI appears unable to use its market power to significantly influence country storage and handling costs<sup>12</sup>.



# Implications of Reform

## Reform Options

The Wheat Export Marketing Consultation Committee is currently investigating three broad approaches to wheat marketing arrangements. These are discussed briefly below.

### Deregulation

Deregulation of wheat exports is akin to arrangements for most other commodities. Growers wishing to export would choose, based on price and service, whether to sell to AWB or another bulk exporter.

Supporters of deregulation argue that increased competition would provide benefits to growers through, for example, improved efficiency in the supply chain, greater contestability of marketing and transport services, better transmission of market signals, more options for growers, product and market development improvements, and elimination of regulatory costs<sup>13</sup>. On the other hand, opponents of deregulation argue that it may increase short-term price volatility, resulting in benefits for some growers and reduced returns for others, and the elimination of the possibility of obtaining price premiums for Australian wheat and end grower control of marketing<sup>14</sup>.

### Partial Deregulation – Licensing Systems

There are numerous variations of licensing models which would result in varying numbers of additional exporters. A multiple licensing system requires the development of a pre-determined, specific criteria against which additional licences would be issued. Proponents of a licensing system argue that they provide some competition benefits and increased choices for growers without jeopardising all of the benefits of a single desk. Opponents of a licensing system argue that they are a halfway house delivering neither the benefits of a single desk nor deregulation while adding regulatory complexity<sup>15</sup>.

Licensing arrangements can be structured to give varying levels of market access and competition – with criteria potentially developed to issue licences to particular markets, quantities, and/or wheat types. Additional licences could be limited and restrictions gradually lifted over time to provide for increased competition. Alternatively, criteria could be developed based solely on the characteristics of the potential exporter. The buyer of last resort obligation could also be reviewed.

This type of market structure exists in Western Australia's grains market (other than wheat), with the establishment of the Grains Licensing Authority provided with the powers to issue special export licences, and to monitor the performance of the Grain Pool Pty Ltd as the main export licence holder.



## Single Desk

Under the single desk model, a single company would have the right to export wheat in bulk without consent from the WEA and the right to veto other bulk exports. The WEA would issue wheat export consents to parties other than the company managing the single desk and monitor and report on the single desk manager's export performance.

Proponents of the single desk argue that it minimises uncertainty, enables price premiums to be obtained, shares risk across the industry and allows economies of scale to be achieved. Opponents of the single desk argue that price premiums realised for Australian exports are the result of higher quality wheat rather than the single desk. They also argue that it does not deliver the most efficient services or the range of services growers desire and that it exposes growers to risks associated with a single seller<sup>16</sup>.

Currently the *Wheat Marketing Act 1989* stipulates that AWB is the manager of the single desk.

It is not the purpose of this report to analyse the single desk arrangements, which has been subject to numerous reviews over the years, with varying results. In the context of the current inquiry, however, opinion remains divided as to whether the single desk arrangements should continue.

In the context of this report, it should be noted that purely from a competition policy standpoint, in its 2002, 2003, 2004 and 2005 assessments of the *Wheat Marketing Act 1989* as part of National Competition Policy, the NCC noted that the Australian Government had failed to demonstrate that restricting competition in the export of wheat was in the public interest<sup>17</sup>.

## Supply Chain Implications of Reform

Much of the discussion surrounding the wheat export marketing arrangements has focussed on the perceived benefits that would likely be achieved if the single desk marketing arrangements were deregulated.

This section briefly explores the possible implications of deregulation in relation to the competitive dynamics within the wheat industry in Western Australia.

Overall, it is likely that the removal of the single desk marketing arrangements will result in a major shift in chain power relationships. According to a study of the power relationships in the grain supply chain undertaken by Strategic Design and Development (SDD)<sup>18</sup>, such a change will result in the migration of chain "control" further away from the grower and in the direction of the monopoly-holding port terminal, which in Western Australia is CBH. With control over the storage and handling of wheat to ship, this will mean that CBH will



become an even more powerful player with respect to other parties in the supply chain (such as marketers).

While marketers like AWB will retain a privileged position in the supply chain due to grower loyalty and their international marketing expertise, this advantage will be reduced as transnational marketers and bulk handling companies such as CBH which already have a well resourced trading function and close operational ties to the grower, enter the marketing space.

The SDD study found that because the trading and storage functions of the bulk handling companies are not separated, this will provide internal pricing advantages, and ensure that the bulk handling company becomes the dominant player in a multi-operator environment.

In a deregulated wheat marketing environment, the grower will have access to a greater range of export buyers for their grain, and therefore a broader choice of marketing options and services. In this way, it is argued that efficiencies would flow through supply chain, by allowing bulk handlers to compete with AWB in the contracting of storage, transport and port terminal services for the movement of export wheat.

However, because the storage and handling infrastructure will remain at the control of CBH, this will increase their market power. While the CBH Group would certainly benefit from such supply chain control, this will come at the expense of other players in the supply chain – particularly growers and marketers.

According to the research conducted by SDD:

*“The natural tendency for such a powerful organisation would be to ‘cherry pick’ the tonnage it handled from ‘farm gate to port’, depending on its access to reasonable freight services (i.e. a single dedicated train). This would leave the remaining business to be transferred to port by AWB, ABB and other traders at far higher costs, as these smaller freight customers would have minimal buying power. Eventually a majority of business would be handled by this single integrated organisation, but by no means all. Some growers would benefit from this arrangement, but inequity among growers (even between neighbours) would be greatly increased, and average chain costs would increase.*

*BHCs [Bulk Handling Companies] acting as traders or marketers will have strong operational cost drivers dictating how grain products are blended and binned, both up-country and at port. Marketers argue that BHCs would favour a reduction in segregations and the range of quality products currently being marketed. Any blending profits available in the cargo assembly process (i.e. where lower quality grains are mixed with high quality products to meet a customer’s specification) would be delivered to the BHC, rather than to the growers via the current pooling mechanisms.*



The section, Issues for Review on page 37 looks at this issue further in the context of CBH's recent service agreement for the 2006-07 season.

### **Deregulation**

If wheat marketing arrangements are completely deregulated, this will mean that AWB would become one of a number of grain accumulators seeking to purchase grain for export.

It could be argued that the familiarity of growers with the AWB, its extensive networks both within Australia and overseas, and the fact that many growers are shareholders in the privatised entity, would mean that AWB would continue to remain a competitive force in relation to the marketing of wheat for export.

While there are incumbent and scale advantages that are likely to provide AWB will an advantage in a deregulated market, given the extent of CBH's operations in the wheat supply chain, and in relation to other grains, this represents a competitive threat to AWB's core business of marketing wheat.

To the extent that CBH controls the wheat supply chain from the grower to the port, and has recently commenced exporting wheat, this will place AWB and other traders at a competitive disadvantage against CBH. This form of market power could therefore act to inhibit the development of competition in wheat marketing.

For CBH, complete deregulation of the wheat marketing arrangements would represent an opportunity for it to grow its business. CBH has articulated and demonstrated a strategy of moving from a pure cooperative storage and handling company towards a vertically integrated grain business.

For example, in November 2002 CBH merged with Grain Pool Pty Ltd and in 2004 invested in Asian flour Mills through a joint venture with Pacific Agrifoods. In addition, CBH recently commenced exporting wheat under a licence granted by the Federal Minister for Agriculture.

CBH has the capacity to expand into marketing of wheat on the basis that the Grain Pool already performs such a function as the main licence to export barley, canola and lupins in bulk out of Western Australia. This trading function performed by the Grain Pool is well resourced and has close operational ties to growers of these other grains.

Concerns over supply chain control not confined to the wheat industry, but also downstream with flour millers both within Australia and overseas concerned over the supply chain control that will result to bulk handlers like CBH as a result from deregulation.



For example, the Flour Millers Council of Australia has not supported deregulation. In a recent article to the Weekly Times, it said:

*“...deregulation would play into the hands of the bulk handlers, with the three regional monopolies exerting influence over the market.”<sup>19</sup>*

As a consequence of CBH being granted a special licence to export wheat to its flour mills across South East Asia, a number of competing flour mills overseas<sup>20</sup> have also detailed their concerns to both the Wheat Export Authority and the Prime Minister. These concerns centre on the ability for CBH to potentially cross-subsidise or provide its own flour mills with preferential access, thereby limiting the ability of other flour mills to compete.

#### *Reforms to Coarse Grains Marketing*

Under the *Grain Marketing Act 2002*, the Grain Pool is granted the main export licence for barley, canola and lupins. However, it should be noted that following reforms to the Act, a provision was inserted into the Act to require the Minister to carry out a review of the operation and effectiveness of this Act. This review is to be carried out as soon as is practicable after the expiration of five years from the commencement of this Act, which would be 31 October 2007. A review of the Act may commence earlier, however, if the national wheat single desk is removed (Clause 49).

It should be noted that the possible deregulation of the wheat market does not automatically infer that the coarse grain industry will also be deregulated, as this will be a decision for the relevant Western Australian Minister following the review.

The possible deregulation of the grains market in Western Australia could potentially present an opportunity for AWB to compete in the coarse grain market – which incidentally was identified as a risk when the partial deregulation of the grains market in WA was implemented with the introduction of the *Grain Marketing Act 2002*.

#### **Partial Deregulation**

The implications of partial deregulation on the wheat industry will largely depend on what system is implemented.

For example, if a similar system is adopted to that which exists in the Western Australian coarse grains market, the competitive implications will depend on which party is provided with the main export licence. If, however, AWB is granted to main export licence, it is foreseeable that this would help to ensure that the market power of the bulk handlers like CBH is controlled to some degree.



However, in a partially deregulated environment bulk handling companies such as CBH could still “cherry pick” the tonnage it handled from farm gate to port. If AWB, as the main export licence holder, is encumbered with a requirement to be the buyer of last resort, bulk handling companies will have the opportunity acquire wheat and deliver to the AWB grades/quality they do not want and and/or grain that has a freight disadvantage.

It is not the purpose of this report to investigate the competitive implications of all possible systems, because of the questions as to the number of export licences that would be issued, and whom they would be issued to.

That said, the analysis undertaken under the complete deregulation option helps to highlight the possible implications of deregulation across the wheat industry, if market power on the part of CBH remains unfettered.

### **Summary**

What this section highlights is the need for any decision regarding the reform to wheat marketing arrangements to consider the supply chain implications.

This section has found that reform to wheat marketing arrangements – either through partial or full deregulation – could have anti-competitive implications for the wheat industry overall.

These concerns need to be investigated by Government when making its decision on reform to wheat marketing arrangements.

While the objective of reforming wheat marketing arrangements is founded on National Competition Policy (NCP) principles, which have been committed to by all Australian governments, the potential for such reforms to lessen or restrict competition across the supply chain would be inconsistent with such principles. The background to NCP is provided in Appendix B.

It is important to understand that the purpose of NCP is to undertake reforms which help to promote competition in business activities undertaken by government and other sectors of the economy.

The overall outcome of any changes to the wheat industry should be that there is a truly competitive environment in all aspects of the industry – not just in relation to one specific part of the supply chain (that is, wheat marketing).

***Finding:*** *Because reforms to wheat marketing arrangements could have anti-competitive implications for the wheat industry overall, it is important that this is investigated by Government prior to making any decision on reform to wheat marketing arrangements.*



## Facilitating Competition

The purpose of this report has been to analyse the competitive environment that currently exists in the wheat industry and, in particular, examine the competitive dynamics that exist across the supply chain.

This report has found that prior to any decision over possible changes to the wheat marketing arrangements, it is important that the Government understand the likely competitive implications on the wheat industry supply chain.

Notwithstanding the control that CBH has over the key storage and handling infrastructure in Western Australia, there are a number of key issues which require further consideration in order to help facilitate competition in the wheat industry.

### Issues for Review

#### Supply Chain Transparency

An important aspect in facilitating competition will be to review the ways in which bulk handling companies can control the supply chain, such as through the standard service agreements that CBH currently requires its customers to accept. Through their control over the supply chain, and because of the structure of the standard service agreements, CBH is provided with both informational and operational advantages, which are not available to other market participants.

- *Information advantages* take the form of stock holdings, what is being delivered to warehouses, what supplies of critical grades are being delivered, and the quality profiles at storage sites. Such information is not available to traders, meaning that if CBH is able to start marketing wheat, this will provide a significant advantage over traders such as AWB.
- *Operational advantages* exist by virtue of the fact that CBH is able to move stock at their discretion down the supply chain, reducing the benefits that can be obtained by traders if they have to pay additional freight rates. In addition, CBH is able to move its stock to port in preference to other customers, on account of its control over the facilities.

The issue of supply chain transparency is a common concern that has been expressed in relation to grain market reforms. For example, in the SA Barley Marketing Working Group Report, it found that (in the context of the South Australian barley industry):

*“it is important to have a clear and transparent booking system, where the owner of the ship loader cannot disadvantage the other party simply because they own the infrastructure.”<sup>21</sup>*



**Finding:** *The lack of transparency across the supply chain has provided bulk handling companies like CBH with both informational and operational advantages, which will be exacerbated upon deregulation of the wheat marketing arrangements.*

### **Pricing Structures**

In addition, in the case of CBH, they have recently introduced a differential pricing structure which provides a cheaper price to traders for port outloading provided that CBH controls the supply chain (that is, accumulates the grain and controls the transport). Three different charges are imposed, depending on the services that are utilised by the traders, namely:

- (i) *Export Assist* – This is charged when CBH accumulates the cargo (site selects) and controls the transport component. This product is charged at \$6.85/tonne.
- (ii) *Export Select* – This is charged when CBH controls the transport component and the customer nominates the site selections for cargo accumulation. This product is charged at \$7.35/tonne.
- (iii) *Export Standard* – This is charged when the customer controls both the transport and accumulation of the cargo (select sites). This product is charged at \$8.35/tonne<sup>22</sup>.

Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest price. If traders wish to have some control over their stocks (i.e. arrange transport or select cargoes), they will have to pay higher costs for port outloading. The alternative is to accept handing complete supply control to CBH in order to compete on supply chain costs.

While such a pricing structure makes sound business sense for CBH, there is a concern that such a pricing structure will provide CBH with further competitive advantages in a deregulated market that allows it to also become a marketer of wheat. It will mean that CBH will have the opportunity to control their own stocks and effectively charge their marketing division a cheaper price on account that the stock will be fed through the CBH supply chain.

Although it is unclear whether such a pricing structure breaches the *Trade Practices Act 1974* (TPA), this will need to be investigated further.



---

**Finding:** *The application of differential pricing to traders for port outloading will be likely to provide CBH with further competitive advantages in a deregulated environment. While it is unclear whether such a pricing structure breaches the TPA, this should be investigated.*

---

### **Vertical Integration**

In a deregulated environment, it is expected that CBH will become a more vertically integrated business, and by expanding into wheat marketing, this will provide it the opportunity to complete its supply chain link from the grower right through to its overseas flour mills.

These concerns over the impact of CBH as a vertically integrated entity on the Australian wheat industry have been discussed in detail on page 31.

However, there are also international implications because of CBH's strategic investments in flour mills in South East Asia. As a consequence of CBH being granted a special licence to export wheat to its flour mills in South East Asia, a number of competing flour mills have detailed their concerns to both the Wheat Export Authority and the Prime Minister.

These concerns centre on the ability for CBH to potentially cross-subsidise or provide its own flour mills with preferential access, thereby limiting the ability of other flour mills to compete.

It is important to ensure that competition is protected and promoted in the wheat industry as the industry becomes more vertically integrated. Whether this can be achieved in the current environment, backed up by the provisions preventing the abuse of market power in the TPA, is a question that will require further analysis.

Concerns with vertical integration across the supply chain stem from the power it provides the infrastructure owner to offer preferential pricing to its affiliates at the expense of independent competitors. At worst, such power can lead to the denial of access to external parties. This may result in higher prices and/or inefficient restrictions on output.

In order to address such issues, this may necessitate the introduction of some form of access arrangement for the infrastructure services, or may also require some form of price monitoring.

---

**Finding:** *As CBH becomes more vertically integrated and therefore increases its market power, this will have implications for other competitors that utilise its services.*

---



## Avenues for Review

While it is important that the implications of the current wheat marketing arrangements on the wheat industry more generally need to be understood, there are also ways in which competition could be facilitated – both in the context of the current environment and, more importantly, in a partially or fully deregulated wheat marketing environment.

There are a number of ways by which competition could be facilitated, including:

- through the Economic Regulation Authority (ERA); or
- pursuing the review of CBH’s port and infrastructure facilities under the new COAG *Competition and Infrastructure Reform Agreement*; or
- seeking CBH’s facilities to be declared “essential infrastructure” under Part IIIA of the *Trade Practices Act 1974* (TPA).

Each of these issues is examined further below.

There are also a number of policy reform opportunities for Government to pursue during any amendment to the current wheat marketing arrangements and as part of any transitional arrangements to partial and/or eventual deregulation. These issues, however, are not explored in this report.

### Economic Regulation Authority

If AWB believe that CBH are taking advantage of their significant market power, then one avenue by which this could be investigated is to refer the issue to the ERA.

This becomes more important given that the *Bulk Handling Act 1967* does not contain any provisions for review of the legislation.

In WA, there is a need for an independent body to review anti-competitive legislation and market structures. These responsibilities would sit ideally with the ERA, as the independent economic regulator for the state. The ERA currently oversees regulation and licensing for the gas, electricity, water and rail industries.

Synergies already exist between the functions of the ERA and the objectives of competition policy. The *Economic Regulation Authority Act 2003* allows for the State Treasurer to refer any matter related to a regulated industry to the Authority for the purposes of an inquiry<sup>23</sup>. The Act goes on to state the matters that can be referred to the Authority include, but are not limited to:

- prices and pricing policy in respect of goods and services provided in the



industry concerned;

- quality and reliability of goods and services provided in the industry concerned;
- investment and business practices in the industry concerned; and
- costs of compliance with written laws that apply to the industry concerned.

The Act specifically directs the ERA to have regard for the need to promote competitive and fair market conduct, as well as to prevent abuse of monopoly or market power in performing its functions.

***Finding:** In Western Australia, the ERA exists to promote competition and fair market conduct, and prevent the abuse of monopoly or market power. If it is deemed that CBH is abusing its market power in relation to its storage and handling infrastructure, the WA Treasurer could refer this issue to the ERA to be investigated. Such a referral would be consistent with the WA Government's obligations under the New National Reform Agenda.*

### **COAG Competition and Infrastructure Reform Agreement**

As part of the new national reform agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure.

The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. The relevant section from the agreement is detailed in Appendix B.

Essentially, the agreement notes that ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power. The agreement also stipulated that each jurisdiction would review the regulation of ports and port authority, handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with the principles set out in clauses 4.1 and 4.2. Significant ports include:

- major capital city ports and port facilities at these ports;
- major bulk commodity export ports and port facilities, except those considered part of integrated production processes; and
- major regional ports catering to agricultural and other exports.



**Finding:** *On the basis of the COAG agreement, it is imperative that the port facilities controlled by CBH are reviewed by the WA Government to determine whether regulation is warranted in order to promote competition in the wheat industry.*

### **Access Arrangements**

As part of National Competition Policy, the Commonwealth Government introduced a national access regime for infrastructure services in 1995. Background information on ncp is provided in Appendix B.

Part IIIA of the TPA establishes the legal rights for third parties to share the use of certain infrastructure services of national significance on reasonable terms and conditions. In essence, the Part IIIA framework covers nationally significant infrastructure services where such infrastructure has natural monopoly characteristics, and where it is deemed that access to such infrastructure is necessary to promote competition in an upstream and downstream market.

Part IIIA also requires that access be economically feasible and not be allowed to compromise the system integrity of infrastructure, and the benefits of access regulation must not outweigh the costs.

The National Competition Council (NCC) is responsible for administering the Part IIIA framework, and there are essentially three avenues for a party to seek access to an infrastructure service – through declaration; by using an effective access regime; or under the terms and conditions set out in a voluntary undertaking approved by the Australian Competition and Consumer Commission.

The declaration pathway is the common way in which a business will try to gain access to a particular infrastructure service, with the NCC in making its deliberation taking into consideration a number of criteria to establish whether the relevant service is provided by a nationally significant facility that has natural monopoly characteristics and that occupies a bottleneck position in an industry. In addition, a public interest assessment is undertaken to weigh the costs and benefits of imposing access regulation.

If an infrastructure service is declared, it does not provide the access seeker with an automatic right to use that service; rather, it establishes a right for any party to negotiate terms and conditions of access with the service provider.

The NCC cannot recommend that a service be declared unless it is satisfied that all of the following criteria (set out in section 44G(2) of the TPA) are met:



- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service
- (b) that it would be uneconomical for anyone to develop another facility to provide the service
- (c) that the facility is of national significance, having regard to:
  - (i) the size of the facility or
  - (ii) the importance of the facility to constitutional trade or commerce or
  - (iii) the importance of the facility to the national economy
- (d) that access to the service can be provided without undue risk to human health or safety
- (e) that access to the service is not already the subject of an effective access regime and
- (f) that access (or increased access) to the service would not be contrary to the public interest.

The Council must also consider whether it would be economical for anyone to develop another facility that could provide part of the service (section 44F(4)).

The Council must be affirmatively satisfied that all of the declaration criteria in section 44G(2) are met before it can recommend declaration. If the Council is not satisfied that one or more of the criteria are met, then it must recommend that the service not be declared.

Part IIIA therefore provides a regime by which businesses can obtain access to major infrastructure provided that the application is made in good faith (section 44F(3)), and whether it would be economical for anyone to develop another facility that could provide part of the service (section 44F(4)).

In the case of major infrastructure, businesses should have legal avenues to pursue the use of nationally significant infrastructure services owned and operated by others on commercially negotiated terms.

Where commercially negotiated terms and conditions are not possible, implementing authorities must be sensitive to the implications of their decisions including possible disincentives to future investment that may result from mandated access and it is important that where access is given it is on 'reasonable' terms and conditions and at "fair" prices.



By seeking to have CBH's facilities "declared" under Part IIIA, the resulting development of an access regime would provide certainty on the terms and conditions on which CBH would provide access. Importantly, this would require the development of transparent costing and pricing policies, and would ensure that prices are set by an independent arbitrator.

However, the Part IIIA process is time consuming, and it is not clear whether all the infrastructure owned by CBH would satisfy the criteria for it to be declared an essential service. In this regard, it should be noted that in their discussions with the SA Barley Marketing Group over the SA barley market, the NCC remain of the view that up-country storage and handling facilities would not be seen as a natural monopoly as there is already some competition<sup>24</sup>. However, in the case of port infrastructure, this may not be the case.

***Finding:*** Seeking to have the infrastructure owned by CBH declared an essential service for the purposes of Part IIIA of the TPA represents a legal avenue for access, if it is deemed that access cannot be obtained on "reasonable" terms and conditions at "fair" prices.

#### *Victorian Grain Access Regime*

In the context of the previous discussion, it should be noted that a grain access regime was developed by the Victorian Government in 2003 to cover the export grain handling and storage facilities at the ports of Geelong and Portland.

Rather than direct price regulation, the regime establishes a "negotiate-arbitrate access regime". Under the new framework, GrainCorp Operations Limited, the owner/operator of the regulated terminals, must provide access to its on "fair and reasonable terms". The Essential Services Commission in Victoria will arbitrate any disputes over the conditions of access that cannot be resolved through commercial negotiation.

The regulatory framework applying to GrainCorp's export grain handling terminals at the ports of Geelong and Portland is specified in the *Grain Handling and Storage Act 1995* (GHSA) and in the Guidelines for the Grain Handling and Storage Access Regime (Guidelines) published by the Essential Services Commission. The regulatory objectives of the Commission in relation to export grain handling services are specified in section 14 of the GHSA as follows:

- to promote competition in the storage and handling of grain;
- to protect the interests of users of the grain handling and storage facilities in terms of price by ensuring that charges across users and classes of services are fair and reasonable; and



- to ensure users and classes of users have fair and reasonable access for grain to the port facilities whilst having regard to the competitiveness and efficiency of the regulated industry.

Under the negotiate/arbitrate regulatory framework that is now in place under the GHSA, the Commission will only make a determination concerning prices if notified that parties cannot agree on terms and conditions of access to the prescribed services. A determination can be made under sections 18 or 21 of the GHSA depending on the nature of the dispute.

As required under Section 23(1) of the GHSA, in 2006 the Commission completed an inquiry as to whether or not Victorian export grain terminals are “significant infrastructure facilities”.

Overall, the Commission found that there is “a significant degree of actual and potential competitive substitution”<sup>25</sup>. However, it accepted views within the industry of the importance of the existing access regime for the development of competition in grain marketing – particularly in an industry that may be further deregulated in the future.

While the Commission did not believe that the risk of misuse of market power directed towards the minor marketers is sufficient to warrant the continuation of access regulation over a five year term, it was persuaded for the regime to be reviewed again in two years time (by no later than 30 June 2008) in light of the significant degree of change in the industry.

Instead, the Commission recommended that in the interim it would have a monitoring role, to determine whether the port terminals provide access on fair and reasonable terms. Under this monitoring role the Commission would require each of the terminals to prepare an undertaking, which would be as light handed as possible, and contain a binding dispute resolution process. The Commission’s regulatory role would be confined to a last resort, if the undertaking is not adhered to.



## Appendix A – Standard Service Agreements

A review of the standard service agreement for Bulk Handling Companies (BHC) helps to highlight the ways in which supply chain control can be exerted. The service agreements have been sourced from the National Agricultural Commodities Marketing Association.<sup>26</sup>

### Stock information

A BHC can determine the relevant stock holdings of competing traders. This stock information provides them information on ownership levels by grade. This advantages the BHC in knowing who to approach for trades, swaps and other opportunities.

With a deregulated market, growers may wish to warehouse their grain until they are ready to make a selling decision. For BHCs that also act as a trader (e.g. CBH), this will mean that they have access to who has delivered to warehousing, their tonnages and quality. This allows BHCs to target growers who have delivered to warehousing. No other trader has access to this information.

### Site level Information

Under the CBH Standard Services Agreement, Clause 5.4(d) states:

*“CBH warrants the accuracy of Customers Grain Entitlement in respect of a Port Zone Entitlement Stock only and does not warrant the correctness of Site Stock data supplied to the Customer”*

The value of grain for a trader is in its position. If a CBH can only provide accuracy of data at a port zone level, particularly when CBH have the right to move the grain at their discretion (see below), then this value can be eroded for other traders.

Having access to the quality profiles of the individual bins and bunkers at a storage site allows the BHC to be able to arbitrage stock within grades. For example, at a large site the BHC can internally reserve all their ownership against bins that contain better quality grain (e.g. pre-rain product).

In the CBH Standard Services Agreement, Clause 5.3 states:

*“Subject to Clauses 22 and 25, any Grain stored in Common Stack Segregation will be Outturned by CBH to a quality no less than the minimum Receival Standard which applies to Common Stack Segregation in which the Customer's Grain is stored.”*

and Clause 5.2 states:



*"All Grain will be stored by CBH in Common Stack Segregations"*

Currently AWB pays growers premiums for superior quality above the base grade. Under the Standard Services Agreement, CBH is only obliged to outturn grain to the minimum receival standard.

Quality arbitrage can be managed by BHCs in numerous ways. This is available by having access to superior information on the quality profile of grain at, and within, each storage site. This superior knowledge combined with the ability to control the supply chain allows the BHC a greater capability than other traders to blend different grades to a customer specification.

These agreements also provide the ability for BHCs to cherry pick stocks to gain freight/quality advantages. If there is partial deregulation and AWB is the buyer of last resort CBH can deliver to the AWB national pool grades/quality they do not want and and/or grain that has a freight disadvantage.

**Ability to move clients/competitors stock to erode value of competitor**

Under Clause 11.1 (b):

*The customer expressly and irrevocably authorises CBH to:*

*(i) move at it discretion, grain held at any site; and*

*(ii) incur transportation costs, either in CBH's name or the Customer's name (as the case requires)*

Under Clause 11.1 (e):

*CBH is not obliged to notify customers prior to the movement of any Grain.*

Because the value of grain to a trader is in its position, if it is moved by CBH, the trader could lose value either through position or through the cost of a freight rate that CBH chooses to charge.

**Differential pricing**

In its 2006-07 Season Grain Services Agreement, CBH has introduced three new Port Outloading Charges for Export Grain.

*(i) Export Assist – This is charged when CBH accumulates the cargo (site selects) and controls the transport component. This product is charged at \$6.85/tonne.*



*(ii) Export Select – This is charged when CBH controls the transport component and the customer nominates the site selections for cargo accumulation. This product is charged at \$7.35/tonne.*

*(iii) Export Standard – This is charged when the customer controls both the transport and accumulation of the cargo (select sites). This product is charged at \$8.35/tonne.*

Under this pricing structure CBH, as a marketer, will have the opportunity to control their own stocks and effectively charge their marketing division the cheapest Export Product (i.e. \$6.85/tonne).

However, most other grain traders who wish to have some control over their stocks (i.e. arrange transport or select cargoes) will have to pay higher costs for port outloading. The alternative is to accept handing complete supply control to CBH in order to compete on supply chain costs.

Similar charges were introduced by CBH in 2004-05 for domestic outloading products.

### **Operational Advantages**

BHCs can restrict access to stock owned by clients through claiming a mechanical fault or insect infestation. This can damage a trader's relationship with a customer and/or force a trader into a swap that will benefit the BHC.

CBH is also able to move its stock to port in preference to competitors, and therefore gaining priority in vessel loading. By having control of the supply chain, CBH can preferentially move their stock to port and therefore gain priority loading on vessels.



## Appendix B – Competition Policy

### National Competition Policy

The formal push towards a national competition framework in Australia commenced in 1992, when the Commonwealth and State governments established an Independent Committee of Inquiry into a National Competition Policy for Australia.

The committee's recommendations, known as the Hilmer Report, made a vital contribution to the evolution of competition policy in Australia. Its key contributions were to propose a co-ordinated, systematic and uniform approach to competition policy across all government jurisdictions, and to recommend mechanisms designed to address the institutional and political factors that can lead governments and regulators to adopt anti-competitive measures that are not in the public interest. In particular, it proposed:

- the establishment of a clear principle that anti-competitive regulation and legislation should be permitted only when it can be demonstrated to be in the interest of the community, and cannot be achieved by other means; and
- the establishment of 'arms-length' bodies to oversee and advise on the general implementation of competition policy (the National Competition Council) and regulate its detailed application (the Australian Competition and Consumer Commission).

On 11 April 1995, the Council of Australian Governments (COAG) agreed to a national competition policy package providing for uniform legislation on the protection of consumer and business rights and increased competition in all jurisdictions. The Prime Minister, Premiers and Chief Ministers signed two inter-governmental agreements to implement the package. COAG reaffirmed its commitment to continuing micro-economic reforms in key industries and this was reflected in a third agreement which provided for financial arrangements, including a series of competition payments to be paid to the State Governments in return for implementing competition policy reforms.

In summary, the three key measures provided:

- a *Conduct Code Agreement* along with *The Competition Policy Reform Act* and various State and Territory legislation, which extended coverage of Part IV of the *Trade Practices Act* to all businesses irrespective of their legal form or ownership;
- a *Competition Principles Agreement*, which set standards on structural reform



of public monopolies, reviews of anti-competitive legislation and regulation, prices oversight, access to essential infrastructure, competitive neutrality, and local government; and

- an *Agreement to Implement the National Competition Policy and Related Reforms*, which set out conditions for financial transfers to the States and local government in return for implementing competition reforms.

The co-ordination and structure of Australia's NCP program (and prior reforms) has been recognised as being exceptional among the international community. According to the OECD:

*"In the last decade of the 20th century, Australia became a model for other OECD countries in two respects: first, the tenacity and thoroughness with which deep structural reforms were proposed, discussed, legislated, implemented and followed-up in virtually all markets, creating a deep-seated 'competition culture'..."<sup>27</sup>*

The specific program of reform established under NCP ended in 2005. However, the initial NCP agreements provided for a review and consideration of another agenda towards the end of the initial agreement period.

That review process commenced in April 2004, with the Commonwealth Treasurer requesting that the Productivity Commission undertake a Review of National Competition Policy Reforms. Drawing on that study, as well as recommendations from COAG senior officials, the COAG agreed in February 2006 to a new national reform agenda.

## **National Reform Agenda**

The COAG agreed to a *National Reform Agenda* on 10 February 2006. The agenda includes a new wave of collaborative reforms which build on the success of the NCP and previous economic and social policy reforms.

The COAG agenda is split into three streams - human capital, competition and regulatory reform. The latter two are the focus of this paper.

The competition stream of the new agenda aims to further boost competition, productivity and the efficient functioning of markets through further reform and initiatives in the areas of transport, energy, infrastructure regulation and planning and climate change. This agenda follows the formula of national competition policy reforms, with governments working together to identify reform opportunities, and agreeing on a process for delivering them.

Importantly, all governments have recommitted to the principles contained in the National Competition Principles Agreement, which was established under the



NCP. Jurisdictions have also agreed to continue and strengthen gate-keeping arrangements established under the NCP to prevent the introduction of unwarranted restrictions on competition in new and amended regulations and all outstanding priority legislation reviews from the NCP review program also need to be completed.

The specific competition reform objectives of the new agenda and how they relate to Western Australia are discussed in section titled *The Reform Agenda for Western Australia*.

The regulatory reform stream of the new agenda focuses on reducing the regulatory burden imposed by the three levels of government. The measures proposed in the agenda aims to ensure that markets operate efficiently and fairly, in balance with other social and economic objectives (that is, that consumers and the environment are suitably protected and that the benefits from regulation do not outweigh their compliance and implementation costs).

It is expected that further action to address burdensome regulation and red tape will be taken as the Commonwealth considers and responds to the report of the *Taskforce on Reducing the Regulatory Burden on Business*, and as State, Territory and local governments undertake their own regulation review processes. In its initial report in response to the recommendations of the Regulation Taskforce, the Federal Government indicated support for only 86 of the 178 recommendations. It is hoped that more of the recommendations will be embraced in the second part of the Government's report which is due for release in July 2006.

COAG has agreed in principle to establish new intergovernmental arrangements for the governance of the *National Reform Agenda*. Like NCP, it is envisaged that Governments at all levels will have a central role in elaborating and implementing the agenda.

Several steps still need to be taken to advance the new agenda, particularly as to who will administer the new process. COAG has agreed in principle to establish a COAG Reform Council (CRC) to report to COAG annually on progress in implementing the National Reform Agenda. It is envisaged that the CRC will be an independent body that will replace the National Competition Council which currently oversees the NCP process.

The primary role of the CRC would be to report to COAG annually on progress towards the achievement of agreed reform milestones and progress measures across the broad National Reform Agenda.



## Competition and Infrastructure Reform Agreement

As part of the new national reform agenda, COAG signed a *Competition and Infrastructure Reform Agreement* to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure. CCI supports the proposed agenda.

The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

A key aspect of this agreement was in relation to port competition and regulation. The relevant section from the agreement is detailed below.

### *4.1. The Parties agree that:*

- a. ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in upstream or downstream markets or to prevent the misuse of market power; and*
- b. where a Party decides that economic regulation of significant ports is warranted, it should conform to a consistent national approach based on the following principles:*
  - i. wherever possible, third party access to services provided by means of ports and related infrastructure facilities should be on the basis of terms and conditions agreed between the operator of the facility and the person seeking access;*
  - ii. where possible, commercial outcomes should be promoted by establishing competitive market frameworks that allow competition in and entry to port and related infrastructure services, including stevedoring, in preference to economic regulation;*
  - iii. where regulatory oversight of prices is warranted pursuant to clause 2.3, this should be undertaken by an independent body which publishes relevant information; and*
  - iv. where access regimes are required, and to maximise consistency, those regimes should be certified in accordance with the Trade Practices Act 1974 and the Competition Principles Agreement.*



4.2 *The Parties agree to allow for competition in the provision of port and related infrastructure facility services, unless a transparent public review by the relevant Party indicates that the benefits of restricting competition outweigh the costs to the community, including through the implementation of the following:*

- a. *port planning should, consistent with the efficient use of port infrastructure, facilitate the entry of new suppliers of port and related infrastructure services;*
- b. *where third party access to port facilities is provided, that access should be provided on a competitively neutral basis;*
- c. *Commercial charters for port authorities should include guidance to seek a commercial return while not exploiting monopoly powers; and*
- d. *any conflicts of interest between port owners, operators or service providers as a result of vertically integrated structures should be addressed by the relevant Party on a case by case basis with a view to facilitating competition.*

4.3 *Each Party will review the regulation of ports and port authority, handling and storage facility operations at significant ports within its jurisdiction to ensure they are consistent with the principles set out in clauses 4.1 and 4.2.*

- a. *Significant ports include:*
  - i. *Major capital city ports and port facilities at these ports;*
  - ii. *Major bulk commodity export ports and port facilities, except those considered part of integrated production processes; and*
  - iii. *Major regional ports catering to agricultural and other exports.*



## References

ACIL Tasman, 2005, *Marketing Western Australian Wheat: An analysis of the impact of the National Wheat Export Monopoly on the Western Australian wheat industry.*

Australian Bureau of Statistics, 2006, *Year Book Australia, 2006*, Cat.No.1301.0

Australian Wheat Board:

- 2006, *Your Single Desk.*
- 2006, *Annual Report 2006*
- 2005, *2004-05 AWB National Pool Performance*
- 2005, *Annual Report 2005*
- 2004, *Annual Report 2004*
- 2003, *Annual Report 2003*
- 2002, *Annual Report 2002*
- 2001, *Annual Report 2001*

CBH Group:

- 2006, *CBH Corporate Profile.*
- 2006, *Annual Report 2006*
- 2005, *Annual Report 2005*
- 2004, *Annual Report 2004*
- 2003, *Annual Report 2003*
- 2002, *Annual Report 2002*
- 2001, *Annual Report 2001*

Council of Australian Governments, 2006, *Competition and Infrastructure Reform Agreement*, 10 February 2006.



Department of Agriculture and Food, 2006, *Western Australia's Agri-Food, Fibre and Fisheries Industries 2007*.

Essential Services Commission, 2006, *Grain Handling Regime Review – Final Report*.

Grain Licensing Authority, 2006, *Annual Report to Minister: Operation and effectiveness of the licensing scheme for export controls, 2005-06*.

National Competition Council:

- 2003, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2005*.
- 2005, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2005*.
- 2007, *National Competition Policy and wheat marketing: Submission to the Wheat Marketing Consultative Committee*.

Porter, M. E., *Competitive Strategy: Techniques for Analysing Industries and Competitors*.

Strategic Design and Development, 2004, *Single Desk and the Grain Supply Chain: A Study of Power Relationships*, March 2004.

SA Barley Marketing Working Group, 2006, *Report to the Hon Rory McEwen MP, Minister for Agriculture, Food and Fisheries and SA Farmers Federation Grains Council*.

Wheat Export Marketing Consultation Committee, 2007, *Discussion Paper*, January 2007.



## Endnotes

---

<sup>1</sup> This information has been sourced primarily from the 2006 ABS Yearbook (Cat. No.1301.0)

<sup>2</sup> Department of Agriculture and Food, 2006, *Western Australia's Agri-Food, Fibre and Fisheries Industries 2007*.

<sup>3</sup> ACIL Tasman, 2005, *Marketing Western Australian Wheat*, p.28.

<sup>4</sup> Ibid, p.28.

<sup>5</sup> Department of Agriculture and Food, 2006, *Western Australia's Agri-Food, Fibre and Fisheries Industries 2007*.

<sup>6</sup> AWB International, 2005, *2004-05 AWB National Pool Performance Report*, p.1.

<sup>7</sup> Source: <http://www.awb.com.au/aboutawb/corporate/corporatestructure>.

<sup>8</sup> Porter, M. E., *Competitive Strategy: Techniques for Analysing Industries and Competitors*.

<sup>9</sup> This information is sourced from the National Agricultural Commodities Marketing Association website: [www.nacma.com.au](http://www.nacma.com.au).

<sup>10</sup> AWB, 2006, *AWB Annual Report 2006*, p.12.

<sup>11</sup> WEA, 2006, *The Growers' Report 2006 For Australian Wheat Growers – Performance Monitoring of AWB (International) Limited under the Wheat Marketing Act 1989*.

<sup>12</sup> Ibid, p.6.

<sup>13</sup> Ibid, p.7.

<sup>14</sup> Ibid, p.8.

<sup>15</sup> Wheat Export Marketing Consultation Committee Discussion Paper, 2007, p.7.

<sup>16</sup> Wheat Export Marketing Consultation Committee Discussion Paper, 2007, p.6

<sup>17</sup> National Competition Council, 2005, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2005*.



<sup>18</sup> Strategic Design and Development Pty Ltd, 2004, *Single Desk and the Grain Supply Chain: Study of Power Relationships*.

<sup>19</sup> Weekly Times, 2007, *Flour Millers Back Single Desk*, 21 March 2006.

<sup>20</sup> Includes: Pt. Fugui Flour and Grain Indonesia, FFM Berhad, Kuantan Flour Mills Berhad, Prima Limited, Malayan Flour Mills Berhad, Seberang Flourmills Sdn Bhd.

<sup>21</sup> SA Barley Marketing Working Group, 2006, *Report to the Hon Rory McEwen MP, Minister for Agriculture, Food and Fisheries and SA Farmers Federation Grains Council*.

<sup>22</sup> CBH, 2006, *2006-07 Season Grain Services Agreement*.

<sup>23</sup> Economic Regulation Authority Act 2003. Part 5, References on regulated industries, Division 1.0, s.032.

<sup>24</sup> SA Barley Marketing Working Group, 2006, *Report to the Hon Rory McEwen MP, Minister for Agriculture, Food and Fisheries and SA Farmers Federation Grains Council*.

<sup>25</sup> Essential Services Commission, 2006, *Grain Handling Regime Review – Final Report*.

<sup>26</sup> [http://www.nacma.com.au/location\\_differentials/registered\\_bulk\\_handlers](http://www.nacma.com.au/location_differentials/registered_bulk_handlers).

<sup>27</sup> OECD. *Economic Survey of Australia 2004: Economic performance and key challenges*.  
February 2005.  
[http://www.oecd.org/document/29/0,2340,en\\_2649\\_201185\\_34037213\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/29/0,2340,en_2649_201185_34037213_1_1_1_1,00.html).

