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

15 May 2008

To whom it may concern,

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.

Under the 1989 Commonwealth Wheat Marketing Act AWB managed Australia's bulk wheat exports under the single desk arrangements. However, the Wheat Export Marketing Bill 2008 will introduce greater competition to Australia's bulk wheat export marketing arrangements.

AWB will continue to be an exporter of wheat from Australia and the company'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 2002

In general terms AWB welcomes the opportunity to contribute to the WA Government's review of the WA Grain Marketing Act and thanks the ERA for acknowledging the issues raised by AWB in its original submission to the Review.

AWB welcomes the ERA's key finding that measures be introduced to reduce restrictions on grain exports from Western Australia by no longer prescribing barley, lupins and canola. These recommendations are largely in line with the Federal Government's proposed Wheat Export Marketing Bill 2008 and the South Australian Barley Exporting Act 2007.

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While we recognise that there are benefits in having a consistent approach to grain exports across Australia it is worth noting that the Grain Marketing Act 2002 was seen by industry as a transition to greater competition and the value of implementing further incremental transitional changes is therefore debatable.

More specifically AWB notes the ERA's comments on supply chain access and supports the view that "Access to infrastructure is an important element in ensuring competition in the accumulation of Western Australian grains."

We welcome the recognition by the ERA that should the ACCC be required to approve a CBH access undertaking regarding wheat exports from Western Australian port facilities a number of AWB's concerns could be satisfied. However, we believe it is also important that the principles of transparency and efficiency be applied to the entire supply chain and grains industry.

On this issue, the South Australian Essential Services Commission's report on port pricing recommended that:

> "The Commission also recommends that the Government consider the question of whether or not grain storage and bulk handling facilities should be subject to access regulation as part of a broader review, having regard to the entire grain supply chain.
>
> "In the Draft Report, the Commission sought comment on whether or not the ports access regime should be extended to cover at-port grain storage and bulk handling facilities. The appropriateness of such action depends on the potential for, or actual, misuse of market power by the provider of these facilities, and benefits of imposing regulation on them. Having considered comments on this issue raised in submissions to the Draft Report, the Commission has concluded that there is a prima facie case for regulating access to at-port grain storage and bulk handling facilities given the existence of market power, but that it is appropriate for any regulatory scheme to be considered in a broader context by the State Government, having regard to the whole of the grain supply chain. The current ports access review is necessarily limited to at-port services and many of the services envisaged here extend well beyond the port boundary."

Compounding concerns in Western Australia are a number of recent developments in the grains industry supply chain that are potentially damaging to the interests of wheat growers.

In Western Australia the current multi-party rail contract between entities including ARG, Co-operative Bulk Handling Ltd (CBH) and AWB for the transport of grain by rail expires on 31 October 2008.

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CBH have more recently presented the details of its proposed new commercial arrangement "Grain Express". AWB believes that Grain Express would further increase CBH's vertical integration and dominance of the supply chain in Western Australia This will be through the bundling of transport services with the bulk storage and handling services under CBH's banner, and the associated removal of access by CBH clients to site level grain inventory management.

Under Grain Express competition will be impacted in three distinct components of the export grain supply chain:

1. **The transport of grain from up country storage sites to ports**. Grain Marketers will be compelled to use the transport service arranged by CBH with no control over the cost and no opportunity to use back-loading opportunities, rival transport modes and/or companies in order to put downward pressure on logistics costs. Similarly, the opportunity to seek grain swapping and transport arbitrage opportunities based on ownership at multiple points is removed.
2. **The acquisition of grain from growers.** Whilst Grain Express still appears to allow traders to enter into purchase agreements direct with growers for each load tendered for delivery into the CBH system this is not specifically the case. The sale transaction actually only allows the trader to purchase entitlement to access grain of similar standard that will be provided by CBH from a nominated supply point. These supply points are ports and/or a very small sample of country sites. There is a de-link of the sale of the grower's product to the product actually being collected by the trader.
3. **Integrated marketing.** Grain Express effectively removes a trader's access to country site level grain and the associated quality information. This removes the opportunity for the trader to be able to offer an integrated quality aggregation and accumulation service to milling clients based on the quality data at a site level. For example, AWB historically have performed a number of tests at a site level, post the receival process on grain to determine its intrinsic milling characteristics. Some of these tests are for dough extensibility, flour ash content and starch content and quality. Without access to the site level quality characteristics and guaranteed access to grain purchased from growers at individual site a trader is removed from offering an integrated quality offering.

CBH Chief Executive Imre Mencshelyi is reported in the media claiming that if CBH is unable to introduce 'Grain Express' as proposed then "chaos will rule".

AWB's view, however, is that the bundling by CBH of grain freight services based on exclusive rail and road transport access coupled with CBH's monopoly over port control in WA would be detrimental to competition in the above three markets, as well as the market for storage and handling services. The bundling of services by CBH,

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particularly through 'Grain Express', appears likely to have this anti-competitive effect because it would enable CBH to extend its enormous market power in the storage and handling market to transportation and grain marketing. AWB's concern is that this would potentially reduce competition and discourage innovation in the grains industry supply chain. AWB is also concerned about the potential impact on pricing of relevant services and the potential influence on the actual price posted at individual receival sites.

In AWB's view, CBH's proposal is clearly at odds with the Federal Government's draft exposure bill for new wheat marketing arrangements, which has the clear objective of promoting and achieving fair and open access to grains industry infrastructure.

AWB feels that these developments in Western Australia pose significant risk to the grains industry and warrant immediate consideration by the ACCC to test to whether the arrangement is not anti-competitive and potentially destroying value in the grain export value chain in Western Australia. We note CBH have recently made public comments (ABC Radio, May 16) which appear to concede this point.

There are additional matters relating to possible misuse of market power in the grains industry and the export wheat market that we would be pleased to provide any additional information or advice to assist on and we would be available meet with you to discuss these or any other matters should you require.

We would also draw your attention to the recent comments by the ASX on the need for timely and equal access to stock data in the supply chain.

The ASX told the recent Senate Committee inquiry that *"Supplying data by port zone is important as ASX grain futures contracts are based on certain port zones. Independent and timely supply of data would ensure that all market participants have equal access to information to enable efficient pricing and assist in maintaining market integrity."*

AWB supports the view that the public availability of grain stock, quality and movement information by location is critical to assist in the efficient functioning of what will be a changed grain market should the ERA's proposed reforms be adopted. CBH has privileged access to this information at present, and there is a need to ensure that all grain marketers get equal access to this information in the future.

If the Grain Marketing Act is to be repealed it may also prudent for the WA Bulk Handling Act to be reviewed and considered as a vehicle for regulating fair and open access to all grain export infrastructure and services, including the provision of stock data.

To assist the ERA in understanding these issues in greater detail we have provided a copy of the Allen Consulting Group report "Competition in the Export Grain Supply

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Chain," a report commissioned by AWB to analyse supply chain issues as they are impacted by grain market deregulation.

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

For assistance please contact:

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The Allen Consulting Group

Competition in the export grain supply chain

Access and information asymmetries

March 2008

Report to AWB Limited

The Allen Consulting Group

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Chapter 1

Introduction

1.1 Background

There has been a single manager and marketer for Australian bulk wheat exports under an arrangement known as the 'Single Desk' since 1939. Between 1939 and 1999, the Australian Wheat Board held this role. In 1999, the Board was privatised and renamed AWB Limited (AWB), and since then, a subsidiary of AWB, AWB International Limited ('AWBI'), has been the exclusive manager and marketer of Australian bulk export wheat. This arrangement, which is established by the Commonwealth *Wheat Marketing Act 1989,* has been the subject of intense debate in recent years, and examined in a number of inquiries and consultative committees.

During the 2007 election campaign, and in light of public interest in wheat export policy following the Oil-for-food Inquiry, the then Labor Opposition released a policy paper on future wheat marketing arrangements, indicating its intention to move to an accreditation model for wheat exports, similar to that adopted for barley in South Australia:

> under Labor's plan there will be a single desk with multiple accredited exporters. Labor's plan will ensure that export marketing services are contestable thus applying downward pressure to export supply chain costs for the first time in Australian history (O'Brien, 2007).

The Wheat Export Marketing Bill 2008, which was released for public comment in early March 2008, is intended to give effect to the (now Labor) Government's policy.

The removal of legislated monopolies, such as that held by AWBI, is of itself pro-competitive and consistent with the principles underpinning the National Competition Policy. That said, a report that examined the potential deregulation of wheat exports from Australia by allowing multiple exporters while retaining the single desk concluded that this:

> …will not produce a contestable market for the sale of Australian wheat unless regional monopolies in grain handling and storage in Western Australia, South Australia and New South Wales are comprehensively over-hauled as part of a structural adjustment process (ITS Global 2006: 4).

Another report commissioned by AWB (CCIWA 2007: 7) found that the Government's proposed reforms may actually have anti-competitive implications for the Australian wheat industry overall. If true, the implication is that a move to accredit multiple wheat exporters is, of itself, unlikely to achieve the Government's stated policy objective of putting downward pressure on wheat export supply chain costs.

The Government has acknowledged that the new export wheat marketing arrangements must support genuine competition, with companies being given access to the infrastructure of the three dominant bulk handlers in Australia, CBH in Western Australia, and ABB and GrainCorp in the Eastern States, to ensure there is:

> a competitive market…[and]…we don't replace a national exporter…[to] simply end up with three regional monopolies…of CBH, ABB and GrainCorp (AFR 2008: 9).

1.2 Scope of this report

In this report, the infrastructure and processes of the export grain supply chain generally, and the structure of the supply chain in each of the major wheat producing Australian States is examined in some detail. The effect that the structure of the supply chain may have on the competitive pressures that are exerted on service providers, and in particular, the potential for the current arrangements to give rise to market power and conflicts of interest is also considered.

In addition, the likely implications for competition of the Government's proposed reforms are examined, including the extent to which existing competitive pressures may be enhanced or reduced by the reforms.

Key challenges are likely to arise for the export grain supply chain in terms of access to monopoly infrastructure services, and in dealing with information asymmetries. These challenges are similar to those that were behind the emergence of the National Competition Policy, which sought to remove legislated monopolies, establish formal access rights to natural monopoly infrastructure and restructure vertically integrated firms.

Drawing on the principles underpinning the National Competition Policy, and after examining a number of other industries that have been the subject to pro-competitive reforms, a number of relevant lessons are identified in the context of the proposed reforms of the export wheat supply chain.

Finally, a number of measures that would support and enhance competition in the export grain supply chain following the Government's proposed reforms are identified.

1.3 Structure of this report

This report is structured as follows.

- In Chapter 2 the export wheat supply chain is described, and an overview of the market structures for the provision of grain transportation, storage and export services in each of the major Australian wheat producing states is also provided.
- Past reforms of the Australian wheat industry, commencing with the 1986 Royal Commission into Grain Storage, Handling and Transport are outlined in Chapter 3, which then considers the possible competitive implications of the Government's proposed reforms in export wheat marketing arrangements.
- In Chapter 4 the thinking behind National Competition Policy is examined in some depth, and in particular the motivation for the removal of legislated monopolies and for separating vertically integrated monopolies, both of which are relevant in the context of reforms being contemplated for the export wheat market.
- The implementation of a market reforms in a number of other key Australian industry sectors, including electricity, telecommunications and airport terminals are discussed in Chapter 5.

- Finally, in Chapter 6, a range of mechanisms through which competition in the export grain market may be supported should an accreditation model be adopted are considered.

Chapter 2

The Australian export grain supply chain

2.1 Introduction

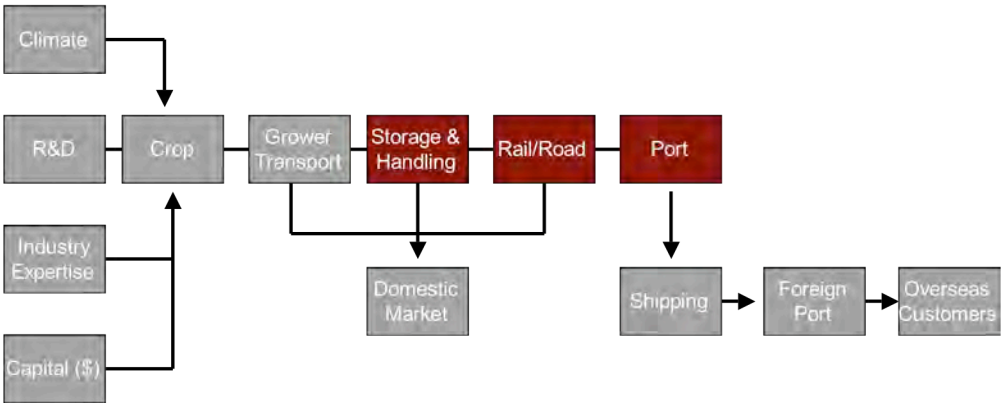
This chapter provides a general overview of the Australian grain supply chain, and the associated infrastructure and processes of the key elements of the export grain supply chain. The export grain supply chain in each of the major grain producing Australian States is then summarised, including the participants in each segment of the chain.

2.2 Grain supply chain

Figure 2.1 provides an overview of the Australian grain supply chain, including primary inputs (climate, research and development, industry expertise and capital), grain production, transportation (road, rail and ship), storage and handling and the domestic and foreign markets.

Figure 2.1

GRAIN INDUSTRY SUPPLY CHAIN



Source: Ernst & Young (2008)

A function that is not immediate obvious from this figure is that of 'position management' and 'sales and operational planning'. These functions play an important role in coordinating the separate elements of the overall supply chain, thereby facilitating the movement of grain from farm to domestic, or overseas, buyers.

As the export marketing of grain is characterised by bulk sales in spot markets (as opposed to long term contracts for many other commodities such as iron ore and coal), timing to market is of critical importance in taking advantage of prevailing market prices. It is understood that Australian marketers are generally able to take advantage high prices that have historically been prevalent during the early months of each calendar year due to lower availability in the global supply of grain, thereby maximising prices received by growers.

A feature of the Australian grain supply chain is that generally a marketer does not take firm control of the grain until it is delivered to the port terminal (see for example Box 2.1). That is, while a marketer may purchase an amount of wheat from a grower, it is stored in a commingled arrangement and effectively the marketer only has notional control of this wheat until the wheat is delivered to port.[1]

Box 2.1

GRAINCORP STORAGE AND HANDLING AGREEMENT

Co-ownership

2.13 ….the Client acknowledges that when GrainCorp receives the Client's Grain and both of the following occur (i) the weighbridge documentation notates the tare weight and the final net mass of the load is known, and (ii) the Client (or the Client's agent) has signed the Receival Docket, it becomes Stored Grain. At this time, full ownership in the Grain automatically transfers from the Client to the Co-owners, and in return, an Interest transfers from the Co-Owners to the Client. As a result, the Client becomes a Co-owner of the Stored Grain.

2.14. ….For the avoidance of doubt the Client's Interest represents an ownership right to Grain of the same type and grade of the Grain that is delivered by the Client (and not the same physical Grain that is delivered by the Client).

Stock-swaps

2.45. The Client acknowledges that for Operational Reasons, GrainCorp can swap a grade of Grain with the same grade of Grain between Country Sites in the Natural Port Zone, and by entering into this Agreement, subject to Clause 2.47, the Client consents to any such stock swap occurring. GrainCorp will effect [sic] these swaps by filling out a Stock Swap Form, forwarding this form to the Client and amending the location of the Client's Accounting Stocks in the GrainCorp Stock System.

Source: GrainCorp (2007f)

The infrastructure and processes through which grain moves along the grain supply chain to domestic and foreign buyers are central to understanding the potential competition issues that already exist in the marketing of export wheat, as well as additional challenges which may arise as a result of the Government's proposed reforms of wheat marketing. The infrastructure and processes of each of the major elements of the export grain supply chain are summarised below.

Storage and handling

The first key stage in the supply chain is generally the delivery by growers of grain to an 'up-country' receival facility, although where grain is sold into the domestic market, growers may instead choose to deliver grain directly to the buyer. Growers generally deliver grain to these facilities via road.

At the receival facility, the grain is weighed and sampled against receival standards. The operator issues the grower (or the grower's agent) a ticket registering the tonnage, grade and quality of the grain.

[1] This is similar to a person having notional savings at a bank, rather than of the physical funds that are deposited at any point in time.

With the exception of wheat, the domestic and international marketing of field grains in Australia is no longer regulated. State Governments in South Australia, Western Australia and New South Wales previously regulated the marketing of export barley. However, from 2005 onwards, these Governments gradually deregulated their barley marketing arrangements, and the last to do so was South Australia when the *Barley Exporting Act* became operational on 1 July 2007.

Although AWBI effectively controls bulk wheat exports, there is an active secondary market for wheat and growers may choose to sell either to AWBI (as operator of the National Pool), or to one of around 50 other wheat traders. Alternatively, the operator of the receival site may warehouse the grain on behalf of the grower for sale at a later date.

When selling grain to AWBI as the operator of the National Pool, farmers receive partial payments over a 15-month period, whereas other traders may offer more attractive cash prices. While traders may not be able to export bulk wheat directly, the secondary market provides arbitrage opportunities through selling wheat into the domestic market or to AWBI at a later date. Around 33 per cent of annual export wheat is delivered to AWBI through the secondary market rather than directly from the farm by growers (AWB 2008).

In each State, these 'up-country' receival sites are in most cases owned and operated by one of the three, largely State-based, storage and handling operators, CBH Group (CBH) in Western Australia, ABB in South Australia or GrainCorp in New South Wales, Victoria and Queensland.[2]

By registering the tonnage, grade and quality of the grain, the operators of receival sites generate and control valuable commercial information on the overall tonnages and quality of grain entering the grain supply chain, and importantly, the location of that grain in the overall supply chain.

Transportation

Grain at receival facilities is then transported to either domestic buyers, or to a port terminal for export, using road or rail transport. Rail tends to be the dominant means of transporting export-destined grain to port terminals. There may be grain storage facilities at the port, but the movement of grain by rail to port terminals requires co-ordination with the rail program (that is, take account of other traffic on the relevant rail lines) and the shipping stem (which details what ships are due at a given time).

While road haulage is often a very competitive industry, within each State rail transportation services for grain tend to be provided by a single monopoly firm. In some States, a dedicated haulage services provider provides grain haulage services, while in others the same firm may also be the owner of the rail track infrastructure.

Rail track infrastructure in all Australian States are covered by State-based access regimes, which have been certified as 'effective' access regimes, although as discussed in Box 2.2, this has not seen marked increase in third party provision of grain haulage services.

[2] These three companies are collectively referred to in this report as 'the Bulk Handling Companies' or BHCs.

Box 2.2

RAIL ACCESS AND GRAIN TRANSPORT IN AUSTRALIA

All Australian states have rail infrastructure access regimes, enabling third party operators to provide rail services by obtaining access to rail networks on commercial terms.

As with the diverse arrangements in place for the operation and ownership of rail networks across Australia, the specific nature of rail infrastructure access regimes differs between states. However, the common principles that underpin each of the access regimes are expected to become more consistent as a result of COAG's Competition and Infrastructure Reform Agreement of February 2006 (refer to Box 6.2).

Although access regimes exist in all states, there are few examples of third party operators successfully establishing operations on rail networks. For example, in New South Wales, there have been up to five different rail operators providing services to the grain industry since the introduction of rail infrastructure access regimes.

Recent consolidation within the rail industry has resulted in there now being only one rail operator carrying bulk grain in New South Wales. In contrast, no third party operators have successfully used rail infrastructure access regimes in South Australia, Victoria or Western Australia.

Source: Allen Consulting Group and SVGA (2007a)

Port terminals

Ports are recognised as vital infrastructure in a region's, and indeed nation's, logistics networks and economies, and are frequently characterised as providing an essential service. In many cases, port-based infrastructure services exhibit natural monopoly characteristics — that is, it would not be economic for another party to duplicate the infrastructure to provide the service.

The export grain supply chain infrastructure at port terminals comprises the following facilities (AWB 2008a).

- *Intake or receival facilities* — all grain received at an export terminal has to be weighed, quality tested, checked for insect infestation, promptly unloaded (in particular for rail unloading), and transported to grain silos containing grain of a similar type and quality.
- *Storage facilities* — including grain silos, shipping elevator towers and conveyor belts, are used to blend grain and transport it between silos and to the ship weigher.
- *ship weigher* — a conveyor belt is used to transport grain from the storage facilities to the weigher.
- *shipping belt* — transporting grain from the ship weigher to the ship loader.
- *ship loader* — which is located either on a jetty or a land based berth and which pours grain into the hatches of bulk grain vessels.

There is no export grain terminal within Australia where there is separate ownership or management of receival, storage and ship-loading assets. At each grain terminal, these various assets are owned and managed by a single entity, which other than in one instance is one of either CBH in Western Australia, ABB in South Australia or GrainCorp in New South Wales, Victoria and Queensland. These operators also tend to operate their grain terminals on a 'portfolio' basis, with a standard set of charges, and no competition between ports for grain cargo.

Victoria is the only State where a port terminal is owned by a party other than the dominant State-based storage and handling operator, in this case jointly by AWB GrainFlow and ABA.[3]

The following sections provide a more detailed discussion of the export wheat supply chain in each of the major grain producing States, and the participants in each segment of the supply chain. A more detailed overview of the key players in the Australian export wheat supply chain is provided in Appendix A.

2.3 Australian export grain supply chain

Western Australia

Storage and handling

CBH is the sole storage and handling company operating in Western Australia. It manages almost 200 receival sites throughout the State's grain belt, which have a total storage capacity of 19 million tonnes (CBH 2008a). The company announced plans to rationalise its storage and handling network, reducing the number of its receival sites to 60 'mega-sites' (Bolt 2004: 31).

Transportation

In Western Australia rail is the primary means through which grain is transported from receival sites to export ports, accounting for the delivery of 65 per cent of the State's grain for export (SVGA 2007b: 8). However, as this percentage implies, road is also an important method of transporting grain in Western Australia. One of CBH's four export terminals (Esperance) receives approximately 90 per cent of its grain via road, while two other terminals (Albany and Geraldton) receive approximately 50 per cent of their grain via road (SVGA 2007a: 26). Furthermore, 85 per cent of Western Australia's grain for domestic milling is delivered by road (SVGA 2007b: 8).

The Australian Railroad Group (ARG), a subsidiary of State-owned Queensland Rail, owns and operates the above-rail components of Western Australia's rail network. In 2000, Westnet Rail obtained a 49-year lease to manage the Western Australian intrastate freight rail network (that is, the below-rail components), which comprises of both standard and narrow gauge. Access rights to Westnet Rail's below-rail assets are provided for via an access regime certified under Part IIIA of the *Trade Practices Act 1974*. The Western Australia Economic Regulation Authority oversees this access regime (SVGA 2007a: 26).

It is understood that there is currently a tripartite 'industry rail contract' between AGR, the CBH Group and AWB for the transport of grain by rail. AWB has indicated that on the expiry of the current contract in 2008, this contract is expected to be replaced by a contract between AGR and the CBH Group only (AWB, personnel communication, 2008).

[3] ABA is a joint venture between ABB and Japanese trading house Sumitomo.

Port terminals

There are four export grain terminals in Western Australia, all of which are owned and operated by the CBH Group. The largest of these, which handles approximately half of the State's grain for export, is located at Kwinana, near Fremantle (CCI WA 2007: 14). The Kwinana grain terminal uses concrete silos, 'A Type' horizontals and 'CLS' bulkheads to store grain, and has a total capacity of over one million tonnes. The Kwinana grain terminal can inload grain from rail at a rate of 4,000 tonnes per hour (tph), and offload grain onto ships at a rate of 5,000tph (CBH 2008b).

CBH Group's second largest grain terminal is located at the Port of Geraldton. Relying on a combination of silos, depots and bulkheads, it also has a total storage capacity of over one million tonnes. The Geraldton grain terminal can offload grain onto ships at a rate of 2,000tph (CBH 2008b).

The grain terminal at the Albany port was built in 1956, and recently received a $130 million upgrade 'to increase operating efficiencies and create greater storage capacity' (CCI WA 2007: 14). It uses concrete silos and 'A Type' horizontals to store grain, and has a total capacity of over 420,000 tonnes. The Albany grain terminal can inload grain from rail at rates between 800 and 2,000tph, and offload grain onto ships at a rate of 1 600tph (CBH 2008b).

Finally, the CBH Group's grain terminal at the Port of Esperance has a total storage capacity of over 240,000 tonnes, and can offload grain onto ships at a rate of 2,500tph (CBH 2008b).

The *Bulk Handling Act 1967* requires that CBH allow any party to use the bulk handling facilities and equipment controlled by it at ports in the State on the payment of a (prescribed) charge. That is, access to the facilities is essentially available on a 'common-user' basis, although there are no provisions in the Act that govern the manner in which access is to be provided, nor how prices are to be determined.

New South Wales

Storage and handling

There are three companies that own and operate grain storage and handling infrastructure in New South Wales. The largest of these is GrainCorp, which handled approximately 82 per cent of the State's wheat receivals for the five years to 2005-06 (ITS Global 2007: 2). It did so through a network of four 'sub-terminals' (which have a combined storage capacity of 1.2 million tonnes), 30 'primary sites' (which are permanently staffed and handle the majority of grain) and 65 'storage sites' (which either handle the variable grain crop or are exclusively designated for particular grain commodities or domestic customers) (GrainCorp 2007b).

The second largest storage and handling company in New South Wales is AWB GrainFlow, a subsidiary of AWB. AWB GrainFlow handled approximately 14 per cent of the State's wheat receivals between 2001-02 and 2005-06 (ITS Global 2007: 2). The company maintains 10 receival sites in New South Wales, which are distributed throughout the three major grain production areas (AWB 2007b).

The smallest of the three storage and handling companies in the State is Australian Bulk Alliance (ABA), which owns three receival sites in the State located in the Riverina and South West. These sites handled approximately 3 per cent of the State's wheat receivals between 2001-02 and 2005-06 (ABA 2008; ITS Global 2007: 2).

Transportation

Rail is the dominant method of transporting grain from receival sites in New South Wales, with an estimated 90 per cent of grain for export and 75 per cent of grain for milling delivered by rail (SVGA 2007b: 8).

RailCorp, a State-owned corporation, provides and maintains rail track in New South Wales, although it has 'delegated the maintenance and management of most country freight lines to the Australian Rail Track Corporation (SVGA 2007a: 16). Pacific National, a wholly owned subsidiary of Asciano Limited, is the dominant operator offering grain rail transport services in New South Wales. GrainCorp is the other bulk grain rail operator in the State, although it only operates 'a single (leased) train.' (SVGA 2007a).

Pacific National announced in February 2008 that it was planning to withdraw from transporting bulk grain to port in New South Wales, and hence future arrangements for rail grain haulage services are uncertain at this time.

Port terminals

There are two export grain terminals in New South Wales for field grains, both of which are owned and operated by GrainCorp. The first of these is located at the Port of Newcastle, and has a total of 110 storage bins, which vary in size from 400 to 1,800 tonnes. Overall storage capacity at the Port of Newcastle is 126,640 tonnes fumigable and 61,600 tonnes non-fumigable. The terminal can inload grain from rail at a rate of 2,700tph and offload grain onto ships at a rate of 4,000tph (GrainCorp 2007c).

The second grain terminal in New South Wales is located at Port Kembla. This has 30 storage bins and a total capacity of 260,000 tonnes fumigable. The Port Kembla grain terminal can inload grain from rail at a rate of 3,600tph and offload grain at a rate of 5,000tph (GrainCorp 2007c).

South Australia

Storage and handling

Two companies operate grain storage and handling facilities in South Australia. The dominant player is ABB, which handled approximately 95 per cent of the State's wheat receivals between 2001-02 and 2005-06 (ITS Global 2007: 2). In South Australia, ABB operates a network of 111 receival sites, ranging in capacity from 10,000 to 440,000 tonnes. The total storage capacity of ABB's network in South Australia (including its port facilities) is an estimated 10 million tonnes (ABB 2008).

The other storage and handling company in South Australia is AWB GrainFlow, which handled approximately 5 per cent of the State's wheat receivals for the five years to 2005-06 (ITS Global 2007: 2). AWB GrainFlow owns and operates four receival sites in South Australia.

Transportation

Although rail is the primary mode for transporting grain in South Australia, road is also of considerable importance as most grain productions areas are close to the coast. Indeed, '[a] majority of ABB grain receival sites are now not serviced by rail', and five of ABB's seven export terminals (Thevenard, Wallaroo, Port Pirie, Port Giles and Ardrossan) are largely, if not wholly, serviced by road (ABB 2004; SVGA 2007a: 23). Nevertheless, due to the size of ABB's two primarily rail-serviced export terminals (Ports Lincoln and Adelaide), 70 per cent of South Australia's export grain is delivered by rail (SVGA 2007b: 8).

Genesee and Wyoming Australia Pty Ltd (GWA), a wholly owned subsidiary of the American regional freight company Genesee and Wyoming Inc (GWI), owns and operates South Australia's rail network (GWI 2008), and grain comprises the dominant traffic on this network. While GWA has an access unit, it "has yet to face competition on its tracks" (SVGA 2007a: 23).

Port terminals

There are seven grain export terminals in South Australia, the most of any State, which are all owned and operated by ABB. These terminals re located in Port Adelaide, Port Lincoln, Port Giles, Port Pirie, Ardrossan, Thevenard and Wallaroo. The combined storage capacity of ABB's grain export terminals is 3.4 million tonnes (ABB 2005: 2). Port Adelaide and Port Lincoln are ABB's largest export terminals, with the former possessing a storage capacity of 650,000 tonnes (ABB 2008).

In addition to its seven existing export terminals, ABB is currently investing $110 million in the construction of a new terminal at Outer Harbour, near the Port of Adelaide (Homer 2007). This terminal will be able to accommodate Panamax class vessels, which have a capacity of 65,000 tonnes. While the Outer Harbour terminal will have a relatively small storage capacity of only 65,000 tonnes, through a newly built railway it will be able to call on the larger storage facilities of Port Adelaide, Bowmans, Roseworthy, Snowtown and Tailem Bend (Nicholas 2007).

Victoria

Storage and handling

Four storage and handling companies operate in Victoria, the largest of which is GrainCorp, which handled approximately 76 per cent of wheat receivals in Victoria between 2001-02 and 2005-06 (ITS Global: 2). GrainCorp operates a network of two sub-terminals (which have a combined capacity of 750 000 tonnes), 27 primary sites (which have a storage capacity of 100 000 tonnes each) and 63 storage sites. The total storage capacity of GrainCorp's network in Victoria is 5.8 million tonnes (GrainCorp 2007d: 2).

AWB GrainFlow is the second largest storage and handling company in Victoria, and owns and operates four receival sites. It handled approximately 16 per cent of wheat receivals between 2001-02 and 2005-06 (ITS Global: 2).

The two remaining storage and handling companies in Victoria are ABA and ABB, which between them handled approximately 8 per cent of wheat receivals in Victoria. The former has four receival sites in the State, while the latter has two (ABA 2008; ABB 2008).

Transportation

Rail is the primary method of transporting grain from receival sites in Victoria, accounting for the delivery of approximately 80 per cent of the State's grain for export (SVGA 2007b: 8). However, it is estimated that around 70 per cent of Victoria's grain for milling is transported by road. GrainCorp has indicated that the use of rail to transport grain for export and milling has declined over the past decade, largely due to the deterioration of the State's rail infrastructure (GrainCorp 2007d: 7).

VicTrack, a State Government agency, owns the rail system in Victoria. Pacific National has leased the broad gauge country rail network from VicTrack for a 45-year term from 1999 (SVGA 2007a: 19). Pacific National also operates all grain rail services in Victoria.

Port terminals

There are three grain terminals in Victoria. The busiest of these is located at the Port of Geelong. Owned by GrainCorp, this terminal handles approximately 46 per cent of Victoria's grain for export (SVGA 2007a: 21). It has a total storage capacity of 225,000 tonnes and can offload grain onto ships at a rate of 2,500 tph (GrainCorp 2007c).

The second busiest grain terminal is located at the Port of Melbourne and is jointly owned by AWB GrainFlow and ABA.[4] On average, this terminal handles one million tonnes, or approximately 31 per cent, of Victoria's grain for export (AWB 2005; SVGA 2007a: 21).

The third grain terminal in Victoria is located at Portland and is owned by GrainCorp. It uses a combination of sheds and bins to store grain, with a total capacity of 140,000 tonnes. The terminal can inload grain from rail at a rate of 1,000tph and offload grain onto ships at a rate of 1,400tph (GrainCorp 2007c).

Queensland

Storage and handling

Grain storage and handling infrastructure in Queensland is owned and operated by two companies. The largest of these is GrainCorp, which handled approximately 79 per cent of the State's wheat receivals between 2001-02 and 2005-06 (ITS Global 2007: 2). It did so through a network of 10 primary sites and 32 storage sites.

The second storage and handling company in Queensland is AWB GrainFlow, which handled approximately 21 per cent of the State's wheat receivals for the five years to 2005-06 (ITS Global 2007: 2). AWB GrainFlow maintains four receival sites in Queensland, all of which are located in the Darling Downs (AWB 2007b).

Transportation

The transport of grain from receival sites in Queensland is unique, in that 100 per cent of export grain is delivered by rail, while 100 per cent of grain for domestic milling is delivered by road (SVGA 2007b: 8). However, given the larger volume of grain associated with export (generally three times larger than that for milling), a significantly greater tonnage of grain is transported by rail.

[4] ABA is a joint venture between ABB and Japanese trading house Sumitomo.

Responsibility for below-rail and above-rail components in Queensland lies with Queensland Rail, a state-owned corporation. The grain network in Queensland is predominantly limited to 15.75 tonnes per axle, 'which means that each grain wagon can only be loaded to around 44 tonnes' (SVGA 2007a: 15). Tariff rates for grain transport are set by Queensland Rail Access and approved by the Queensland Competition Authority (SVGA 2007a: 14).

Port terminals

There are three grain terminals in Queensland, all of which are owned and operated by GrainCorp. The most important of these is located at Fisherman Islands, near Brisbane. It uses a combination of multi-commodity sheds, pads (with capacities of 25,000 tonnes) and bins (with capacities ranging from 50 to 7,500 tonnes) to store grain, and has a total capacity of 218 400 tonnes fumigable (GrainCorp 2007c). The Fisherman Islands grain terminal can inload grain from rail and offload grain onto ships at a rate of 2 200tph.

A further grain terminal is located at Gladstone. It uses a combination of silos and bulk sheds to store grain, and has a total capacity of 86,900 tonnes. The Gladstone grain terminal can inload grain from rail at a rate of 1,400tph, and offload grain onto ships at a rate of 1,000tph (GrainCorp 2007c).

The last grain terminal in Queensland is located at Mackay. It has eight concrete silos and pads, with a total storage capacity of 82,000 tonnes. The Mackay grain terminal can inload grain from rail at a rate of 750tph and offload grain onto ships at a rate of 900tph (GrainCorp 2007c).

2.4 Competition issues

Table 2.1 summarises the key structure of the export grain supply chain in each of the major export wheat producing States.

Table 2.1

GRAIN SUPPLY CHAIN — SUMMARY

State	Transportation		Storage and handing		Ports	
	Mode (export wheat)	Companies	Number of firms	Market share	Number of ports	Market share
Western Australia	Rail (65%)	• ARG (100%)	1	• CBH (100%)	4	• CBH (100%)
New South Wales	Rail (90%)	• Pacific National (100%)	3	• GrainCorp (82%) • AWB GrainFlow (14%) • ABA (3%)	2	• GrainCorp (100%)
South Australia	Rail (70%)	• GWA (100%)	2	• ABB (95%) • AWB GrainFlow (5%)	7	• ABB (100%)
Victoria	Rail (80%)	• Pacific National (100%)	4	• GrainCorp (76%) • AWB GrainFlow (16%) • ABA and ABB (8% combined)	3	• GrainCorp (2) (68%) • AWB GrainFlow and ABA (1) (31%)
Queensland	Rail (100%)	• QR (100%)	2	• GrainCorp (79%) • AWB GrainFlow (21%)	3	• GrainCorp (100%)

Note: ABA is a joint venture between ABB and Japanese trading house Sumitomo

Source: Various, refer preceding sections.

Table 2.1 highlights that the storage and handling element of the export grain supply chain in each of the major export wheat producing States is dominated by a single integrated bulk handling company (BHC). Further, in most instances, these BHCs also own and control port-based grain export infrastructure in their respective States. In addition, in each State a single operator provides grain rail haulage services.

The structure of the export grain supply chain displays two characteristics that may serve to decrease competitive pressures in the export grain market. These are the existence of market power and potential conflicts of interests, which are discussed in more detail below.

Market power

In the absence of competition, a firm may exert market power to the detriment of buyers in the market and society as a whole. This may occur through setting monopoly prices for goods or services provided by it. The inherent incentives for monopolist to set monopoly prices and to constrain the supply of goods or services are especially strong if the firm also competes in downstream and/or upstream markets.

Considering the structure of the export grain supply chain (as summarised in Table 2.1), it is clear there exists potential for market power to be exercised with respect to the provision of export grain terminal services. Box 2.3 provides a specific example where a BHC has imposed a charge that appears to unreasonably impact on a particular marketer and imposes more onerous obligations than accepted standard practice.

Box 2.3

MARKET POWER IN THE EXPORT GRAIN SUPPLY CHAIN — VESSEL NOMINATION FEE

With regard to wheat storage and handling costs, the Export Wheat Commission's (EWC) commented that it is:

> "Of note is that AWBI pays the same as any non-AWBI traders to GrainCorp, more than the non-AWBI traders to CBH Ltd and less than non-AWBI traders to ABB Grain."

The EWC found that the high storage and handling costs (which include demurrage) paid in Western Australia to CBH by AWBI could be attributed to the Vessel Nomination Fee (VNF) introduced by CBH in October 2006. The VNF was designed to act as a financial incentive to improve planning arrangements for vessel loading and discharge.

The VNF consists of a fee of AUD 0.50 per tonne for vessels where notice given was between 15 and 30 days and AUD 1 per tonne for vessels where the notice was less than 15 days. The VNF charge has cost Western Australian National Pool participants (growers) almost $3 million since 2006/07.

While the fee applies to all CBH customers, only one other company, apart from AWBI, has been charged the fee. Further, industry have indicated 15-20 days, rather than 30+ days, is standard practice for vessel nomination. This means that users will be penalised even where they comply with standard industry practice.

Although the EWC noted that it was not aware of any other port operators having similar charges, it is understood that ABB also charges a VNF although this only applies where less than 21 days notice is received (the fee for less than 10 days is $1 per tonne, and between 10 and less than 21 days, $0.50 per tonne where an intent to ship is provided).

Source: Allen Consulting Group, EWC (2007: 15) and ABB (2007b)

Although there is only a single grain rail haulage provider in each State, in each case there does exist a rail access regime that allows other parties to gain access to rail track infrastructure to enter the market to provide haulage services. However, as noted in Box 2.2 this has not seen marked increase in third party provision of grain haulage services. It is likely that the seasonal nature of the grain industry, substantial upfront capital costs and complexity of negotiating an access arrangement for multiple rail lines decrease the attractiveness of this market. While this implies rail grain haulage providers have a degree of market power, this is reduced to the extent there are opportunities for substitution with road transport.

For the five years to 2006-07, wheat exports accounted for an annual average of 72 per cent of total field grain exports (in terms of both value and production), while barley, the other major field grain export, accounted for 26 per cent (ABARE 2007). As a result, AWBI's legislated monopoly as marketer of Australian export wheat also gives it market power. Sd&D (2004) concluded that this 'centralisation' of market power in the export wheat supply chain around AWBI, and the owner and operator of port terminals meant that export wheat marketers were:

> locked in strategic manoeuvrings with bulk handlers, but were still able to stimulate competitive pressure on them by maintaining their monopsonies. Similarly, marketers extracted premium transport rates by stimulating competition where state rail access regimes were in place. Growers generally received the benefits of these cost reductions directly through transparent pool management practices (Sd&D 2004: 7).

The effective exclusion of the BHCs from the marketing of export wheat through the current *Wheat Marketing Act 1989* means there is no ability (and hence incentive) for them to limit competition in the downstream export wheat market by refusing to supply monopoly port infrastructure services.

As a result, while the current arrangements with respect to export wheat marketing appear to be anti-competitive on the surface, it has been argued they act to establish countervailing sources of market power that ultimately preserve some competitive tension in the export wheat market.

However, to the extent that the BHCs compete in the marketing of a range of other grains that require the same port infrastructure services, there would be an incentive for them to prioritise access to port-based storage, handling and loading infrastructure for their grain. This highlights the need for access to port grain terminals to be provided on a transparent basis, and in accordance with fair and reasonable commercial terms. The current access arrangements for grain terminals are discussed in more detail in Chapter 6.

Information asymmetry and conflicts of interest

Each of the dominant BHCs is vertically integrated — operating up-country receival sites, (in many cases) coordinating the transport of export grain to port terminals, and owning and operating the export grain terminals.

The BHCs provide a number of services (for example, receival, weighing, sampling, storage, transportation, and loading) internally for their own grain marketing activities, while also providing these services to other firms that compete with them in providing marketing functions for a range of grains, including wheat sold into the domestic market.

As discussed in Section 2.2, the operation of receival sites and storage facilities either generates, or gives the BHCs access to, valuable information on the tonnages, grades, quality and location of grain entering the grain supply chain, including grain that has been sold to competing marketers. This information is not available to other market participants. As a result, where the BHCs compete with those marketers in the sale of grain to domestic and/or foreign buyers, they have a significant informational advantage that could be used to their commercial advantage.

Further, the operation by these BHCs of export gain terminals gives them information on, and control of, the 'shipping stem'. This is the term used to describe the port-by-port breakdown of which ships are due at a given time. To the extent this information is not publicly available, and the vessel nomination process is not transparent, there is potential for the BHCs to give preference to vessels transporting their grains ahead of the grain of competing marketers.

For example, as a marketer doesn't physically take ownership of grain until it is 'at port', the BHCs have an opportunity to notionally 'switch' grains. A shipment of grain delivered to a receival site that had been sold to a competing marketer may already have been transported to port storage by the BHC to make room for a subsequent delivery of grain (of the same grade and quality) sold to the BHC. However, the BHC may notionally 'switch' the two deliveries, allowing it to export its shipment ahead of a competing grain marketer. As timing to market is critical in maximising market returns, this could give rise to a significant financial advantage to the BHC, leading to a commercial advantage in marketing its services to grain growers.

Potentially illustrating this advantage, CBH's 2007 Annual Report states that:

> In a landmark decision in December 2006 the Wheat Export Authority and Federal Minister for Agriculture announced approval for the CBH group to export 500,000 tonnes of wheat in bulk. The first shipments began in January 2007, enabling the CBH group to release *value in the supply chain* and return an estimated $13.50 per tonne of additional value over the national pool's APW base grade (emphasis added) (CBH 2007:19).

The potential effect of information asymmetries is further illustrated in Box 2.4.

Box 2.4

INFORMATION ASSYMETRIES — SHIP LOADING

When using CBH's export grain terminals, marketers are required to submit a Vessel Notification Advice (VNA) to CBH to notify of their vessel's expected arrival date. In addition, marketers must also lodge a Cargo Accumulation Plan (CAP) that is intended to allow CBH to perform the role of logistics co-ordinator and cargo accumulation, including site selection and transportation management to meet the CAP and vessel-loading window.

As a result, CBH gains access to extensive information on planned vessel arrivals, required vessel loading windows, the quantity and quality of grain being exported and associated transport requirements.

To the extent this information is not available to grain marketers generally, this may adversely affect their ability to optimise their shipping schedules. For example, when planning shipping journeys, individual grain marketers would not be aware whether there are already vessels scheduled to arrive and load during the same time period, and hence whether there exists an increased likelihood that loading of its vessel might be delayed, thus incurring demurrage costs.

Further, without knowledge of scheduled vessel arrivals, it is also difficult to form a view on the fairness and equity with which berthing and loading windows are initially allocated and might subsequently be reallocated should vessels be delayed.

Source: Allen Consulting Group based on AWB 2008b

As the *Wheat Marketing Act 1989* effectively prevents the BHCs from competing with AWBI in the marketing of bulk export wheat, these companies are as yet unable to fully exploit these existing information asymmetries for financial and/or commercial advantage. Consequently, the current arrangements for export wheat marketing, while appearing to be anti-competitive on the surface, do appear to provide a source of competitive tension in the broader grain market. However, this is likely to change should the BHCs in future be able to compete with AWBI in the marketing of export wheat.

The following chapter examines briefly the reforms that have been implemented in the grain supply chain over the past two decades, as well as the drivers for further reform, and an overview of the reforms of export wheat marketing arrangements that the Government is likely to put forward.

Chapter 3

Export wheat market reforms

3.1 Introduction

As noted in Chapter 1, there has been a monopoly manager and marketer of Australian bulk wheat exports under the 'single desk' arrangement since 1939. Following the establishment of AWB through the privatisation of the Australian Wheat Board in 1999, export wheat management and marketing has been through AWB's subsidiary, AWBI. While the single desk remains engrained in the Commonwealth *Wheat Marketing Act 1989*, the Australian grain industry itself has seen significant changes over the past 20 years.

In this chapter, the efforts of the Royal Commission on Grain Storage, Handling and Transport in the late 1980s to create greater competition in the Australian grain market are examined. The current wheat marketing arrangements are then summarised, followed by summary of some of the key drivers for reform and an overview of the changes that the Government has signalled it will seek to implement.

3.2 The Royal Commission on grain storage, handling and transport

In 1986, the Federal Government and the Governments of all mainland States agreed to establish a Royal Commission into Grain Storage, Handling and Transport. The catalysts for this inquiry were the rural recession of the mid-1980s and the apparent high costs of storing, handling and transporting grain in Australia compared to other countries (Office of Technology Assessment 1989: 129). The terms of reference for the Royal Commission were to report on the most efficient integrated grain distribution system for Australia's future needs, and to make recommendations about implementing such a system.

The report of the Royal Commission (the 'McColl Report') was published in 1988, and concluded that 'significant resource cost savings' (on average, nine dollars per tonne) could 'potentially be achieved by moving from the current institutional arrangements for grain distribution to arrangements which allow greater choice and flexibility' (McColl Report 1988: 131).

The McColl Report, along with the Industries Assistance Commission's wheat industry report (which was also released in 1988), had a significant impact on the grain distribution system in Australia. Key developments included the following.

- *The deregulation of the domestic wheat market* – in 1989, the Federal Government passed the *Wheat Marketing Act*. This 'terminated the compulsory acquisition and administration of pricing arrangements under the so called "pooling" concept' (BTE 1992: 65). Growers were now free to choose whether they delivered 'directly to the Australian Wheat Board or to a trader for cash' (Quiggin *et. al.* 1994: 263). Growers were also now free to choose where they delivered their grain.

- *The rationalisation of the grain transport network* – after the McColl Report, a number of less efficient branch lines were closed in the New South Wales, Victorian and South Australian rail systems. The Sydney export terminal was also closed, and two new port facilities for grain export were opened at Port Kembla and Fisherman Islands.
- *The greater use of price signals to reflect market values* – in the late-1980s, the Australian Wheat Board began offering different prices for grain based on its protein content and port of delivery (ABARE 1991: 15).

Another key recommendation of the McColl Report was that State Governments deregulate the grain storage and handling industry, and no longer restrict the provision of grain storage and handling services 'to only one licensed receiver in each State' (McColl Report 1988: 171). This process was completed across the mainland States by the early-2000s, although as demonstrated in Chapter 2, the previous monopoly holders (or their successor entities) continue to dominate this sector in their respective home States.

The removal of regulatory restrictions on competition and moves to operate the grain supply chain in accordance with more commercial principles, through reducing cross-subsidies and improving price signals, are consistent with the broader principles underpinning the National Competition Policy. This policy became the basis for applying these and related reforms more broadly to Australian industries, and is discussed in detail in the following chapter.

3.3 The 'single desk'

The McColl Report did not comment directly on the 'desirability or otherwise of changes to export or domestic marketing arrangements: it regards this subject as being beyond the scope of its inquiry.' However, it noted that:

- deregulation of domestic and export marketing arrangements could bring greater competitive pressure to bear on grain distribution in Australia; and
- in the event of export deregulation, 'vertical integration of marketing and storage, handling and transport ... is likely to occur primarily because the marketer needs to be assured of access to grain' (McColl Report 1988).

The *Wheat Marketing Act 1989* governs the export of wheat from Australia. Section 57(1) of the Act states that a person shall not export wheat unless the Export Wheat Commission has given its written consent to the export of the wheat, and the export of the wheat is in accordance with the terms of that consent.

This section is, of itself, is not restrictive. Rather the 'single desk' arrangements are established as a result of following sections in the Act, which state that:

- the prohibition in Section 57(1) does not apply to AWBI;
- the Export Wheat Commission must consult AWBI prior to giving consent to the export of wheat; and
- that the Export Wheat Commission must not give its consent without prior approval in writing from AWBI

The role of AWBI has changed somewhat since 2006, when AWBI's power to withhold its consent to the Export Wheat Commission's written approval to the export of wheat was transferred to the Minister for the period up to 30 June 2008 by the Wheat Marketing Amendment Bill 2006 (and the Wheat Marketing Amendment Bill 2007). Furthermore, the Minister now must also approve a decision of the Export Wheat Commission to decline to consent to the export of wheat.

Under these arrangements, the Minister for Agriculture, Fisheries and Forestry announced on 8 February 2008 a decision to grant three bulk wheat export permits to Paris-based Louis Dreyfus for 100,000 tonnes for sale to Iraq, to Swiss-based Glencore International AG for 300,000 tonnes for sale to Iraq, and to GrainCorp for 50,000 tonnes for sale to the United Kingdom (Morris 2008). The combined volume of these three permits represents 3.4 per cent of Australia's annual average total wheat exports over the five years to 2006-07 (ABARE 2007).

Finally, the prohibition on wheat exports in Section 57(1) of the Act does not apply to the export of wheat in bags or containers — it is only bulk wheat exports that are regulated. In 2006-07 over 877,000 tonnes of wheat was exported from Australia in bags and containers, representing 8.7 per cent of total wheat exports (EWC 2007). The export of wheat in bags or containers has almost doubled since 2003-04 (EWC 2007).

However, the opportunity to substantially increase containerised wheat exports is limited as this trade largely takes advantage of 'back loading' opportunities, which relies on utilising containers destined for specific destinations that would otherwise leave the country empty. Consequently, this is largely an opportunistic export trade.

3.4 The push for further reform

Over the past few years, numerous factors have fundamentally changed the policy environment surrounding export wheat marketing arrangements in Australia. However, the key event to spur the current push for further reform of export wheat marketing arrangements was the 2005 *Inquiry into Certain Australian Companies in Relation to the UN Oil-for-Food Programme*, which was published in November 2006, and raised debate about the potential negative outcomes of wheat export monopolies.

In response, the Howard Government appointed a Wheat Export Marketing Consultation Committee (WEMCC) in January 2007, which sought to determine the 'wheat export marketing needs' of the Australian grains industry. The WEMCC's report was presented to the Government on 30 March 2007, although the report has not been publicly released.

In May 2007, the Howard Government announced that although it intended to retain the single desk for wheat export marketing, AWBI would only retain its monopoly rights until June 2008, and that control over the single desk would then transfer to an unspecified new entity separate from AWB. The Howard Government indicated that this new entity could be either a new grower-owned entity, or a demerged (from AWB) AWBI (Hansard 2007).

In October 2007, the (then) Labor Opposition released its policy for Australian wheat export marketing, a key plank of which was that there would be 'a single desk with multiple accredited exporters'. The Labor Party was subsequently elected to govern in November 2007, and the reforms it intends to introduce are discussed in more detail below.

3.5 Proposed reforms to export wheat marketing arrangements

The pre-election policy on export wheat marketing of the Labor Party, now Rudd Government, was to set up a new body, to be known as Wheat Exports Australia. This body would manage the single desk for bulk wheat exports, which would then develop and administer an export accreditation scheme. Under this arrangement, Wheat Exports Australia would control bulk wheat exports and accredit a number of exporters (O'Brien 2007: 15).

These changes would see AWBI simply become one of a number of accredited exporters, and it would no longer have a 'general exemption' from control of the Export Wheat Commission or the power to veto the accreditation of other exporters (O'Brien 2007: 15).

Rather than being forced to sell export grain to AWBI, the new arrangements would increase choice for growers by providing a number of selling options, including the option to access foreign markets direct through accredited grower cooperatives or alliances. It was anticipated that the increase in contestability would improve returns to growers by increasing competitive pressures in the export wheat supply chain (O'Brien 2007: 15).

On 5 March 2008, the Rudd Government released the Wheat Marketing Amendment Bill 2008, which would give affect to its proposed reforms, for public comment.[5] The reforms now being contemplated for export wheat marketing arrangements are consistent with those implemented in the domestic grains market following the Royal Commission, and would complete the deregulation of the Australian grain supply chain.

3.6 Possible competitive implications

A recent report that examined the potential deregulation of wheat exports by allowing multiple exporters under a single desk arrangement concluded that this would:

> …not produce a contestable market for the sale of Australian wheat unless regional monopolies in grain handling and storage in Western Australia, South Australia and New South Wales are comprehensively over-hauled as part of a structural adjustment process (ITS 2006: 4).

As discussed in Chapter 2, as the BHCs compete in the marketing of a range of other grains that require grain terminal services, there exists an incentive for the BHCs to prioritise access for its grain to port-based storage, handling and loading infrastructure. However, it was noted that the effective exclusion of the BHCs from the marketing of export wheat through the current *Wheat Marketing Act 1989* arrangements meant there is no ability (or incentive) for them to limit competition in the downstream export *wheat* market by impeding access to, or refusing to supply, monopoly port infrastructure services.

[5] A copy of the amendment Bill is available on the Department of Agriculture, Fisheries and Forestry's website, www.daff.gov.au/agriculture-food/wheat-sugar-crops/wheat-marketing/legislation.

This situation would change should the reforms flagged in the Government's exposure draft of the Wheat Export Marketing Bill 2008 be implemented. Previously, the BHCs only had an incentive to use their market power to charge prices above the efficient price — there was no ability to reduce competition in the export wheat market by reducing access to its infrastructure as the BHCs themselves were prevented from competing in this market.

If the BHCs were to receive accreditation to export bulk wheat, and hence compete directly with AWBI, there will exist a strong incentive for them to use their market power to reduce competition in the downstream marketing of export wheat. The reforms of export wheat marketing arrangements proposed by the Government make it critical that access to export wheat supply chain infrastructure, and especially export grain terminals, is available on a transparent basis, and on fair and reasonable commercial terms.

Enabling the BHCs to compete with AWBI in the marketing of bulk export wheat also means those companies will have incentives to exploit the informational advantages they hold (as discussed in Chapter 2).

The Government has acknowledged that the new export wheat marketing arrangements must support genuine competition, with companies being given access to the infrastructure of the three large bulk handlers, CBH in Western Australia, and ABB and GrainCorp in the Eastern States, to ensure there is:

> a competitive market…[and]…we don't replace a national exporter…[to] simply end up with three regional monopolies…of CBH, ABB and GrainCorp (AFR 2008: 9).

Although the primary focus of the debate to date has been on AWBI's role as the (effectively) exclusive marketer of Australian export wheat, it is necessary to consider more broadly those factors that have the potential to limit competition in the export wheat supply chain (as discussed in Chapter 2). This is to ensure that the objective of producing a more competitive export wheat market is not stifled due to the characteristics of the export wheat supply chain itself.

In this context, the development of National Competition Policy in Australia in the early 1990s provides a sound set of guiding principles for developing reforms intended to reduce restrictions on competition, and for this reason provides a good template for considering the reforms of the export wheat marketing arrangements now being proposed.

Chapter 4

National Competition Policy

4.1 Introduction

This chapter examines the thinking behind the National Competition Policy framework, and in particular the motivation for the removal of legislated monopolies and for separating vertically integrated monopolies, both of which are relevant in the context of reforms being contemplated for the export wheat market.

The purpose of this chapter is to draw on the principles of the National Competition Policy to consider the possible implications for the Australian export grain supply chain of the coming changes to export wheat marketing arrangements.

4.2 The Hilmer Report

The 1993 report by the National Competition Policy Review Committee, which has since become known as the Hilmer Report after its chairman, highlighted the importance of competition to improving productivity, enhancing Australia's international competitiveness and in maintaining and improving the living standards of its residents:

> Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole (Hilmer 1993: 1).

The importance of effective competition in key infrastructure sectors such as energy supply, transportation, communications and water supply was also noted by the then Chairman of the National Competition Council (the Council), now Chairman of the Australian Competition and Consumer Commission (the Commission), Graeme Samuel, when he commented that these sectors:

> …play a pivotal role in the Australian economy. They generate major business inputs, representing between 7 and 16 per cent of production costs for most Australian industries and also provide essential services to the community. Any inefficiencies in infrastructure provision directly impact on Australia's growth, competitiveness, and ultimately on living standards (Samuel 1998).

The Hilmer report identified six key areas where national action was required to reduce restrictions on competition in the Australian economy, many of which were directed at reducing inefficiencies in infrastructure provision.

- Extending the anti–competitive conduct provisions of the *Trade Practices Act* to unincorporated and government businesses.
- Reviewing and removing regulatory restrictions on competition, unless it could be clearly demonstrated that the restriction was in the public interest.
- Adopting a set of principles for structural reform of public monopolies before introducing competition into the market, or before privatising a public monopoly. The set of principles were to include separation of regulatory from commercial functions, and of potentially competitive elements from natural monopoly elements.

- Providing for independent prices oversight for government businesses that continue to hold a legislative, or natural, monopoly or where the market is otherwise poorly contestable.
- Applying the principles of competitive neutrality where government-owned business were in direct competition (actual or potential) with the private sector (for example, requiring the business to pay the equivalent of Commonwealth company income tax).
- Establishing rights for third parties to access declared essential facilities where such access is required for effective competition in upstream or downstream markets.

In April 1995, the Council of Australian Governments (COAG), which comprises of the governments of the Commonwealth and all Australian States and Territories, reached agreement on a plan to promote enhanced competition in Australia based on these recommendations.

4.3 Policy framework

The policy framework of the Hilmer Report's recommendations formed the basis for what is known as the National Competition Policy, which in turn is underpinned by three intergovernmental agreements: the Competition Principles Agreement; the Conduct Code Agreement; and the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement).

The Competition Principles Agreement established the core public policy principles underpinning the National Competition Policy, including:

- prices oversight of State and Territory government business enterprises, competitive neutrality, structural reform of public monopolies and legislation review and reform;
- public–interest factors that were to be considered when assessing the costs and benefits of a particular policy or course of action; and
- arrangements for access by third parties to services provided by significant infrastructure facilities.

The Conduct Code Agreement:

- committed the parties to extending the prohibitions against anti–competitive behaviour in the *Trade Practices Act* to virtually all businesses in Australia; and
- required each government to notify the Australian Competition and Consumer Commission when it enacted legislation that relied on section 51 of the *Trade Practices Act*, which enables State and Territory Governments to exempt conduct from the prohibitions against anti competitive behaviour in Part IV of the Act.

Finally, the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement):

- set out reform obligations covering national markets in electricity and gas, water reform and national road transport regulations; and

- provided for payments by the Commonwealth to the States and Territories where satisfactory progress was achieved in the implementation of the National Competition Policy and related reforms.

In 2005, the Productivity Commission noted that most of the agreed reforms had been, or were being, implemented, and that National Competition Policy and other microeconomic reform had produced significant payoffs in productivity and income growth:

> the observed productivity and price changes in key infrastructure sectors in the 1990s — to which NCP and related reforms have directly contributed — have increased Australia's GDP by 2.5 per cent, or $20 billion. And such modelling does not pick up the 'dynamic' efficiency gains from more competitive markets (PC 2005: xvii).

4.4 Legislation review

Clause 5 of the Competition Principles Agreement obliged governments to review and, where appropriate, reform legislation that restricted competition. Specifically, it required governments to remove restrictions on competition unless it could be demonstrated that the restriction benefited the community overall (that is, was in the public interest) and that the objectives of the legislation could only be achieved by restricting competition.

Clause 5 also imposed two ongoing obligations.

- It obliged governments to review, at least once every 10 years, any restrictive legislation against the guiding principle, with the aim being to ensure that regulation remained relevant in the face of changes in circumstances and/or in government and community priorities.
- It specified that governments must ensure new legislation that restricted competition was demonstrably consistent with the Clause 5(1) guiding principle.

In this context, Section 57 of the *Wheat Marketing Act 1989* prohibits a party from exporting wheat unless the Wheat Export Commission has given its consent, although this prohibition does not apply to either AWBI or to the export of wheat in bags or containers. Further, the Act also requires that the Wheat Export Commission consult AWBI before it gives consent for another party to export wheat from Australia, and bars it from providing such consent without the written approval of AWBI. Consequently, the effect of Section 57 of the *Wheat Marketing Act 1989* is to give AWBI the ability to exclude competition.

As part of its annual assessment on the progress of governments in meeting their obligations under the Competition Principles Agreement, the National Competition Council consistently found (in its assessments for the years 2002, 2003, 2004 and 2005) that the Commonwealth Government had not met its Clause 5 obligations in relation to the *Wheat Marketing Act 1989* because it had failed to show that restricting competition in the export of wheat was in the public interest (NCC 2005: 10.4).

A report commissioned by the Government in early 2000 argued that, rather than a continuation of the export controls, introducing greater competition was more likely to deliver greater net benefits to growers and the wider community (NCC 2005: 10.1-10.2). The Committee also found that:

- any price premiums earned by virtue of the single desk were likely to be small (estimated at around US$1 per tonne in the period 1997–99);
- the single desk inhibited innovation in marketing;
- the single desk impeded cost savings in the grain supply chain.

However, the Hilmer Report and the National Competition Policy also recognised that where legislation supporting statutory monopolies are removed, remaining structural barriers to entry in some industries would continue to impede effective competition. Structural barriers to competition in industries dominated by monopolies are likely to exist where the incumbent monopolist has developed into a vertically integrated monopoly, controlling even the potentially competitive elements of the industry.

For these reasons, both the Hilmer Report and the National Competition Policy also recognised the importance of:

- establishing rights for third parties to access significant infrastructure where such access is required for effective competition in upstream or downstream markets; and
- the structural reform of (public) monopolies.

4.5 Access to significant infrastructure

As noted earlier, the efficient provision of infrastructure services is a critical factor in Australia's economic well-being. However, the economic importance of infrastructure industries is not, in itself, a reason to regulate access to infrastructure facilities. Generally, it is only industries with natural monopoly characteristics that are subject to access and price regulation. Natural monopolies are industries whose output is produced at least cost by just one firm. In these circumstances, it is socially desirable for all the output of the industry (in a particular market) to be produced by a single producer.

Monopoly businesses that are not natural monopolies are not usually regulated. For these industries and businesses, there exists a presumption that the market is contestable, even if it is not competitive. That is, if the monopolist uses its market power to raise its prices and obtain monopoly profits, other firms could enter the industry and undercut the price charged by the monopolist, and so compete away the monopoly profit.[6]

The rationale for regulating access to natural monopoly infrastructure, also often referred to as 'bottle-neck' facilities, is that in the absence of competition, an owner of monopoly infrastructure may exert market power to the detriment of buyers in the market and society as a whole. This may occur through:

- limiting competition in upstream or downstream markets by refusing to supply infrastructure services (that is, access to the monopoly infrastructure); and/or
- setting monopoly prices for infrastructure services provided by the monopoly infrastructure.

[6] Section 46 of the *Trade Practices Act 1974* aims, *inter alia*, to protect these potential entrants from the misuse of market power by the monopolist, where misuse of market power broadly means conduct that damages the competitive process.

The inherent incentives for an owner of monopoly infrastructure to exert market power are especially strong if it is also active in downstream, and/or upstream, markets.

Through amendment of the *Trade Practices Act* (to include Part IIIA), Australian governments have sought to restrict the potential abuse of monopoly power in infrastructure services by providing a statutory right of access to monopoly infrastructure services that meet prescribed conditions, and by regulating prices in a way that enables the owners of the infrastructure to obtain a competitive return on their capital, adjusted for the risks they face.

This framework was introduced into the *Trade Practices Act* in 1995 in response to the finding of the Hilmer Review that competition reform in Australia required the development of effective regulatory arrangements for "bottleneck" infrastructure. The mechanisms for regulating access established by Part IIIA of the *Trade Practices Act* are described in general terms in guidelines published by the National Competition Council, which are summarised in Box 4.1 and discussed in detail in Appendix C.

Box 4.1

MECHANISMS OF REGULATION UNDER PART IIIA OF THE TRADE PRACTICES ACT

The regime set out in Part IIIA establishes legal rights for third parties to share the use of certain infrastructure services of national significance on reasonable terms and conditions. Technically, the regime provides access not to the infrastructure itself, but to services provided through the infrastructure. If, for example, a business gains a right to access a railway line to run trains, then that right would not allow it to physically operate the railway. Rather, the right of access would be the business's right to run its trains on the railway subject to control by the railway operator. The service in this case would be a rail service.

…

The establishment of Part IIIA of the [Trade Practices Act] in 1995 drew together the various pathways to access under an umbrella framework. It covers existing access regimes and provides a mechanism for access to services that were previously outside the scope of access regulation. A number of regimes (notably, those for telecommunications and airport services), however, remain partly or fully outside Part IIIA.

In essence, Part IIIA covers nationally significant infrastructure services where:

- the development of competitive infrastructure would be contrary to the interests of the community as a whole because the infrastructure has natural monopoly characteristics; and
- access is necessary to promote competition in an upstream or downstream market — that is, access regulation would address structural impediments to competition in a market that relies on the infrastructure service as an input.

…

Part IIIA establishes three pathways for a party to seek access to an infrastructure service:

- through declaration;
- by using an existing effective access regime; or
- under terms and conditions set out in a voluntary undertaking approved by the Australian Competition and Consumer Commission (ACCC).

Source: NCC (2002: 3-8).

4.6 Structural reform

While other elements of the National Competition Policy were designed to promote a level competitive playing field, including providing for third party access and extending prohibitions against anti–competitive behaviour, as shown, it was also recognised that these initiatives would not always be sufficient to establish effective competition (see Box 4.2).

Box 4.2

WHY STRUCTURAL REFORM MAY BE NECESSARY

Protection of public monopolies from competition through regulation or other policies allows anticompetitive market structures to develop. Rectifying strategies include liberalising market access and ensuring public monopolies adhere to competitive neutrality principles. These strategies, however, will not always be sufficient to establish effective competition. Structural reform may be needed to dismantle an integrated government monopoly business.

Such reform can involve separating the (potentially) competitive elements from the monopoly elements. Structural reform is important where a public monopoly is to be privatised.

Privatisation without structural reform could result in a private monopoly supplanting the public monopoly, with few real gains and potentially considerable risks. Clause 4 of the Competition Principles Agreement (CPA) sets out obligations of governments that aim to reduce the risks of such adverse outcomes

Source: NCC (2005: 3.1)

In this context, it is worthwhile quoting some particularly relevant passages from the Hilmer Report (variously, pp.218–p222):

> "A number of industries currently dominated by public monopolies involve an element with natural monopoly characteristics, in the sense that a single firm can supply the entire market most economically ….
>
> … where there is a vertical relationship between the two activities, particularly **when access to the natural monopoly element is essential for effective competition in the downstream or upstream market**. …[this] **raises concerns that control over access to the monopoly element may be misused to stifle or prevent competition in the potentially competitive sector**. Even if access is not actually misused, the potential for such behaviour may deter new entry to, or limit vigorous competition in, markets dependent on access to the natural monopoly element…
>
> … There are two broad alternatives for addressing concerns of these kinds. First, **the natural monopoly element can be separated from the potentially competitive elements**. Alternatively, **the integrated structure could be left intact, and reliance placed instead on more intrusive regulatory controls to guard against … the potential misuse of control over access to the natural monopoly element**….
>
> …The Committee strongly supports structural reforms over intensive conduct regulation. … **The Committee is … mindful that incumbents … may have strong incentives to resist wide–ranging structural reform**.
>
> Against this background, the Committee considers that these issues should be subject to a rigorous, open and independent analysis of the costs and benefits of various reform options. **Moreover, where the natural monopoly element is vertically integrated with the potentially– competitive activity, the Committee considers there should be a presumption in favour of full structural separation**, leaving those who support some lesser reform to establish why this is in the long term public interest." [emphasis added]

While the focus of the Hilmer Report was on public monopolies in areas such as telecommunications, and electricity and gas, its comments and conclusions are equally relevant to private monopolies, such as those held by the BHCs.

The continued challenges to economic growth and prosperity created by infrastructure gaps and bottlenecks contributed to the Rudd Government announcing in late January the establishment of Infrastructure Australia (Albanese and Rudd 2008). The role of this new body is to, in partnership with the States, Territories, local government and the private sector, develop a strategic blueprint for the nation's future infrastructure needs and facilitate its implementation. Infrastructure Australia will also identify investment priorities and policy and regulatory reforms that will be necessary to enable timely and coordinated delivery of national infrastructure investment.[7]

The following chapter highlights the challenges that may be encountered following the removal of legislative restrictions on competition, even with the establishment of means through which potential competitors could gain access to the essential infrastructure that was owned or controlled by incumbents. In particular, the examples also highlight the detrimental effect that information asymmetries can have on competition.

[7] Further information on Infrastructure Australia is available at www.infrastructure.gov.au/department/infrastructureaustralia/index.aspx.

Chapter 5

Competitive reforms and industry structure

5.1 Introduction

The previous chapter discussed in some detail the rationale behind the development of the National Competition Policy. This Policy, or elements of it, was widely applied to key national infrastructure services. However, that is not to say that the implementation of the National Competition Policy was not without its challenges.

This chapter highlights some of the challenges encountered in the domestic telecommunications and aviation sectors following the removal of legislative restrictions on competition, even with the establishment of means through which potential competitors could gain access to the essential infrastructure that was owned or controlled by incumbents.

5.2 The telecommunications industry

Australia's telecommunications market has undergone significant changes to its regulatory environment over the past twenty-five years, and provides a good example of the sorts of challenges that can arise in attempting to increase competition in an industry.

Governments have long been involved in nations' telecommunications industries, pursuing social and political objectives, as well as addressing inherent market failures. Government interventions have traditionally included public ownership of assets and operation of services; statutory monopolies; and politicised pricing and investment decisions (Albon 2006).

However, in the 1970s many developed countries sought to promote greater competition in their telecommunications markets. In Australia, the 1982 Davidson Enquiry examined the role for private sector involvement in the telecommunications market, recommending an end to Telecom Australia's monopoly. The subsequent passage of the *Telecommunications Act 1991* provided the legislative foundation for the eventual opening of the market to full-scale competition (ABS 2001).

The Australian telecommunications market was opened to full retail competition on 1 July 1997. To facilitate the entry and effective competition of new firms into the market, Telstra — the formerly government-owned incumbent — became subject to access arrangements for its copper wire telephone network, which up to 88 per cent of Australian homes and businesses rely on for voice services (ACCC 2006, p. 14).

Telstra's copper wire telephone network represents a natural monopoly facility — it would not be economic for any party to develop a competing facility. Reflecting this market structure, the bulk of the Australian Competition and Consumer Commission's (ACCC) regulatory efforts have been directed towards ensuring that 'competitors are able to get access to Telstra's existing copper telephone wires, where they need it, at reasonable prices and on reasonable terms' (Samuel 2005a, p. 517). The need for ongoing regulation within this segment of the market is readily apparent:

> …for as long as one carrier overwhelmingly dominates the telecommunications sector, to the extent that all its competitors are beholden to it for access to the very infrastructure they need to compete, then regulation will be required to ensure that, as far as possible, competition is protected (Samuel 2005b, pp. 10–11).

By comparison, in the mobile telephony market it has been economic for Telstra's competitors to invest in their own infrastructure to provide mobile phone services. As a result, this sector of the market has been characterised by more effective and sustainable competition, and a reduced need for regulation when compared to the fixed-line sector (Samuel 2005).

The following section discusses the competitive challenges that have emerged from Australia's telecommunications market.

Competition challenges

The vertical integration of Telstra's business is the source of many of the competition challenges within Australia's telecommunications market. In fact, Telstra is recognised as being the most integrated communications company in the world (Allen Consulting Group 2006), which has contributed to calls to separate its retail and wholesale operations. Proponents contend such reforms would increase transparency, making it easier for regulators to detect and resolve anti-competitive behaviour. The basis for separating these two components is set out below.

> A vertically integrated incumbent that owns an essential facility usually has a strong incentive to restrict competition in related contestable markets. By restricting competition in contestable markets (through high access prices and/or unreasonable non-price terms and conditions), the vertically integrated firm may be able to stifle new entry or innovation.
>
> As Telstra owns essential infrastructure inputs, most competitors purchase at least some wholesale services from Telstra to participate in fixed-line retail markets, while at the same time competing against Telstra's retail businesses in those markets. By charging high prices for access to its core network and/or implementing delay tactics, Telstra has the capacity to extract monopoly rents and to foreclose competition in downstream markets (Allen Consulting Group 2006: 24).

It is important to note that vertical integration is of itself not *necessarily* anti-competitive. Rather, anti-competitive concerns arise when a vertically integrated provider also has market power through ownership of facilities with natural monopoly characteristics, as its incentives are usually to restrict competition (Allen Consulting Group 2006). A proposal for separating Telstra — as a means to address a range of competition issues within the market — are further discussed in Box 5.1.

Box 5.1

A PROPOSAL FOR THE SEPARATION OF TELSTRA

The ACCC has previously supported the concept of *operational separation* for Telstra, which would overcome many concerns of anti-competitive behaviour through the interactions of Telstra's wholesale and retail operations. Under operational separation proposals, Telstra's wholesale and retail arms would have a clear internal separation between a 'retail business' supplying services to end users, and a 'network business' providing wholesale services to the Telstra retail business as well as its competitors. These two segments would be required to deal with each other on a commercial, arms-length basis and maintain separate accounting systems and staff. Separating the wholesale and retail parts of the business means that it is easier to ensure that the wholesale business does not discriminate unfairly against retail competitors, and that it concentrates on attracting retail businesses on its network. Both arms would continue to be owned by the same firm.

Sources: Samuel (2005a)

Access to Telstra's copper wire network is not regulated under Part IIIA of the *Trade Practices Act* which establishes legal rights for third parties to share the use of certain infrastructure (refer Section 4.5), but rather under the telecommunications industry specific Part XIC of that Act. Nevertheless, the principles governing access are consistent between the two parts.

Although there exists a statutory right of access to Telstra's copper wire network, non-price discrimination has emerged as a key competitive challenge in Australia's telecommunications market. Such discrimination may involve impeding access by competing firms to Telstra's infrastructure. For example, competing firms have lodged complaints with the ACCC concerning significant delays and associated costs incurred in gaining access to Telstra exchanges, which has the effect of restricting the capacity of these firms to provide competing services using Telstra-owned infrastructure (Samuel 2005b).

As discussed in Box 5.2, Telstra has also challenged the validity of the access provisions under Part XIC of the Trade Practices Act. Ultimately, Telstra's challenge was unanimously rejected by the High Court, but the case further highlights the strong incentives Telstra has to exclude firms that compete with it in downstream markets.

Box 5.2

TELSTRA FAILS IN ITS CONSTITUTIONAL CHALLENGE TO COMPULSORY ACCESS LAWS

Telstra commenced action in January last year challenging the provisions of the Trade Practices Act that allow the Australian Competition and Consumer Commission (ACCC) to set prices for compulsory third party access to its copper wire network at what Telstra has argued are 'below cost'.

The Act gives the ACCC a power to designate certain telecommunications services as 'declared services'. Once a service is declared, the owner of that service is obliged to supply that service to any person or entity which seeks access. Under Part XIC of the Act, the ACCC is responsible for arbitrating disputes about access to particular declared services, including in relation to price.

Telstra's action rested on interpreting these provisions as affording the ACCC the power to compulsorily acquire 'property' other than 'on just terms', within the meaning of Section 51(xxxi) of the Australian Constitution. This, Telstra said, rendered the power invalid as it applied to certain declared services provided by Telstra using its copper wire network; Unbundled Local Loop services (ULLS) and Line Sharing services (LSS). According to Telstra, this is because the declaration of ULLS and LSS effectively requires Telstra to hand over its property, (namely, the 'last mile' of copper between the exchange and the consumer), so competitors can provide voice and data services.

However, in an unanimous judgment, the High Court rejected Telstra's arguments, concluding that the legislative provisions for the exercise of access rights by other carriers "*effect no acquisition of Telstra's property in the local loops*":

> *There are three cardinal features of context and history that bear upon the constitutional issues which are raised. First, the PSTN which Telstra now owns (and of which the local loops form part) was originally a public asset owned and operated as a monopoly since Federation by the Commonwealth. Second, the successive steps of corporatisation and privatisation that have led to Telstra now owning the PSTN (and the local loops that are now in issue) were steps which were accompanied by measures which gave competitors of Telstra access to the use of the assets of that network. In particular… the step of vesting assets of the PSTN in Telstra, in 1992, was preceded by the enactment of the 1991 Telecommunications Act.*

That context revealed a flaw with Telstra's approach that led the High Court to describe it as "*synthetic and unreal because it proceeds from an unstated premise that Telstra has larger and more ample rights in respect of the PSTN than it has*".

Source: Minster Ellison (2008)

Actions that impose delays on competitors, or otherwise place them at an unreasonable disadvantage, also termed ‘sabotage’, is anti-competitive behaviour that could be addressed through vertical separation of the monopolist, as such actions would then serve only to lower access sales and therefore profits (Allen Consulting Group 2006).

In addition, Telstra, as the incumbent in the telecommunications market may engage in anti-competitive ‘bundling’ actions to exploit and leverage its market power from one market segment into another. For example, Telstra may use its market power to ‘capture’ a customer by making it attractive for the customer to purchase more than one product from the same firm (say, by offering a discount). As a result, the mobile services market remains ‘vulnerable to the incumbent operating in the fixed-line market leveraging its market power onto the mobile services market’ (Allen Consulting Group 2006: 15).

Telstra could also potentially initiate a vertical 'price squeeze', which occurs when a vertically integrated firm lowers its retail price and/or increases its wholesale price in order to render the business of its retail rivals unviable. Characteristics of a price squeeze were arguably evident when Telstra announced significant price reductions for its retail broadband services in February 2004, without reducing the wholesale prices its competitors paid for these services. The ACCC took action against Telstra, including the issuance of a Competition Notice stating that Telstra had engaged, and was engaging, in anti-competitive conduct. The Competition Notice was revoked after Telstra reduced its wholesale broadband prices (Samuel 2005a).

5.3 The domestic aviation industry

In the decades following the Second World War, economic regulation and restricted competition were prominent features of aviation industries across the globe (Hooper 1998: 105-6). This was especially the case in Australia, where the Federal Government pursued a 'two airlines policy'. Under this approach, the Government sought to maintain a duopoly over the national trunk route network between two favoured airlines: Trans Australia Airlines (TAA, a government business enterprise) and Ansett (a privately-owned company). The cornerstone of the two airlines policy was the *Airlines Agreement Act*, which regulated fares, capacity and the importation of aircraft (Nyathi *et. al*. 1993a: 120-1).

While the two airlines policy remained entrenched for three decades, during the 1980s pressure began to build to allow greater competition. The primary catalysts were the seeming success of the deregulation of America's domestic aviation industry in 1978 and the microeconomic reform program of the Hawke Government (Hooper and Findlay 1998: 171-2). The push for greater competition culminated in October 1987, when the Federal Government announced that, in three years hence (a period of notice required by the *Airlines Agreement Act*), it would deregulate the domestic aviation industry. As Hooper (1998: 107) states:

> In simple terms, deregulation in Australia meant that the airlines were free to act like any other business with the proviso that safety regulations had to be observed. New operators were able to commence once they had been certified and airlines were free to set their own fares, choose whatever aircraft capacity they wanted, and to withdraw from unprofitable routes.

While the Government had intended that deregulation would result in greater competition in the domestic aviation industry, one factor frustrated the realisation of this goal. This factor was the lease agreements that were signed by each of the two airlines, Ansett and Australian Airlines (formerly known as TAA), with the Federal Government in December 1987.

Under these agreements, the incumbent airlines gained control over all existing and future 'gates' at the domestic terminals at Sydney, Melbourne, Perth, Adelaide, Launceston and Coolangatta airports (which then accounted for a total of 66 per cent of domestic passenger movements) (Nyathi *et. al.* 1993b: 196). While the leases did include access arrangements for new entrants, the requirements of these were less than onerous. For instance, Australian Airlines and Ansett were only required to make available two gates each at Sydney and Melbourne and one gate each at Perth, Adelaide and Coolangatta (Productivity Commission 2002: 63).[8]

[8] Ansett was also required to provide one gate at Launceston.

Competition challenges

The attempts by Compass Airlines to enter (and remain in) the Australian domestic aviation market during the early 1990s best demonstrates the restrictive impact that the terminal lease agreements had on competition.

Australia's first two new entrants to interstate aviation were Compass Airlines, which operated between December 1990 and December 1991, and Southern Cross Airlines (trading as Compass Airlines), which operated between August 1992 and March 1993. While there were differences between the operations of Compass Mk I and Compass Mk II, under-capitalisation and an inability to attract sufficient full-fare paying customers contributed to both failures (ACCC 2000: 24).

However, a 1992 inquiry also found that access to airport terminals was a factor that contributed to the failure of Compass Mk I. (ACCC 2000: 4):

- Given that it takes approximately one hour to 'turn around' a flight at each gate, the limited number of gates available to Compass restricted the number of fights it could operate. This, in turn, led it 'to abandon initial plans to use smaller aircraft with more-frequent scheduling to more airports', and instead lease larger aircraft with correspondingly larger operating costs (Douglas 1993: 4).
- The restriction on gate access increased the risk of delays for Compass and the associated costs thereof (since the company lacked the capacity to shift flights to another gate if a problem arose with an aircraft at its existing gates) (Nyathi *et. al.* 1993b: 199).
- The incumbent airlines used their control over the terminals, notwithstanding the relevant access arrangements, to undermine Compass's competitiveness. For instance,
  - in Sydney, Compass eventually negotiated a deal to lease two Australian Airlines gates. However, these gates were non-contiguous and the rates for their use arguably excessive;
  - in Melbourne, Ansett leased Compass two gates that were 1.5 kilometres apart; and
  - in Adelaide, a protracted dispute with Ansett meant that Compass was forced to operate out of a hanger (known as 'the tin shed'), reducing the airline's appeal to business travellers.

While these lease arrangements did restrict competition in the domestic aviation industry during the 1990s, their impact has diminished over the decade primarily facilitated by the demise of Ansett in early-2000s. As part of the company's liquidation process, its terminal leases were sold back to the respective airport operators, which now operate Ansett's old terminal gates on a common-user basis.

Consequently, Qantas (which bought Australian Airlines in 1992) is no longer able to use its control over terminal access to reduce the competitiveness of competing airlines such as Virgin Blue and Tiger Airways. In fact, since airports generally charge airlines using its gates on a 'per passenger basis', Qantas's leasing arrangements may actually be reducing its competitiveness, as it is faced with fixed costs during periods when passenger numbers are low (such as the SARS outbreak in 2003).

5.4 Implications for the export wheat industry

While there are clear differences between the industries discussed above and the export wheat industry, there also exist a number of common elements. The four common elements are outlined below:

- *Natural monopoly characteristics* — in each case, the supply chain involves infrastructure facilities with monopoly characteristics, which would be prohibitively expensive (that is, uneconomic) to duplicate.
- *High barriers to entry* — the markets are characterised by high barriers to entry, particularly through economies of scale and significant costs of key infrastructure.
- *Past legislative protection for incumbents* — in a number of cases, the market was characterised by substantial legislative protection for incumbents from competition.
- *Participation of vertically integrated firms* — both before and after deregulation, each of the markets is characterised by vertically integrated firms that are involved in several stages of the industry supply chain.

As the events that unfolded in the telecommunications and domestic aviation industries have shown, introducing competition in one part of the value chain, *of itself*, may not be sufficient to lead to more competitive market outcomes, and hence cannot be relied on to result in downward pressure on prices.

The experience of new entrants in both the telecommunications and domestic aviation industries also highlight the fact that formal regimes to provide access rights to monopoly infrastructure cannot on their own be expected to curb anti-competitive behaviour by a vertically integrated competitor. In fact, information asymmetries and the resulting non-price forms of discrimination are often the most insidious and difficult to eliminate.

Table 5.1

KEY LESSONS FOR EXPORT WHEAT MARKETING

Industry	Nature of vertical integration	Regulation of access	Outcome
Telecommunications	Wholesale network services and retail services.	Part XIC of the *Trade Practices Act 1974*	Allegations of price and non-price discrimination. Impeded/slowed emergence of competition in retail services.
Aviation	Airport terminal services and airline services	Obligations specified in lease agreements.	Non-price discrimination. Impeded the emergence of competition in airline services. Contributed to market exit.
Export wheat	Port export services and upcountry grain storage and handling services (and possibly, rail haulage services).	Voluntary undertakings at Victorian and South Australia ports. State-based access regime for rail track services, but no provisions for rail haulage services.	?

The role of structural reform

The previous examples illustrate the need to consider more broadly the characteristics of the industry supply chain when introducing reforms in an attempt to establish a more competitive industry structure, and highlight the reasons why the National Competition Policy included two major reform 'strands':

- promotion of a level playing field, including removing legislative restrictions and providing third party access (refer Sections 4.4 and 4.5); and
- structural reform of vertically integrated firms where they control natural monopoly infrastructure and compete in (potentially) competitive upstream or down stream markets (refer Section 4.6).

In this context, the reform of Australia's eastern seaboard electricity industry could be considered a textbook example of how to reform an industry dominated by vertically integrated regional monopolies. It also clearly demonstrates the importance of adopting a comprehensive approach to the introduction of competition, including the separation of potentially competitive elements of the industry (generation and retail) from natural monopoly infrastructure elements (transmission and distribution), prior to market deregulation.

The Electricity Reform Implementation Group (ERIG, 2007) found that the electricity:

> …reforms have produced one of the most competitive and efficient electricity markets in the world [which] has been recognised by the International Energy Agency (IEA). The IEA observed in its review of Australian energy markets that "Australia was one of the pioneers in energy sector microeconomic reform and should be commended for its vision and implementation of a liberalised (electricity) market. Australia now has one of the most transparent and competitive electricity markets in the world and could serve as a model for other countries" (IEA 2005).

Initially dominated by vertically integrated State-owned (and State-based) electricity utilities, the application of the principles underpinning the National Competition Policy first led to their separation into respective supply chain elements, that is, generation, transmission, distribution and retail. The structural separation of the generation and retail elements was further reinforced through the introduction of a gross pool wholesale electricity market, removing the potential for commercial arrangements between generators and retailers to circumvent their structural separation.

The Electricity Reform Implementation Group (ERIG, 2007) concluded that the increase in the level of *independent*, decentralised decision-making in the generation and retail of electricity in the National Electricity Market (NEM), driven by an increase in competitive forces, has been the primary driver for the efficiency gains to date. This has increased the utilisation and performance of generation assets, lowered operating costs and driven efficiency gains through the NEM-wide dispatch of generation. Retailers have also become more responsive to customers and prices for most customer groups have declined over the past decade.

It is likely that reform of state-based electricity markets was assisted by the annual public assessment carried out by the National Competition Council of the States' progress in meeting their reform obligations, which determined whether States would receive all, or a reduced, amount of their National Competition payments. A number of States have also benefited financially by selling part, or all, of their electricity industry assets. Such sales could never have been contemplated in the absence of these reforms.

5.5 Conclusion

The examples in this chapter show that removing legislative restrictions on competition by themselves may not be sufficient to lead to an increase in competition. Rather, the overall structure of the industry supply chain plays an important part in determining how competition subsequently evolves. In order to maximise competition, consideration must be given to:

- arrangements through which access is provided to monopoly infrastructure;
- minimising (or eliminating where possible) potential for conflicts of interest to arise where firms are vertically integrated and also compete in upstream or downstream markets (including information asymmetries).

The implications for the export grain supply chain, if competitive pressures are to be maximised, are considered in the following chapter.

Chapter 6

Supporting competition in the export grain supply chain

6.1 Introduction

The previous chapter illustrated the competitive challenges that can arise when the principles underpinning National Competition Policy are partially applied. In particular, the experience in other industries highlights the importance of the characteristics of the overall industry supply chain in determining the state of competition in the market, and that the level of competition may not be substantially altered by attempts to increase competition in only one part of the supply chain.

As demonstrated in Chapter 2, the characteristics of the export wheat supply chain currently include:

- a legislatively protected export wheat marketer in AWBI (that until recently had the ability to exclude competitors);
- traditional separation of bulk handling and marketing roles (through State legislation), although this has eroded since the deregulation of the domestic wheat market; and
- natural monopoly infrastructure (railways and export terminals at ports).

The nature of the reforms that the Government intends to implement in the marketing of export wheat (see Section 3.5) is likely to lead to the BHCs seeking to gain accreditation to become export wheat marketers. Given the experience highlighted in the previous chapter, and in order to support the emergence of effective competition in the export wheat supply chain, the removal of AWBI's role as the (effectively) exclusive marketer of export wheat should ideally also be accompanied by:

- the establishment of firm rights through effective undertakings for third parties to access monopoly export wheat supply chain infrastructure, where such access is required to effectively compete in upstream or downstream markets;
- measures to reduce the information asymmetries between the BHCs and other marketers; and
- solutions to minimise the incentives for the vertically integrated bulk handling companies to engage in non-price discrimination.

Options that could be considered to maximise competitive pressures with respect to each of these areas is discussed in more detail below.

6.2 Access to export wheat infrastructure

As noted in Chapter 4 (and discussed in detail in Appendix C), Part IIIA of the *Trade Practices Act* establishes three pathways for a party to seek access to an infrastructure service:

- through declaration;
- by using an existing effective access regime; or
- under terms and conditions set out in a voluntary undertaking approved by the ACCC.

Part IIIA of the *Trade Practices Act* also establishes criteria that must be considered by the National Competition Council in making a recommendation for the infrastructure service to be declared or not declared. Access regimes established for particular types of infrastructure also include criteria for determining whether particular infrastructure facilities and activities should be subject to access regulation, typically referred to as 'coverage'.[9] The criteria established by such access regimes are similar to those for declaration under Part IIIA.

Voluntary access undertakings, by their nature, are not associated with criteria for determining whether the infrastructure services may be subject to access regulation — the decision to enter into an undertaking is at the discretion of the owner of that infrastructure. However, in assessing the benefits of entering into a voluntary access undertaking, infrastructure owners are likely to consider the extent to which the declaration criteria are satisfied by their current or proposed infrastructure services, and the risk that the infrastructure may be declared, or become covered by an effective access regime, in the future.

The criteria for declaration under Part IIIA or coverage under an access regime are taken, for the purposes of this report, to be the established policy position of Australian governments on whether it is in the public interest for access regulation to be imposed on a particular infrastructure facility or service. These criteria are set out below.

Criteria for declaration

Section 44G(2) of the *Trade Practices Act* specifies the criteria that must be met in order for the Council to "declare" an infrastructure service, and so establish a right for a party to negotiate terms and conditions of access with the service provider.

The Council cannot recommend that a service be declared unless it is satisfied of **all** of the following matters:

(a) that access (or increased access) to the service would promote a material increase in 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;

[9] For example, the National Third Party Access Code for Natural Gas Pipeline Systems that establishes a code that may apply to a number of natural gas pipelines.

(f) that access (or increased access) to the service would not be contrary to the public interest.

The National Competition Council has published guidelines on application of the declaration criteria of Part IIIA of the *Trade Practices Act*. These guidelines draw on precedents established in the certification of access regimes, consideration of proposed voluntary access undertakings, and decisions by the Australian Competition Tribunal and the courts. A summary of the process for considering whether an infrastructure service should be declared is provided in Box 6.1 and is discussed in more detail in Appendix C.

Box 6.1

PROCESS OF THE NCC IN CONSIDERING AN APPLICATION FOR DECLARATION — SECTION 44G(2) OF THE *TRADE PRACTICES ACT*

(a) Define the service provided by means of the infrastructure facility, delineate the physical assets that comprise the facility and identify the provider of the service.

(b) For the purposes of criterion (b), examine whether it is economic to develop another facility to provide the service. Declaration is confined to facilities exhibiting natural monopoly characteristics — that is, where it would be cheaper over a likely range of reasonably foreseeable demand for the service for the facility subject to declaration, rather than two or more facilities, to provide that service.

(c) If development of another facility to provide the service would be uneconomical, then for the purposes of criterion (a) assess whether declaration of the service would improve the conditions or environment for competition in a dependent market. Whether the conditions for competition would be enhanced depends critically on whether the natural monopoly characteristics associated with the provision of the service confer substantial market power on the service provider that can be exercised to adversely affect competition in a dependent market(s). As part of this evaluation, dependent markets need to be identified, as do factors affecting the ability and incentive to exercise market power to adversely affect competition in a dependent market(s). Such an assessment is relevant to whether criterion (a) is met.

(d) For the purposes of criterion (c), assess whether the facility is of national significance, having regard to the size of the facility, the importance of the facility to trade or commerce, or the importance of the facility to the national economy.

(e) For the purposes of criterion (d), assess whether access to the service can be provided safely.

(f) For the purposes of criterion (e), assess whether access to the service is already the subject of an effective access regime. This may be an easy assessment; for example, a State or Territory access regime may be subject to a decision by the Commonwealth Minister under s. 44N of the TPA that the access regime is an effective access regime for the service, and generally the Council must follow such a decision. Alternatively, there may be no State or Territory access regime in place that affects the service. In some instances, however, a State or Territory access regime may exist that is not the subject of a decision under s. 44N of the TPA, and it will be necessary to assess the State or Territory access regime against the principles set out in the Competition Principles Agreement.

(g) For the purposes of criterion (f), determine whether access would not be contrary to the public interest. This criterion comes into play if the other criteria are satisfied. It enables a consideration of factors not raised under the other three criteria — for example, the regulatory costs of providing access, and transitional pricing arrangements.

Source: NCC (2002)

Competition and infrastructure Reform Agreement

In February 2006, and in addition to the general access arrangements embodied in Part IIIA of the *Trade Practices Act*, COAG agreed to establish a consistent national approach to economic regulation of significant infrastructure, including rail freight and ports. Importantly, the resultant Competition and Infrastructure Reform Agreement (CIRA) stated that, in the first instance, terms and conditions for third party access to services provided by means of significant infrastructure facilities should be on the basis of terms and conditions commercially agreed between the access seeker and the operator of the infrastructure.

In addition, COAG agreed that, where it could improve the level of price transparency, price monitoring of services provided by significant infrastructure facilities should be considered as a first step where price regulation may be required (or when scaling back from more intrusive regulation).

For ports, the CIRA principles advocate that ports only be subject to economic regulation '…where it has been determined that there is a clear requirement for it in order to promote competition in upstream or downstream markets, or to prevent the misuse of market power' (refer Box 6.2, note this Clause 4.1(a) appears to largely mirror Clause 44G(2)(a) of the *Trade Practices Act*). For those ports and railways where economic regulation is determined to be necessary, it was agreed that regulation should be applied through a nationally consistent approach.

The specific agreements reached by COAG for rail freight infrastructure and ports are detailed in Box 6.2.

Box 6.2

COMPETITION AND INFRASTRUCTURE REFORM AGREEMENT, FEBRUARY 2006

2.9 The Parties agree that, to advance the objective of a simpler and consistent national approach to regulation, all state and territory access regimes for services provided by means of significant infrastructure facilities will be submitted for certification in accordance with the Trade Practices Act 1974 and the Competition Principles Agreement.

a. All new third party access regimes will be submitted for certification as soon as practicable.

b. Third party access regimes existing at the time this agreement commences will be submitted for certification as soon as practicable, or as they are reviewed, provided they are submitted for certification no later than the end of 2010.

c. The certification of access regimes under this clause is subject to Parties agreeing a streamlined certification process and appropriate administrative arrangements to be developed as part of the mechanism established under clause 2.8.

Rail freight infrastructure

3.1. The Parties agree to implement a simpler and consistent national system of rail access regulation, using the Australian Rail Track Corporation access undertaking to the Australian Competition and Consumer Commission as a model, to apply to the following agreed nationally significant railways:

a. Interstate rail track from Perth to Brisbane, currently managed by the Australian Rail Track Corporation and other parties, subject to the outcome of commercial negotiations; and

b. Major intra-state freight corridors on an agreed case by case basis depending on the costs and benefits of inclusion under a national regime.

3.2. The Parties agree to develop an agreed approach to the application of the Australian Rail Track Corporation access undertaking model including pricing and access mechanisms that will be appropriate if vertically integrated operators retain control of relevant sections of track.

3.3. The Parties agree that state based rail access regimes governing other significant export related rail infrastructure facilities will be submitted for certification as required by clause 2.9.

Port competition and regulation

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.

Source: COAG (2006)

Application to the export grain supply chain

The following section applies the criteria set out in Section 44G(2) of the *Trade Practices Act* (which will continue to apply in conjunction with the CIRA) to the key monopoly infrastructure facilities in the export wheat supply chain to consider whether the facilities might be able to be 'declared', and so establish a right for a party to negotiate terms and conditions of access with the service provider. However, it should be noted that the CIRA implies that formal declaration is likely to be viewed as a last resort option.

Access to storage and handling infrastructure

While some scale of economies exist in up-country grain receival sites, it is unlikely that these facilities would meet the principles for access regulation. In particular, it is unlikely that it would be found that such infrastructure represented natural monopoly 'bottle-neck' facilities that were uneconomic to replicate. The emergence of AWB subsidiary AWB GrainFlow as a significant provider of storage and handling services in New South Wales and Victoria supports such a conclusion.[10]

That said, the construction of additional storage and handling infrastructure may not be seen as desirable, with the Western Australian Minister for Agriculture (Chance, 2003) commenting that:

> while such a move [the entry of AWB into the handling and storage market] would create competition, it may also result in significant over-capitalisation and this would not result in lower storage and handling charges in the long term. There does not seem to be any sense in growers funding the building of another storage and handling network and any move towards 'parallel' investment will not have State government support.

[10] GrainFlow holds 14 per cent and 16 per cent of these markets respectively (refer Chapter 2).

Conclusion 1

Access to up-country storage and handling infrastructure is important to ensuring competition in the supply chain. It does however pose lower barriers to entry than other elements of the supply chain with natural monopoly characteristics such as rail haulage services and export terminals at ports (including storage and handling at port terminals). It is therefore less likely to be a target for competition regulation, except insofar as it is integrated with those other elements.

Storage and handling infrastructure at port export terminals, which are almost exclusively owned and controlled by the three dominant BHCs, is considered as part of the discussion below on access to port infrastructure.

Access to rail infrastructure

In Western Australia, it is understood that ARG, the grain haulage service provider, is expected to negotiate an exclusive grain haulage 'network' contract with CBH, the dominant BHC in that State. This would replace the current multi-party agreement between ARG, CBH, AWB, the Western Australian Farmers Federation and the Pastoralists and Graziers Association of Western Australia.

As a result, if there were to be an exclusive contract between CBH and ARG, any other party, including AWB/AWBI, that sought to transport grain via rail in Western Australia would be required to enter into a commercial agreement with CBH, rather than being able to do so directly with ARG.

It is understood that the exclusive grain haulage 'network' contract between CBH and ARG would allow CBH to average haulage charges (on say a per tonne kilometre basis) across the entire grain haulage network, resulting in cross subsidies between lines that have a low level of utilisation by those with a high level of utilisation.[11] That is, grain farmers on highly utilised rail lines would face higher rail haulage charges than they would in a competitive market. The attraction of such an arrangement is that it would likely allow ARG (and the provider of track services, Westnet Rail) to maintain the integrity of the State's overall grain haulage network.

However, if ARG and CBH did enter into an exclusive grain haulage 'network' contract, this would also mean that CBH would have gained effective control over the entire export grain supply chain in Western Australia (as it already controls 100 per cent of up-country storage and all port-based export terminals).

As noted earlier and summarised in Box 2.2, rail infrastructure in all Australian States is generally covered by state-based access regimes, that have been certified as 'effective' access regimes.[12] As a result, the declaration provisions of Part IIIA of the *Trade Practices Act* would not apply, and access to track services would need to be negotiated under each State's access regime. Where it has not been certified, the CIRA requires that State-based access regimes be submitted for certification

[11] The volume of grain hauled over an individual line would be the most significant influencing factor in determining the amount of revenue attributable to that line, and hence its commercial viability.

[12] Note that the application by FMG, an iron ore miner, to gain access to railways operated by BHP Billiton and Rio Tinto in the north west of Western Australia, are for access to railways that were privately developed, and it has been claimed, are part of a 'production process'. The application for access relates to access to the rail track infrastructure itself, in order for FMG to provide its own haulage services. In the present case, it is access to haulage services that is at issue.

In the case of Western Australia, as an access regime exists for the rail track, it would be possible for AWB to negotiate with Westnet Rail, the track owner, for access to specific railway lines, and for it to then operate its own rolling stock to provide haulage services. However, there would exist strong incentives for CBH to reduce haulage prices to at least match those that might be set by AWB on any individual line. If CBH were to reduce prices below cost, it would be able to recover lost revenue on these lines from the remainder of its network where it did not face competition. Access may also act to expose a level of cross subsidies that is may exist in the current arrangements, potentially leading to a contraction of the grain rail haulage network.

This highlights that although access may not be an issue per se for rail, effective (and exclusive) control over a significant part of the rail network by any of the major BHCs would give these companies further opportunities to exclude competitors in up-stream and down-stream markets.

Although the arrangements for rail in Western Australia may not be representative, given that the State accounts for between 45 and 74 per cent of Australia's wheat exports, they are of critical importance.

Conclusion 2

In order to maximise competition in the export grain supply chain, bulk handling companies should not be able to extend their control over the export grain supply chain into the transportation of wheat (or grain) through exclusive contracts with providers of haulage services.

Access to port infrastructure

AWB investigated constructing its own port-based export facilities at a number of Western Australian ports, but concluded that this would not be viable, due either to a lack of suitable land at the port in question, or otherwise as a result of existing excess capacity of the export infrastructure given prevailing export volumes (AWB, private communications). This likely also holds for a majority of ports in other jurisdictions, supporting a view that it is likely to be uneconomic to duplicate these terminals.

The experience in a number of other industries having structural similarities with the export wheat supply chain (discussed in Chapter 5) supports a view that the vertical integration of the operators of the majority of Australia's export grain terminals creates strong incentives for them to exploit their market power in the provision of natural monopoly port-based services to the advantage of their upstream (and downstream) activities.

There appears to be an in-principle case for economic regulation of port infrastructure, as the CIRA (refer Box 6.2) states 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.

Generally, access to export grain terminals around Australia appears to be largely determined by the operators of the facilities, rather than through commercial negotiation between the relevant parties. As discussed in Box 6.3, the potential for vertical integration in the broader grain export market to result in anti-competitive outcomes in the provision of export services was recognised in South Australia and Victoria, where specific measures where implemented to minimise such risks.

Box 6.3

GRAIN EXPORT TERMINAL ACCESS REGULATION IN SOUTH AUSTRALIA AND VICTORIA

ABB and AusBulk offered court-enforceable undertakings 'aimed at ensuring competitive access by all parties to the merged entity's bulk storage and handling assets and services at ports in South Australia' after the Australian Competition and Consumer Commission (ACCC) expressed concerns relating to vertical integration when ABB sought to acquire AusBulk in 2004. These undertakings allayed the ACCC's concerns that 'the merged entity would use its market power in storage and handling at South Australian port terminals to deny access to, or discriminate against, competing traders and grain exporters', that would have resulted in additional costs and delays and may deter new entrants from entering existing or future export markets sourced out of South Australia. (ACCC 2007).

Similarly, in Victoria the *Grain Handling and Storage Act 1995* included a state based access regime that applied to export grain terminals at Geelong and Portland. The later constructed Port of Melbourne export grain terminal operated by ABA (and co owned by AWB GrainFlow) was not regulated under that Act.

In 2006, the Essential Services Commission's Grain Handling Regime Review concluded that it was no longer desirable to apply different regulatory regimes to the State's export grain terminals, and that it would be inequitable to apply regulation only to the GrainCorp terminals — if regulation was to apply to any of the terminals, then it should be applied equally to all of the terminals (ESC 2006: 44).

As an outcome of the review, the Commission determined to adopt a more 'light handed' approach to regulation compared with that under the original *Grain Handling and Storage Act 1995*, but which would also apply to the Port of Melbourne, which had not been previously subject to regulation. In this role, the Commission would monitor whether the three terminals provided access on 'fair and reasonable' terms, and would also require each of the terminals to prepare an undertaking containing a binding dispute resolution process. The Commission's regulatory power would be utilised as a last resort if the undertaking were not adhered to.

For example, under the undertaking made by ABA (ABA 2008), the operator of the Port of Melbourne terminal, it agreed to:

- publish standard charges and terms and conditions for access to services provided by its Melbourne Grain Terminal within specified time frames; and
- not unfairly or unreasonably discriminate between grain marketers as to the terms and conditions upon which access to its grain terminal was provided.

Source: (ACCC 2007), (ESC 2006:44) and (ABA 2008)

Given the potential for the operators of export grain terminals to misuse their market power under the current export wheat marketing arrangements has already been recognised, it would appear that the incentives to do so will increase if the three dominant bulk handling companies are permitted to compete as export wheat marketers. Consequently, there appears to be an *a priori* case for regulating access to export grain terminals.[13]

[13] As discussed in Box 5.2, Telstra challenged the provisions of the Trade Practices Act that allow the ACCC to set prices for compulsory third party access to its copper wire network in the High Court. The court found that the legislative provisions for the exercise of access rights by other carriers "effect no acquisition of Telstra's

The CIRA (refer Box 6.2) requires that:

- third party access to port facilities be provided on a competitively neutral basis; and
- any conflicts of interest between port owners, operators or service providers as a result of vertically integrated structures are to be addressed by the relevant party on a case-by-case basis with a view to facilitating competition.

However, the CIRA also makes clear that declaration of port infrastructure and the establishment of an access regime under Part IIIA of the *Trade Practices Act* should be a last resort. This appears prudent given that, and as outlined in Chapter 5, experience suggests that formal arrangements for access to natural monopoly infrastructure operated by vertically integrated firms are often complex and in themselves, may have limited effect.

An initial step that is likely to allay concerns and perceptions of discrimination in the provision of and charging for port access would be to implement a nationally consistent court-enforceable access undertaking, similar to that in place in Victoria and South Australia. This is the least intrusive of the three pathways for a party to seek access to an infrastructure service, and it may be argued the least effective. However, a voluntary undertaking does serve to focus attention on the key competitive concerns, and any breach of the undertaking is enforceable in court.

Key elements of such a voluntary undertaking would likely include:

- to publish charges and standard terms and conditions for access to export grain facilities;
- to not unfairly or unreasonably hinder or deny access to the export grain facilities;
- to not unfairly or unreasonably discriminate between users of export grain facilities as to the charges, terms and conditions (including, priority of access and service levels) upon which access is provided; and
- a dispute resolution provision.

Under such a voluntary undertaking, discrimination would not be taken to be unfair or unreasonable if the relative terms reasonably reflect commercial considerations, including (without limitation):

- relative costs of providing access to different users of export grain facilities, have regard to the grain type, grade and/or throughput; and
- the reasonable cost of providing services reasonably required by or in respect of some users of export grain facilities, but not others.

property in the local loops". In part, this was because the successive steps of corporatisation and privatisation that have led to Telstra owning the copper wire network were steps that were accompanied by measures that gave competitors of Telstra access to the use of the assets of that network (Minster Ellison, 2008). To the extent that similar access provisions apply to the port infrastructure of the BHCs (as apply for example in Western Australia, refer Section 2.3, p.9), the court's findings would also likely hold for such assets.

That said, the requirement to 'publish charges and terms and conditions for access' and to 'not unfairly or unreasonably discriminate between users of export grain facilities' may not be sufficient in itself to ensure that charges, terms and conditions are 'fair and reasonable'. For example, some operators of export grain facilities impose a 'ship loading efficiency fee' that applies when actual ship loading performance exceeds standard benchmarks in order to 'share' some cost savings that accrue to the shipper. However, there is no mirror payment that applies when loading falls below standard benchmarks causing the shipper to incur demurrage costs. Other fees, for example the Vessel Nomination Fee (refer to Box 2.3), may be inconsistent with standard industry terms and could be narrowly targeted.

Further, despite such a voluntary undertaking, it is unclear whether this prevents a different set of charges (and terms and conditions for access) for services provided internally compared to other users of export grain facilities. With changes to export wheat marketing, it is arguable that the voluntary undertaking should be strengthened. For these reasons, it is considered that pricing of export grain terminals should be required to be consistent with the CIRA pricing obligations [Clause 2.4(b)].

Conclusion 3

To allay concerns and perceptions of potential discrimination in the provision of and charging for access to export grain facilities, consideration should be given to requiring operators of export grain facilities to agree to a nationally consistent court-enforceable undertaking with respect to these facilities, Key elements of such a voluntary undertaking would include:

- *to publish charges and standard terms and conditions for access to export grain facilities;*
- *to not unfairly or unreasonably hinder or deny access to the export grain facilities;*
- *to not unfairly or unreasonably discriminate between users of export grain facilities as to the charges, terms and conditions (including, priority of access and service levels) upon which access is provided; and*
- *a dispute resolution provision.*

Conclusion 4

In order to maximise competitive pressures in the whole of the export grain supply chain, a voluntary undertaking should require published standard charges, terms and conditions at export grain terminals to be consistent with the CIRA pricing obligations [Clause 2.4(b)]. That is:

- *generate expected revenue that is at least sufficient to meet the efficient cost of providing access to each export grain facility, and include a return on investment commensurate with the regulatory and commercial risks involved;*
- *allow multipart pricing and price discrimination when it aids efficiency;*
- *do not allow vertically integrated operators of export gain terminals to set terms and conditions that discriminate in favour of its other operations, except to the extent that the cost of providing access to other firms is higher; and*

- *provide incentives to reduce costs or otherwise improve productivity.*

Further, in the absence of formal structural separation, vertically integrated operators of grain export facilities should be required to demonstrate that actual or notional charges (that is, internal transfer pricing), and the terms and conditions for services provided internally are consistent with published charges, terms and conditions.

In this context, the access test imposed by Clause 20 of the Wheat Export Marketing Amendment Bill 2008 exposure draft is, of itself, unlikely to adequately mitigate the inherent incentives for vertically operators of export grain facilities to misuse their market power.

6.3 Information asymmetries and conflicts of interest

The potentially detrimental effect that information asymmetries and actual (or perceived) conflicts of interest can have on market confidence (and hence future investment) has been specifically recognised in the financial services sector. The *Corporations Act 2001* imposes a specific statutory obligation regarding conflicts of interest on the financial services industry, and Box 6.4 summarises some of the means through which this obligation may be discharged. Regulatory bodies, including the Australian Securities and Investment Commission and the Australian Stock Exchange also invest significant resources in monitoring and enforcing with the obligations imposed by the Act.

Box 6.4

CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES SECTOR

The key piece of Australian legislation relating to the management of conflicts of interest in the financial sector is the *Corporations Act 2001*. Section 912A(1)(aa) of this Act states that a financial services licensee must:

> have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.

The Australian Securities and Investments Commission (ASIC), as the administrator of the Corporations Act, suggests two means by which a financial services company may seek to manage conflicts of interest. The first of these is through a combination of internal controls and disclosure. The most prominent example of an internal control in the financial sector is the use of 'Chinese Walls'. These are information barriers erected within firms to insulate persons who make investment decisions from persons who are privy to undisclosed material information that may influence those decisions. Chinese Walls may involve physical separation or simply an 'ethical barrier'. Disclosure, meanwhile, is the practice of 'providing enough detail in a clear, concise and effective form to allow clients to make an informed decision about how the conflict may affect the service being provided to them' (ASIC 2004).

The second means by which a financial services company may seek to manage conflicts of interest is by avoiding them. This approach is preferred when 'conflicts cannot be adequately managed through controls and disclosure' (ASIC 2004).

According to ASIC (2004), to be adequate, conflicts management arrangements must:

- 'successfully identify conflicts of interest and control the effects of those conflicts on the provision of financial services so that the quality of those financial services is not significantly compromised';
- involve monitoring procedures, so that instances of non-compliance are quickly identified and 'appropriately acted upon';
- be relevant to each company's particular circumstances; and
- involve documentation and record keeping procedures.

Source: Allen Consulting Group and ASIC (2004)

As also discussed in Chapter 2, in the absence of competition, a vertically integrated owner of monopoly infrastructure has a strong incentive to limit competition in upstream or downstream markets by refusing to, or impeding the, supply infrastructure services (that is, access to the monopoly infrastructure). This is illustrated for a vertically integrated provided of rail track and rail haulage services in Box 6.5.

Box 6.5

CONFLICTS OF INTEREST IN RAIL

Conflicts of interest in the Australian rail system have arisen between a vertically-integrated owner-operator and a competing rail operator. For example, a conflict of interest could occur if the owner-operator used its position, either directly or indirectly, to hinder the competing rail operator's access to the rail network, diminishing its competitiveness as a result.

Everett (2005) highlights the example of FreightCorp, which secured a coal contract in Central Queensland in the early-2000s. However, the company faced significant delays in securing access to the Queensland network owned by Queensland Rail (QR), which also provides coal haulage services. Eventually, the mining company withdrew the contract and reached an agreement with QR instead. As Everett (2005) notes, QR was 'the incumbent operator as well as the access provider. Arguably there exists, prima facie, the potential for a conflict of interest, in the QR position.'

Source: Everett (2005)

As discussed in Chapter 2, there is currently a significant asymmetry in the information available to BHCs and grain marketers in terms of:

- information on the tonnages, grades, quality and location of grain entering the grain supply chain, including grain that has been sold to competing marketers; and
- the shipping stem (that is, the port-by-port breakdown of which ships are due at a given time).

The existing *Wheat Marketing Act 1989* largely prevents the BHCs from exploiting these existing information asymmetries for financial and/or commercial advantage. However, this will change under the accreditation model that the Government intends to adopt.

To address these information asymmetries and establish a more level playing field, information on the quantity, grades and quality of grain entering the supply chain, and on the shipping stem at each port should be available to all grain marketers.

Conclusion 5

In order to maximise competitive pressures in the export grain supply chain, vertically integrated operators of grain receival sites should be required to publish information on the quantity, grades and quality of grain received. This should be on a regular, at least weekly, basis and be available to all grain marketers.

In this context, the annual reporting obligations imposed by Clause 13 of the Wheat Export Marketing Amendment Bill 2008 exposure draft are unlikely to adequately mitigate existing information asymmetries in the grain supply chain.

Conclusion 6

In order to maximise competitive pressures in the export grain supply chain, operators of grain export facilities should be required to make available information to show that the vessel nomination process, and allocation of port-based storage and shipping capacity does not discriminate between shippers.

Conclusion 7

Operators of export grain facilities should be required to make available shipping stem information to all grain marketers. This information should be updated at least daily, and provide the following details for each vessel nomination advice the operator receives:

- *Port*
- *Vessel name;*
- *Vessel nomination advice date;*
- *Vessel loading dates (start date and completion date);*
- *Commodity type, volume and grade;*
- *Receival type*
- *Cumulative percentage of Cargo Accumulation Plan accumulated;*
- *Shipper name; and*
- *Shipping stem manager contact detail.*

6.4 Minimising incentives to exploit market power

The measures outlined in the preceding section mandating open access and comparable treatment will reduce to some extent the scope for operators of export grain facilities to exploit market power.

Further, the proposed requirement for greater transparency, particularly with respect to pricing arrangements and the shipping stem, is likely to assist in monitoring whether the operators of export grain facilities are actually exploiting market power. While these measures would go a long way to maximising the level of competition in the export grain supply chain, ensuring that the services and prices the integrated operator of a export grain facility provides to, and charges its competitors are equivalent to what it provides to, and charges itself could necessitate transaction–by–transaction regulatory oversight. Further, monitoring and enforcing compliance may be particularly difficult when quality of service is time sensitive as is the case in the export of wheat and other grains.

While these measures may assist in detecting and minimising opportunities for price and non-price discrimination, they do not address the incumbent's underlying incentive to restrict competition. For example, Beard, Kaserman and Mayo (2001) show that policies such as mandatory accounting separation have little or no effect on the profitability or otherwise of sabotage opportunities. There remains an underlying incentive for the vertically integrated firm to seek to restrict competition in dependent markets.

For this reason, behavioural approaches to address the inherent incentives to exploit market power that arise as a result of vertical integration, such as the accounting separation implied by the requirements outlined above, are inferior to structural reform. The industry examples in Chapter 5 highlighted that in the longer term the most effective means through which incentives to exploit market power can be minimised is through structural separation of the natural monopoly parts of the business from the competitive areas. For the export grain supply chain, this would require formal structural separation of the natural monopoly parts of the business from the competitive areas.

Although in future it may be necessary to consider structural separation, options to achieve this are not considered in this report. Implementation of the measures outlined in Conclusions 1-6 would act to maximise competitive pressures in the export grain supply chain within existing structural constraints, and are likely to support the evolution of a more competitive export grain supply chain structure.

Conclusion 8

The measures outlined in Conclusions 1-7 are necessary measures to maximise competitive pressures in the export grain supply chain. However, in the longer term, the most effective means through which to minimise the potential exploitation of market power by operators of export grain facilities is for formal structural separation of the natural monopoly parts of the business from the competitive areas.

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Appendix A

The Australian grain industry

A.1 Australian grain production

Field grains, comprising wheat and coarse grains, such as barley, oats, sorghum, maize and triticale, are one of Australia's largest and most valuable agricultural products. For the five years to 2006-07, the gross value of field grain production in Australia averaged $6.1 billion per annum. This figure represents 33 per cent of the total value of agricultural crop production and 17 per cent of the total value of farm production in Australia.

Field grains are primarily grown in Australia's 'wheat belt'. As shown in Figure 6.1, this is a narrow crescent running through mainland Australia, stretching from Queensland, through New South Wales, Victoria and South Australia. In Western Australia, the 'wheat belt' continues around the south-west corner of the State and some way north up the western side of the continent' (AWB 2006).

Figure 6.1

AUSTRALIA'S 'WHEAT BELT'

Source: www.awb.com.au

Wheat is the predominant field grain grown in Australia, accounting for two thirds of the gross value of field grain production (refer Table 6.1). Of the coarse grains, barley is the most popular, comprising 64 per cent of total coarse grain production, while maize is the least produced field grain in Australia, responsible for just over one per cent of total field grain production.

As is evident from Table 6.1, Australia's wheat crop is predominantly grown in Western Australia, with additional strong production areas in New South Wales, South Australia and Victoria. The production of barley is spread relatively evenly through the mainland states, bar Queensland. Oats are largely grown in Western Australia, New South Wales and Victoria. New South Wales, Victoria and South Australia account for the majority of triticale production, while maize and sorghum are chiefly grown in New South Wales and Queensland.

Table 6.1

AUSTRALIAN FIELD GRAIN PRODUCTION, ANNUAL AVERAGE 2002-03 TO 2006-07

	New South Wales		Victoria		Queensland		Western Australia		South Australia		Australia		
	Area 000 ha	Prod. kt	Area 000 ha	Prod. kt	Area 000 ha	Prod. kt	Area 000 ha	Prod. kt	Area 000 ha	Prod. kt	Area 000 ha	Prod. kt	Value $m
Wheat	3 603	5 450	1 313	1 917	673	962	4 679	7 634	1 988	2 679	12 263	18 671	4 090
Barley	916	1 393	856	1 308	118	175	1 199	2 136	1 187	2 018	4 285	7 054	
Sorghum	231	663	1	1	442	1 015	1	1	-	-	676	1 681	
Oats	383	386	167	296	13	6	276	529	81	92	925	1 317	
Triticale	122	217	124	188	1	1	34	41	101	94	383	548	
Maize	22	178	1	6	40	162	1	3	-	-	64	350	
Total coarse grain	*1 674*	*2 836*	*1 148*	*1 800*	*615*	*1 358*	*1 510*	*2 709*	*1 369*	*2 204*	*6 332*	*10 951*	*2 004*
Other crops													12 389
Total farm production													**35 980**

Source: ABARE (2007)

A.2 Western Australia

Western Australia is the country's largest grain producing State, responsible for 35 per cent of the country's total grain production. It is also the largest exporting State, with between 45 and 74 per cent of Australian wheat exports supplied by Western Australia (WEA 2007).

Wheat, barley and oats are the dominant grain varieties grown in Western Australia, accounting for 74 per cent, 21 per cent and five per cent of total grain production respectively. In 2004-05, the gross value of Western Australia's field grain production was $2,338 million, which represents 45 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Western Australia are (CCI WA 2007: 11):

- the central (Kwinana) region, which is responsible for approximately 50 per cent of total grain production;
- the northern (Geraldton) region, which produces approximately 27 per cent of total production;
- the southern (Albany) region, which produces approximately 14 per cent of total production; and
- the Esperance region, which produces approximately nine per cent of total production.

The significance of this for the export supply chain is that production in Western Australia is widely distributed, and reliant on storage and transportation links that have to be well coordinated at harvest, and effectively integrated with port facilities. The absence of a large domestic market in Western Australia accentuates this requirement. Chapter 3 examines these issues in detail.

A.3 New South Wales

New South Wales is Australia's second largest grain producing State, and also supplies 32 percent of the country's wheat exports. Wheat and barley are the dominant field grain varieties, accounting for 66 per cent and 17 per cent of total production. For 2004-05, the gross value of New South Wales's production of field grains was just over $2 billion, which represents 23 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in New South Wales are (NSW DPI 2005, 2006, 2007):

- the North West Slopes and Plains (encompassing Narrabri, Moree and Werris Creek), which produces approximately 36 per cent of total grain production;
- the Riverina and South West (primarily centred around Lockhart and Oaklands), which produces approximately 36 per cent of total production; and
- the Central West (stretching from Dubbo, through Parkes and West Wyalong to Hillston), which produces approximately 27 per cent of total production.

As in Western Australia, grain production in New South Wales is widely distributed (refer Figure 6.1), and reliant on well-coordinated storage and transportation links at harvest. The storage and transportation links are also effectively integrated with port facilities. Again, given it accounts for a large percentage of the export market, the effectiveness of these links is of significant importance, as discussed in Chapter 2.

A.4 South Australia

South Australia is the third largest grain producing State in Australia, and 16 per cent of Australia's wheat exports are supplied by the State. Wheat and barley are the primary grain varieties grown in South Australia, accounting for 55 per cent and 41 per cent of total grain production, respectively. In 2004-05, the gross value of South Australia's field grain production was $887 million, which is 23 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in South Australia are (PIRSA GID 2005: 13-4; PIRSA GID 2006: 13-4; PIRSA GID 2007: 14-5):

- the Northern Area (stretching from Quorn in the north to Roseworthy and Stockwell in the south), which is responsible for approximately 30 per cent of total grain production;
- the Eyre Peninsula (stretching from Pintumba in the west to the Spencer Gulf in the east), which produces approximately 28 per cent of total production; the Yorke Peninsula, which produces approximately 19 per cent of total production;
- the Murray Mallee, which is responsible for approximately 14 per cent of total production; and
- the South East (stretching from Tailem Bend in the north to Millicent in the south), which produces approximately 7 per cent of total production.

While Figure 6.1 appears to indicate that grain production in South Australia is concentrated in a smaller area than the previous two States, as discussed in Chapter 2 the supply chain is more fragmented with seven export grain terminals.

6.5 Victoria

Victoria is Australia's fourth largest grain producing state, responsible for 13 per cent of the country's total grain production and 11 per cent of exported wheat. Wheat, barley and oats are the dominant field grain varieties grown in the State, accounting for 52 per cent, 35 per cent and 8 per cent of total grain production, respectively. In 2005-06, the gross value of field grain production in Victoria was $669 million. This figure represents 8 percent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Victoria are: Mallee (covering the northwest of the state); the Wimmera (covering the southwest of the state); North Central; and Northeast.

A.5 Queensland

Queensland is the smallest grain producer of the five mainland states; responsible for both 5 per cent of Australia's total wheat production and wheat exports, although it does produce 12 per cent of Australia's coarse grain. Sorghum and wheat are the dominant grain varieties grown in Queensland, accounting for 44 and 42 percent of total grain production, respectively. In 2004-05, the gross value of Queensland's production of field grains was $475 million, or 6 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Queensland are (QLD DPI 2007):

- the Darling Downs (stretching from Toowoomba and Warwick in the east to Roma and Thallon in the West), which is responsible for approximately 65 per cent of total grain production; and
- Central Queensland, which produces approximately 35 per cent of total grain production.

A.6 Other States and Territories

Tasmania, the Northern Territory and the Australian Capital Territory produce negligible quantities of wheat.

Appendix B

Major grain supply chain operators

This appendix provides a brief overview of the major players in the Australian grain supply chain.

B.1 AWB Limited

AWB is a publicly listed agribusiness. Formerly the Australian Wheat Board, a Federal Government body tasked with exporting Australia's wheat, AWB was privatised in 1999 and floated on the Australian Stock Exchange in 2001. Its primary business is the accumulation, marketing and trading of grain, both nationally and internationally.

As noted in Chapter 1, the current Single Desk is likely to be significantly altered through the Wheat Export Marketing Bill 2008. This is the arrangement where AWBI, a wholly owned subsidiary of AWB, retains the sole right to export Australian wheat, Instead of a holding a monopoly on this trade, AWBI is more likely to become one of a number of accredited marketers in a move intended to create a more competitive trading environment.

AWB is also involved in other elements of the Australian grain supply chain. For example, through another subsidiary, AWB GrainFlow, it owns and operates 22 receival sites throughout Queensland, New South Wales, Victoria and South Australia. A further key AWB business is the provision of agricultural products and services (including financial) through its subsidiary Landmark, which has 400 outlets across Australia.

For the year ending 30 September 2007, AWB reported total revenue of $4.8 billion, a net profit of $27 million, and net assets of $1.1 billion (AWB 2007a). AWB's accumulation, marketing and trading of grain accounted for 59 per cent of the company's revenues, its provision of rural services (through Landmark) for 33 per cent, and its supply chain operations for just over one per cent (AWB 2007a: 16).

B.2 Co-operative Bulk Handling Limited

Co-operative Bulk Handling Limited ('CBH') is a co-operative agribusiness controlled by more than 5,700 grower-members across Western Australia. It operates pursuant to the State-based *Bulk Handling Act 1967*.

CBH's primary business is the storage and handling of grain, and it owns and operates almost 200 receival sites in Western Australia. These sites have a total storage capacity of over 19 million tonnes, and receive on average 10 million tonnes of grain per year (CBH 2006: 4). In addition, CBH owns and operates four grain export terminals at Albany, Esperance, Geraldton and Kwinana in Western Australia, which have a combined storage capacity of near three million tonnes.

CBH is also involved in the trading of grains, with its subsidiary, Grain Pool Pty Ltd, holding the main licence to export barley, lupins and canola from Western Australia. Another subsidiary, AgraCorp Pty Ltd, trades other non-prescribed grains internationally and all grains domestically (CBH 2006: 3). Other key CBH activities include the provision of engineering services, through the Bulkwest Pty Ltd subsidiary, and Pacific Agrifoods (a joint venture with The Salim Group) through which CBH Groups holds stakes in flour mills in Indonesia, Malaysia and Vietnam, and a grain terminal in Indonesia.

For the year ending 31 October 2006, CBH reported total revenue of $513 million, a net profit of $87 million, and net assets of $916 million (CBH 2007: 43-4). Grain handling accounted for 49 per cent of CBH's revenues, while grain trading accounted for 41 per cent (CBH 2007: 66).

B.3 ABB Grain Limited

ABB Grain Limited ('ABB') is a publicly listed agribusiness. It was formed in 2004 as the result of a merger between three South Australian grain companies: the Australian Barley Board (ABB), AusBulk and United Grower Holdings. It is the dominant storage and handling company in South Australia and has a minor presence in Victoria. Overall, ABB owns and operates 113 receival sites and seven grain export terminals in South Australia, with a combined storage capacity of 10 million tonnes (ABB 2008).

ABB is also significantly involved with the accumulation, marketing and trading of grain, both nationally and internationally. Though the company lost its sole rights to export barley from South Australia on 1 July 2007, it still is the State's dominant barley marketer. A further key ABB business is its malting division, Joe White Maltings, which is capable of producing up to 500,000 tonnes of malt annually.

For the year ending 30 September 2007, ABB reported total revenue of $1.5 billion, a net profit of $7.3 million, and net assets of $899 million (ABB 2007a: 8, 10). Grain marketing accounted for 77 per cent of ABB's revenues, malt production for 16 per cent, and supply chain operations for 7 per cent (ABB 2007a: 8).

B.4 GrainCorp Limited

GrainCorp Limited ('GrainCorp') is a publicly listed agribusiness, that is the product of a series of mergers that occurred during the early-2000s between the New South Wales-based GrainCorp Operations Limited, the Victorian-based Vicgrain and the Queensland-based Grainco. Consequently, GrainCorp is the dominant grain storage and handling company in eastern Australia. It owns and operates 233 receival sites throughout Queensland, New South Wales and Victoria, with a total storage capacity of 25 million tonnes. GrainCorp also owns and operates eight grain export terminals on the eastern seaboard, stretching from Mackay to Portland.[14]

Other key GrainCorp activities include: grain marketing (primarily wheat, barley, sorghum and canola), both nationally and internationally; milling, through the Allied Mills joint venture with Cargill; the provision of agricultural chemicals, broad acre seed and fertilisers; and on-farm road transport solutions.

[14] GrainCorp's export terminal at Kooragang does not handle field grains, and thus is not included in this tally.

For the year ending 30 September 2007, GrainCorp reported total revenue of $825 million, a net loss of $20 million, and net assets of $399 million (GrainCorp 2007e: 19-20). Grain marketing accounted for 73 per cent of GrainCorp's revenue, while storage and handling was responsible for 19 per cent (GrainCorp 2007e: 39).

B.5 Queensland Rail

Queensland Rail (QR) is a fully integrated transport provider owned by the Government of Queensland. In its home state of Queensland, QR is responsible for both maintaining the rail network and providing freight and passenger services. In an average year, QR will transport approximately 1.1 million tonnes of grain from Queensland receival sites to export terminals at Mackay, Gladstone and Fisherman Islands (SVGA 2007b: 8).

Through its purchase of the Australian Railroad Group in June 2006, QR now also provides freight services in New South Wales and Western Australia. It is the only grain haulage operator in Western Australia.

For the 2006/07 financial year, QR reported total revenue of $3.2 billion, a net profit of $183 million, and net assets of $3.1 billion (QR 2007: 72).

B.6 Pacific National

Pacific National (PN) is a private freight rail operator owned by Asciano, a publicly listed corporation. It transports the majority of grain in New South Wales and Victoria from receival sites to export terminals and 15 domestic locations (PN 2007: 5). PN is also the second-largest coal haulage operator in Australia and the country's largest carrier of interstate rail freight.

Appendix C

Access regulation for infrastructure services

This appendix provides an overview of the underlying economics of regulating access to infrastructure, identifying the major regulatory mechanisms by which regulation can be imposed, and identifying the circumstances in which access regulation is desirable. A review is provided of statutory arrangements that have been put in place for regulation of access to infrastructure, including the access provisions of Part IIIA of the *Trade Practices Act* and the National Third Party Access Code for Natural Gas Pipeline Systems (the National Gas Code).

The appendix concludes with a set of principles, derived largely from Part IIIA of the *Trade Practices Act*, that may be applied in an analysis of whether there is likely to be a benefit to considering access regulation for selected infrastructure.

C.1 Regulation of access to infrastructure services

The accepted policy position of Australian governments on the circumstances under which infrastructure services should be regulated, or should not regulated, was developed during the 1990s and is now well established. The role of the current study is not to develop new policy proposals for the regulation of access to export wheat supply chain infrastructure, but rather to consider how the existing policy framework for regulation of infrastructure services might apply.

Declaration under Part IIIA[15]

A business wanting access to a particular infrastructure service may apply to the National Competition Council (the Council) to have the service declared. The Council considers the application before forwarding a recommendation to the relevant Minister for a decision. The Australian Competition Tribunal may review the Minister's decision.

Declaration of a service establishes a right for any party to negotiate terms and conditions of access with the service provider. If negotiations fail, then declaration also gives an access seeker the right to seek binding arbitration by the Australian Competition and Consumer Commission.

Infrastructure services that are already the subject of an effective access regime or an access undertaking (described further in the following sections) cannot be declared.

Effective Access Regimes

The Competition Principles Agreement (at Clause 6) provides for State and Territory Governments to establish access regulation through legislation that is specific to particular types of infrastructure services.

[15] For a more detailed discussion refer to National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p.9.

Criteria for the types of infrastructure services that may be subject to an effective access regime are also set out in the Clause 6 principles, but closely reflect the declaration criteria in Part IIIA of the *Trade Practices Act* (set out in detail in Section 2.4, below).

An access regime may be declared "effective" under Part IIIA:[16]

> In the case of a State or Territory access regime, the question of effectiveness can be pre-determined through a process called 'certification'. This process is activated if a Premier or Chief Minister applies to the Council for a recommendation on the effectiveness of the regime. The Council considers the application before forwarding a recommendation to the relevant Commonwealth Minister, who then decides whether to certify the regime as effective. The applicant government may apply to the Tribunal for a review of the decision.

In considering whether the access regime is effective, the National Competition Council is required to have considered whether the regime is consistent with the principles of the Competition Principles Agreement. However, once a State or Territory access regime is certified as effective, that regime exclusively governs access to the designated service, ruling out the declaration provisions of Part IIIA. Certification remains in force for the duration specified in the Commonwealth Minister's decision.[17]

Examples of existing State or Territory access regimes that have been declared effective include:

- the National Third Party Access Code for Natural Gas Pipeline Systems (the National Gas Code), which is implemented through coordinated legislation by State and Territory Governments;
- the Western Australian Electricity Networks Access Code, which is established under the Western Australian *Electricity Industry Act 2004*;
- Northern Territory electricity network access regime, established under the Northern Territory *Electricity Networks (Third Party Access) Act 2000*; and
- the AustralAsia Railway Access Regime for access to rail services provided between Tarcoola in South Australia and Darwin, established under the *AustralAsia Railway (Third Party Access) Act (NT) 1999* and the *AustralAsia Railway (Third Party Access) Act (SA) 1999*.

A key benefit of a certified access regime is that it provides certainty to the infrastructure owner on how regulation will be applied. An access regime that has been certified (that is, found to be effective) may also be the preferred approach to providing access to certain infrastructure services where access regulation is expected to apply in a very similar manner to multiple pieces of infrastructure and multiple businesses.

[16] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p. 9

[17] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p.10.

Access Undertakings

Finally, Part IIIA of the *Trade Practices Act* also allows infrastructure owners to submit a voluntary access undertaking to the Australian Competition and Consumer Commission. A voluntary access undertaking sets out the terms and conditions on which a business proposes to provide access to relevant services. Acceptance by the Commission of an undertaking provides an equivalent outcome to certification. That is, the terms and conditions set out in the undertaking exclusively regulate access, and the services covered by that undertaking are immune from declaration.

As with certification, an access undertaking has the primary purpose of allowing access providers to obtain, in advance, a degree of certainty about the terms and conditions on which access will be made available. In particular, it allows parties that are considering establishing new infrastructure to settle these matters before they invest.

A voluntary access undertaking cannot be accepted for a service that is already declared.

C.2 Determining whether infrastructure services should be subject to access regulation

Part IIIA of the *Trade Practices Act* establishes criteria that must be considered by the National Competition Council in making a recommendation for the infrastructure service to be declared or not declared. Access regimes established for particular types of infrastructure also include criteria for determining whether particular infrastructure facilities and activities should be subject to access regulation, typically referred to as "coverage". The criteria established by the access regimes are similar to those for declaration under Part IIIA.

Voluntary access undertakings, by their nature, are not associated with criteria for determining whether the infrastructure services may be subject to access regulation — the decision to enter into an undertaking is at the discretion of the owner of that infrastructure. However, in assessing the benefits of entering into a voluntary access undertaking, infrastructure owners are likely to consider the extent to which the declaration criteria are satisfied by their current or proposed infrastructure services, and the risk that the infrastructure may be declared, or become covered by an effective access regime, in the future.

The criteria for declaration under Part IIIA or coverage under an access regime are taken, for the purposes of this study, to be the established policy position of Australian governments on whether it is in the public interest for access regulation to be imposed on a particular infrastructure facility or service. These criteria are set out below.

Criteria for declaration

Section 44G(2) of the *Trade Practices Act* specifies the criteria that must be met in order for the Council to "declare" an infrastructure service, and so establish a right for a party to negotiate terms and conditions of access with the service provider.

The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

> (g) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
>
> (h) that it would be uneconomical for anyone to develop another facility to provide the service;
>
> (i) that the facility is of national significance, having regard to:
>
> (iv) the size of the facility; or
>
> (v) the importance of the facility to constitutional trade or commerce; or
>
> (vi) the importance of the facility to the national economy;
>
> (j) that access to the service can be provided without undue risk to human health or safety;
>
> (k) that access to the service is not already the subject of an effective access regime;
>
> (l) that access (or increased access) to the service would not be contrary to the public interest.

The National Competition Council has published guidelines on application of the declaration criteria of Part IIIA of the *Trade Practices Act*. These guidelines draw on precedents established in the certification of access regimes, consideration of proposed voluntary access undertakings, and decisions by the Australian Competition Tribunal and the courts. A summary of the National Competition Council's process for considering whether an infrastructure service should be declared is provided in Box C.1.[18]

[18] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, pp.13-14.

Box C.1

PROCESS OF THE NCC IN CONSIDERING AN APPLICATION FOR DECLARATION — SECTION 44G(2) OF THE *TRADE PRACTICES ACT*

(a) Define the service provided by means of the infrastructure facility, delineate the physical assets that comprise the facility and identify the provider of the service.

(b) For the purposes of criterion (b), examine whether it is economic to develop another facility to provide the service. Declaration is confined to facilities exhibiting natural monopoly characteristics — that is, where it would be cheaper over a likely range of reasonably foreseeable demand for the service for the facility subject to declaration, rather than two or more facilities, to provide that service.

(c) If development of another facility to provide the service would be uneconomical, then for the purposes of criterion (a) assess whether declaration of the service would improve the conditions or environment for competition in a dependent market. Whether the conditions for competition would be enhanced depends critically on whether the natural monopoly characteristics associated with the provision of the service confer substantial market power on the service provider that can be exercised to adversely affect competition in a dependent market(s). As part of this evaluation, dependent markets need to be identified, as do factors affecting the ability and incentive to exercise market power to adversely affect competition in a dependent market(s). Such an assessment is relevant to whether criterion (a) is met.

(d) For the purposes of criterion (c), assess whether the facility is of national significance, having regard to the size of the facility, the importance of the facility to trade or commerce, or the importance of the facility to the national economy.

(e) For the purposes of criterion (d), assess whether access to the service can be provided safely.

(f) For the purposes of criterion (e), assess whether access to the service is already the subject of an effective access regime. This may be an easy assessment; for example, a State or Territory access regime may be subject to a decision by the Commonwealth Minister under s. 44N of the TPA that the access regime is an effective access regime for the service, and generally the Council must follow such a decision. Alternatively, there may be no State or Territory access regime in place that affects the service. In some instances, however, a State or Territory access regime may exist that is not the subject of a decision under s. 44N of the TPA, and it will be necessary to assess the State or Territory access regime against the principles set out in the Competition Principles Agreement.

(g) For the purposes of criterion (f), determine whether access would not be contrary to the public interest. This criterion comes into play if the other criteria are satisfied. It enables a consideration of factors not raised under the other three criteria — for example, the regulatory costs of providing access, and transitional pricing arrangements.

Source: (NCC 2002)

The following section describes alternative service scenarios and then assesses the alternative services against the criteria for determining whether there may be benefits in applying access regulation.

Would the service be a "service" for the purpose of Part IIIA of the Trade Practices Act?

Section 44B of Part IIIA of the Trade Practices Act defines a service as:

> "service" means a service provided by means of a facility and includes:
>
> (a) the use of an infrastructure facility such as a road or railway line;
>
> (b) handling or transporting things such as goods or people;
>
> (c) a communications service or similar service…
>
> but does not include:

(d) the supply of goods; or

(e) the use of intellectual property; or

(f) the use of a production process;

The following guidelines exist to identify the service to which access has been sought.[19]

- A service is separate and distinct from a facility — a right of access may be given to the services provided by means of the facility, not to the facility itself. That said, the service might consist merely of the use of a facility.
- A facility may provide different services or a number of instances of the same service. For example, gas transportation services provided to two parties by a gas pipeline with the same receipt and delivery points would be two instances of the same service being provided, whereas gas transportation services provided to two parties with different receipt and/or delivery points may represent two distinct services.
- In characterising the service, it may be necessary to specify the purpose for which access to the service is sought to ensure the right to negotiate access to the service following declaration is limited by a reference to purpose. This may also define the relevant upstream and downstream markets to be considered.
- A service cannot be differentiated simply in terms of the access seeker, the different operational ends to which to services may be put, or the market served by the access seeker.

The term "facility" is not defined in the Trade Practices Act, but has been found by the Australian Competition Tribunal to be:[20]

> …a physical asset (or set of assets) essential for service provision'… The relevant facility is therefore comprised of 'the minimum bundle of assets required to provide the relevant services subject to declaration'
>
> …[and]…
>
> delineating the set of physical assets that comprise a facility is a 'key issue' in determining whether criterion (b) is satisfied because:
>
> > The more comprehensive the definition of the set of physical assets ... the less likely it is that anyone ... would find it economical to develop 'another facility' within a meaningful time scale. Conversely, the narrower the definition of facility, the lower the investment hurdle and inhibition on development ...

The Tribunal has found that the declaration criteria should be restricted to a *facility* used to provide a service where it:

(a) exhibits natural monopoly characteristics — that is, one firm can meet the entire range of relevant demand at a lower cost than that of two or more firms; **and** [emphasis added]

(b) creates a bottleneck — that is, access to the facility is essential to compete in any dependent market(s).

[19] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, pp.22-27.

[20] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, p.31.

Would it be uneconomical for anyone to develop another facility to provide the service?

The test of whether it would be uneconomical for anyone to develop another facility to provide a service is, in effect, a test of whether that service has natural monopoly characteristics. That is, whether it is less costly for the service to be provided by single facility rather than multiple facilities, over a relevant range of demand for the service.

If the capacity of the facility is insufficient to meet foreseeable demand then it is necessary to consider whether it is less costly, from a social perspective, to expand or modify the facility or to construct another facility to meet foreseeable demand.

If foreseeable demand outstrips the facility's maximum potential capacity, then it is likely to be considered economical to develop another facility to provide the service.

Would access (or increased access) to the service promote a material increase in competition in related market?

The guidelines of the NCC indicate that the purpose of considering increases in competition in related markets is:

> … to limit declaration to circumstances where it is likely to enhance the environment for competition in any dependent market(s). Whether competition will be enhanced depends critically on the extent to which the incumbent service provider can, in the absence of declaration, use market power to adversely affect competition in the dependent market(s). If the service provider has market power, as well as the ability and incentive to use that power to adversely affect competition in a dependent market, declaration would be likely to improve the environment for competition, offering the prospect of tangible benefits to consumers (including reduced prices and better service provision)

In considering the effects of regulated access on competition in related markets:

- the relevant market(s) in which competition may be promoted must be defined, which must be separate from the market for the service to which access is sought; and
- whether access (or increased access) facilitated by declaration would promote a more competitive environment in the additional market(s) must be determined, which requires assessing:
  - whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s); and
  - whether the structure of the dependent market(s) is such that declaration would promote competition – in particular, high barriers to entry that are unrelated to the existence of the bottleneck facility may preclude any promotion of competition following declaration.

Is the facility of national significance?

The NCC guidelines indicate that this criterion is a test of materiality, intended to ensure that only facilities that have a significant national economic role are subject to Part IIIA. In order to determine whether the facility is of national significance, the NCC has regard to the size of the facility, the importance of the facility to commerce or trade, and the importance to the national economy. The guidelines note that only one of the criteria needs to be met.

Is access to the service already the subject of an effective access regime?

Infrastructure services that are already covered by an effective access regime cannot be declared for access under Part IIIA of the TPA. The main purpose is to allow state or territory governments to develop Competition Principles Agreement-compliant, industry specific access regimes that apply to services excluded under Part IIIA.

Would access (or increased access) to the service not be contrary to the public interest?

Neither Part IIIA of the *Trade Practices Act* nor other access regimes provide guidance on applying the general criterion that regulating access should not be contrary to the public interest. Past determinations on whether facilities should be subject to access regulation and the consideration of greenfields investments by the Productivity Commission and Ministerial Council on Energy suggest that the following factors are relevant in considering the public interest.

- Potential gains and losses in economic efficiency (that is, technical, allocative and dynamic efficiency) — for example, gains might include potentially lower prices resulting from entry or the threat of entry, while losses could include reducing incentives for investment.
- Costs of regulation — there are likely to be direct and indirect costs associated with access (or increased access) and with the administrative processes of regulation , which may also lead to economic efficiency gains or losses.
- Other public interest considerations — including, but not necessarily limited to: ecologically sustainable development, social welfare and equity considerations, economic and regional development and the competitiveness of Australian businesses.

Requirements for an effective access regime

Clause 6(3) of the Competition Principles Agreement outlines the infrastructure services that may be covered by an effective access regime.

> (3) For a State or Territory access regime to conform to the principles set out in this clause, it should:
>
> (a) apply to services provided by means of significant infrastructure facilities where:
>
> (i) it would not be economically feasible to duplicate the facility;
>
> (ii) access to the service is necessary in order to permit effective competition in downstream or upstream market; and
>
> (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and
>
> (b) incorporate the principles referred to in subclause (4).

The Clause 6(3) criteria are essentially a subset of the declaration criteria under section 44G(2) of the *Trade Practices Act*, other than that the coverage criteria under Clause 6(3) does not include the criterion of "national significance" of the infrastructure facility. This criterion may be present in the criteria for declaration as a determinant as to whether access should be regulated under the Commonwealth framework of the *Trade Practices Act*, as opposed to under a State or Territory framework, rather than as a more general principle of the public interest of access regulation.

C.3 Conclusion

There are well established policy and legal frameworks in Australia that govern the circumstances under which a right may be given to one party to gain access to infrastructure services owned and/or operated by another party.

These policy and legal frameworks provide an appropriate basis for an assessment of whether it may be in the public interest to regulate access to grain transportation, storage and export infrastructure. The criteria for declaration of an infrastructure service under Part IIIA of the *Trade Practices Act* provides a basis for deriving a set of principles to assess whether it is appropriate to regulate access to the infrastructure for grain transportation, storage and export. These principles are as follows:

- The infrastructure facility and service should be consistent with the concept of a "service" under the declaration criteria of Part IIIA of the *Trade Practices Act*.
- It would be uneconomical for anyone to develop another facility to provide the service (that is, the infrastructure facility has natural monopoly characteristics).
- Access (or increased access) to the service would promote a material increase in competition in a related market.
- Access (or increased access) to the service would not be contrary to the public interest.
- Access regulation is consistent with promoting efficient investment in, and efficient operation and use of, the infrastructure facility.

A.2 Western Australia

Western Australia is the country's largest grain producing State, responsible for 35 per cent of the country's total grain production. It is also the largest exporting State, with between 45 and 74 per cent of Australian wheat exports supplied by Western Australia (WEA 2007).

Wheat, barley and oats are the dominant grain varieties grown in Western Australia, accounting for 74 per cent, 21 per cent and five per cent of total grain production respectively. In 2004-05, the gross value of Western Australia's field grain production was $2,338 million, which represents 45 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Western Australia are (CCI WA 2007: 11):

- the central (Kwinana) region, which is responsible for approximately 50 per cent of total grain production;
- the northern (Geraldton) region, which produces approximately 27 per cent of total production;
- the southern (Albany) region, which produces approximately 14 per cent of total production; and
- the Esperance region, which produces approximately nine per cent of total production.

The significance of this for the export supply chain is that production in Western Australia is widely distributed, and reliant on storage and transportation links that have to be well coordinated at harvest, and effectively integrated with port facilities. The absence of a large domestic market in Western Australia accentuates this requirement. Chapter 3 examines these issues in detail.

A.3 New South Wales

New South Wales is Australia's second largest grain producing State, and also supplies 32 percent of the country's wheat exports. Wheat and barley are the dominant field grain varieties, accounting for 66 per cent and 17 per cent of total production. For 2004-05, the gross value of New South Wales's production of field grains was just over $2 billion, which represents 23 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in New South Wales are (NSW DPI 2005, 2006, 2007):

- the North West Slopes and Plains (encompassing Narrabri, Moree and Werris Creek), which produces approximately 36 per cent of total grain production;
- the Riverina and South West (primarily centred around Lockhart and Oaklands), which produces approximately 36 per cent of total production; and
- the Central West (stretching from Dubbo, through Parkes and West Wyalong to Hillston), which produces approximately 27 per cent of total production.

As in Western Australia, grain production in New South Wales is widely distributed (refer Figure 6.1), and reliant on well-coordinated storage and transportation links at harvest. The storage and transportation links are also effectively integrated with port facilities. Again, given it accounts for a large percentage of the export market, the effectiveness of these links is of significant importance, as discussed in Chapter 2.

A.4 South Australia

South Australia is the third largest grain producing State in Australia, and 16 per cent of Australia's wheat exports are supplied by the State. Wheat and barley are the primary grain varieties grown in South Australia, accounting for 55 per cent and 41 per cent of total grain production, respectively. In 2004-05, the gross value of South Australia's field grain production was $887 million, which is 23 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in South Australia are (PIRSA GID 2005: 13-4; PIRSA GID 2006: 13-4; PIRSA GID 2007: 14-5):

- the Northern Area (stretching from Quorn in the north to Roseworthy and Stockwell in the south), which is responsible for approximately 30 per cent of total grain production;
- the Eyre Peninsula (stretching from Pintumba in the west to the Spencer Gulf in the east), which produces approximately 28 per cent of total production; the Yorke Peninsula, which produces approximately 19 per cent of total production;
- the Murray Mallee, which is responsible for approximately 14 per cent of total production; and
- the South East (stretching from Tailem Bend in the north to Millicent in the south), which produces approximately 7 per cent of total production.

While Figure 6.1 appears to indicate that grain production in South Australia is concentrated in a smaller area than the previous two States, as discussed in Chapter 2 the supply chain is more fragmented with seven export grain terminals.

6.5 Victoria

Victoria is Australia's fourth largest grain producing state, responsible for 13 per cent of the country's total grain production and 11 per cent of exported wheat. Wheat, barley and oats are the dominant field grain varieties grown in the State, accounting for 52 per cent, 35 per cent and 8 per cent of total grain production, respectively. In 2005-06, the gross value of field grain production in Victoria was $669 million. This figure represents 8 percent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Victoria are: Mallee (covering the northwest of the state); the Wimmera (covering the southwest of the state); North Central; and Northeast.

A.5 Queensland

Queensland is the smallest grain producer of the five mainland states; responsible for both 5 per cent of Australia's total wheat production and wheat exports, although it does produce 12 per cent of Australia's coarse grain. Sorghum and wheat are the dominant grain varieties grown in Queensland, accounting for 44 and 42 percent of total grain production, respectively. In 2004-05, the gross value of Queensland's production of field grains was $475 million, or 6 per cent of the gross value of the State's total farm production (ABS 2006: 10).

The major grain production areas in Queensland are (QLD DPI 2007):

- the Darling Downs (stretching from Toowoomba and Warwick in the east to Roma and Thallon in the West), which is responsible for approximately 65 per cent of total grain production; and
- Central Queensland, which produces approximately 35 per cent of total grain production.

A.6 Other States and Territories

Tasmania, the Northern Territory and the Australian Capital Territory produce negligible quantities of wheat.

Appendix B

Major grain supply chain operators

This appendix provides a brief overview of the major players in the Australian grain supply chain.

B.1 AWB Limited

AWB is a publicly listed agribusiness. Formerly the Australian Wheat Board, a Federal Government body tasked with exporting Australia's wheat, AWB was privatised in 1999 and floated on the Australian Stock Exchange in 2001. Its primary business is the accumulation, marketing and trading of grain, both nationally and internationally.

As noted in Chapter 1, the current Single Desk is likely to be significantly altered through the Wheat Export Marketing Bill 2008. This is the arrangement where AWBI, a wholly owned subsidiary of AWB, retains the sole right to export Australian wheat, Instead of a holding a monopoly on this trade, AWBI is more likely to become one of a number of accredited marketers in a move intended to create a more competitive trading environment.

AWB is also involved in other elements of the Australian grain supply chain. For example, through another subsidiary, AWB GrainFlow, it owns and operates 22 receival sites throughout Queensland, New South Wales, Victoria and South Australia. A further key AWB business is the provision of agricultural products and services (including financial) through its subsidiary Landmark, which has 400 outlets across Australia.

For the year ending 30 September 2007, AWB reported total revenue of $4.8 billion, a net profit of $27 million, and net assets of $1.1 billion (AWB 2007a). AWB's accumulation, marketing and trading of grain accounted for 59 per cent of the company's revenues, its provision of rural services (through Landmark) for 33 per cent, and its supply chain operations for just over one per cent (AWB 2007a: 16).

B.2 Co-operative Bulk Handling Limited

Co-operative Bulk Handling Limited ('CBH') is a co-operative agribusiness controlled by more than 5,700 grower-members across Western Australia. It operates pursuant to the State-based *Bulk Handling Act 1967*.

CBH's primary business is the storage and handling of grain, and it owns and operates almost 200 receival sites in Western Australia. These sites have a total storage capacity of over 19 million tonnes, and receive on average 10 million tonnes of grain per year (CBH 2006: 4). In addition, CBH owns and operates four grain export terminals at Albany, Esperance, Geraldton and Kwinana in Western Australia, which have a combined storage capacity of near three million tonnes.

CBH is also involved in the trading of grains, with its subsidiary, Grain Pool Pty Ltd, holding the main licence to export barley, lupins and canola from Western Australia. Another subsidiary, AgraCorp Pty Ltd, trades other non-prescribed grains internationally and all grains domestically (CBH 2006: 3). Other key CBH activities include the provision of engineering services, through the Bulkwest Pty Ltd subsidiary, and Pacific Agrifoods (a joint venture with The Salim Group) through which CBH Groups holds stakes in flour mills in Indonesia, Malaysia and Vietnam, and a grain terminal in Indonesia.

For the year ending 31 October 2006, CBH reported total revenue of $513 million, a net profit of $87 million, and net assets of $916 million (CBH 2007: 43-4). Grain handling accounted for 49 per cent of CBH's revenues, while grain trading accounted for 41 per cent (CBH 2007: 66).

B.3 ABB Grain Limited

ABB Grain Limited ('ABB') is a publicly listed agribusiness. It was formed in 2004 as the result of a merger between three South Australian grain companies: the Australian Barley Board (ABB), AusBulk and United Grower Holdings. It is the dominant storage and handling company in South Australia and has a minor presence in Victoria. Overall, ABB owns and operates 113 receival sites and seven grain export terminals in South Australia, with a combined storage capacity of 10 million tonnes (ABB 2008).

ABB is also significantly involved with the accumulation, marketing and trading of grain, both nationally and internationally. Though the company lost its sole rights to export barley from South Australia on 1 July 2007, it still is the State's dominant barley marketer. A further key ABB business is its malting division, Joe White Maltings, which is capable of producing up to 500,000 tonnes of malt annually.

For the year ending 30 September 2007, ABB reported total revenue of $1.5 billion, a net profit of $7.3 million, and net assets of $899 million (ABB 2007a: 8, 10). Grain marketing accounted for 77 per cent of ABB's revenues, malt production for 16 per cent, and supply chain operations for 7 per cent (ABB 2007a: 8).

B.4 GrainCorp Limited

GrainCorp Limited ('GrainCorp') is a publicly listed agribusiness, that is the product of a series of mergers that occurred during the early-2000s between the New South Wales-based GrainCorp Operations Limited, the Victorian-based Vicgrain and the Queensland-based Grainco. Consequently, GrainCorp is the dominant grain storage and handling company in eastern Australia. It owns and operates 233 receival sites throughout Queensland, New South Wales and Victoria, with a total storage capacity of 25 million tonnes. GrainCorp also owns and operates eight grain export terminals on the eastern seaboard, stretching from Mackay to Portland.[14]

Other key GrainCorp activities include: grain marketing (primarily wheat, barley, sorghum and canola), both nationally and internationally; milling, through the Allied Mills joint venture with Cargill; the provision of agricultural chemicals, broad acre seed and fertilisers; and on-farm road transport solutions.

[14] GrainCorp's export terminal at Kooragang does not handle field grains, and thus is not included in this tally.

For the year ending 30 September 2007, GrainCorp reported total revenue of $825 million, a net loss of $20 million, and net assets of $399 million (GrainCorp 2007e: 19-20). Grain marketing accounted for 73 per cent of GrainCorp's revenue, while storage and handling was responsible for 19 per cent (GrainCorp 2007e: 39).

B.5 Queensland Rail

Queensland Rail (QR) is a fully integrated transport provider owned by the Government of Queensland. In its home state of Queensland, QR is responsible for both maintaining the rail network and providing freight and passenger services. In an average year, QR will transport approximately 1.1 million tonnes of grain from Queensland receival sites to export terminals at Mackay, Gladstone and Fisherman Islands (SVGA 2007b: 8).

Through its purchase of the Australian Railroad Group in June 2006, QR now also provides freight services in New South Wales and Western Australia. It is the only grain haulage operator in Western Australia.

For the 2006/07 financial year, QR reported total revenue of $3.2 billion, a net profit of $183 million, and net assets of $3.1 billion (QR 2007: 72).

B.6 Pacific National

Pacific National (PN) is a private freight rail operator owned by Asciano, a publicly listed corporation. It transports the majority of grain in New South Wales and Victoria from receival sites to export terminals and 15 domestic locations (PN 2007: 5). PN is also the second-largest coal haulage operator in Australia and the country's largest carrier of interstate rail freight.

Appendix C

Access regulation for infrastructure services

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The appendix concludes with a set of principles, derived largely from Part IIIA of the *Trade Practices Act*, that may be applied in an analysis of whether there is likely to be a benefit to considering access regulation for selected infrastructure.

C.1 Regulation of access to infrastructure services

The accepted policy position of Australian governments on the circumstances under which infrastructure services should be regulated, or should not regulated, was developed during the 1990s and is now well established. The role of the current study is not to develop new policy proposals for the regulation of access to export wheat supply chain infrastructure, but rather to consider how the existing policy framework for regulation of infrastructure services might apply.

Declaration under Part IIIA[15]

A business wanting access to a particular infrastructure service may apply to the National Competition Council (the Council) to have the service declared. The Council considers the application before forwarding a recommendation to the relevant Minister for a decision. The Australian Competition Tribunal may review the Minister's decision.

Declaration of a service establishes a right for any party to negotiate terms and conditions of access with the service provider. If negotiations fail, then declaration also gives an access seeker the right to seek binding arbitration by the Australian Competition and Consumer Commission.

Infrastructure services that are already the subject of an effective access regime or an access undertaking (described further in the following sections) cannot be declared.

Effective Access Regimes

The Competition Principles Agreement (at Clause 6) provides for State and Territory Governments to establish access regulation through legislation that is specific to particular types of infrastructure services.

[15] For a more detailed discussion refer to National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p.9.

Criteria for the types of infrastructure services that may be subject to an effective access regime are also set out in the Clause 6 principles, but closely reflect the declaration criteria in Part IIIA of the *Trade Practices Act* (set out in detail in Section 2.4, below).

An access regime may be declared "effective" under Part IIIA:[16]

> In the case of a State or Territory access regime, the question of effectiveness can be pre-determined through a process called 'certification'. This process is activated if a Premier or Chief Minister applies to the Council for a recommendation on the effectiveness of the regime. The Council considers the application before forwarding a recommendation to the relevant Commonwealth Minister, who then decides whether to certify the regime as effective. The applicant government may apply to the Tribunal for a review of the decision.

In considering whether the access regime is effective, the National Competition Council is required to have considered whether the regime is consistent with the principles of the Competition Principles Agreement. However, once a State or Territory access regime is certified as effective, that regime exclusively governs access to the designated service, ruling out the declaration provisions of Part IIIA. Certification remains in force for the duration specified in the Commonwealth Minister's decision.[17]

Examples of existing State or Territory access regimes that have been declared effective include:

- the National Third Party Access Code for Natural Gas Pipeline Systems (the National Gas Code), which is implemented through coordinated legislation by State and Territory Governments;
- the Western Australian Electricity Networks Access Code, which is established under the Western Australian *Electricity Industry Act 2004*;
- Northern Territory electricity network access regime, established under the Northern Territory *Electricity Networks (Third Party Access) Act 2000*; and
- the AustralAsia Railway Access Regime for access to rail services provided between Tarcoola in South Australia and Darwin, established under the *AustralAsia Railway (Third Party Access) Act (NT) 1999* and the *AustralAsia Railway (Third Party Access) Act (SA) 1999*.

A key benefit of a certified access regime is that it provides certainty to the infrastructure owner on how regulation will be applied. An access regime that has been certified (that is, found to be effective) may also be the preferred approach to providing access to certain infrastructure services where access regulation is expected to apply in a very similar manner to multiple pieces of infrastructure and multiple businesses.

[16] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p. 9

[17] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, p.10.

Access Undertakings

Finally, Part IIIA of the *Trade Practices Act* also allows infrastructure owners to submit a voluntary access undertaking to the Australian Competition and Consumer Commission. A voluntary access undertaking sets out the terms and conditions on which a business proposes to provide access to relevant services. Acceptance by the Commission of an undertaking provides an equivalent outcome to certification. That is, the terms and conditions set out in the undertaking exclusively regulate access, and the services covered by that undertaking are immune from declaration.

As with certification, an access undertaking has the primary purpose of allowing access providers to obtain, in advance, a degree of certainty about the terms and conditions on which access will be made available. In particular, it allows parties that are considering establishing new infrastructure to settle these matters before they invest.

A voluntary access undertaking cannot be accepted for a service that is already declared.

C.2 Determining whether infrastructure services should be subject to access regulation

Part IIIA of the *Trade Practices Act* establishes criteria that must be considered by the National Competition Council in making a recommendation for the infrastructure service to be declared or not declared. Access regimes established for particular types of infrastructure also include criteria for determining whether particular infrastructure facilities and activities should be subject to access regulation, typically referred to as "coverage". The criteria established by the access regimes are similar to those for declaration under Part IIIA.

Voluntary access undertakings, by their nature, are not associated with criteria for determining whether the infrastructure services may be subject to access regulation — the decision to enter into an undertaking is at the discretion of the owner of that infrastructure. However, in assessing the benefits of entering into a voluntary access undertaking, infrastructure owners are likely to consider the extent to which the declaration criteria are satisfied by their current or proposed infrastructure services, and the risk that the infrastructure may be declared, or become covered by an effective access regime, in the future.

The criteria for declaration under Part IIIA or coverage under an access regime are taken, for the purposes of this study, to be the established policy position of Australian governments on whether it is in the public interest for access regulation to be imposed on a particular infrastructure facility or service. These criteria are set out below.

Criteria for declaration

Section 44G(2) of the *Trade Practices Act* specifies the criteria that must be met in order for the Council to "declare" an infrastructure service, and so establish a right for a party to negotiate terms and conditions of access with the service provider.

The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

> (g) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
>
> (h) that it would be uneconomical for anyone to develop another facility to provide the service;
>
> (i) that the facility is of national significance, having regard to:
>
> (iv) the size of the facility; or
>
> (v) the importance of the facility to constitutional trade or commerce; or
>
> (vi) the importance of the facility to the national economy;
>
> (j) that access to the service can be provided without undue risk to human health or safety;
>
> (k) that access to the service is not already the subject of an effective access regime;
>
> (l) that access (or increased access) to the service would not be contrary to the public interest.

The National Competition Council has published guidelines on application of the declaration criteria of Part IIIA of the *Trade Practices Act*. These guidelines draw on precedents established in the certification of access regimes, consideration of proposed voluntary access undertakings, and decisions by the Australian Competition Tribunal and the courts. A summary of the National Competition Council's process for considering whether an infrastructure service should be declared is provided in Box C.1.[18]

[18] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, pp.13-14.

Box C.1

PROCESS OF THE NCC IN CONSIDERING AN APPLICATION FOR DECLARATION — SECTION 44G(2) OF THE *TRADE PRACTICES ACT*

(a) Define the service provided by means of the infrastructure facility, delineate the physical assets that comprise the facility and identify the provider of the service.

(b) For the purposes of criterion (b), examine whether it is economic to develop another facility to provide the service. Declaration is confined to facilities exhibiting natural monopoly characteristics — that is, where it would be cheaper over a likely range of reasonably foreseeable demand for the service for the facility subject to declaration, rather than two or more facilities, to provide that service.

(c) If development of another facility to provide the service would be uneconomical, then for the purposes of criterion (a) assess whether declaration of the service would improve the conditions or environment for competition in a dependent market. Whether the conditions for competition would be enhanced depends critically on whether the natural monopoly characteristics associated with the provision of the service confer substantial market power on the service provider that can be exercised to adversely affect competition in a dependent market(s). As part of this evaluation, dependent markets need to be identified, as do factors affecting the ability and incentive to exercise market power to adversely affect competition in a dependent market(s). Such an assessment is relevant to whether criterion (a) is met.

(d) For the purposes of criterion (c), assess whether the facility is of national significance, having regard to the size of the facility, the importance of the facility to trade or commerce, or the importance of the facility to the national economy.

(e) For the purposes of criterion (d), assess whether access to the service can be provided safely.

(f) For the purposes of criterion (e), assess whether access to the service is already the subject of an effective access regime. This may be an easy assessment; for example, a State or Territory access regime may be subject to a decision by the Commonwealth Minister under s. 44N of the TPA that the access regime is an effective access regime for the service, and generally the Council must follow such a decision. Alternatively, there may be no State or Territory access regime in place that affects the service. In some instances, however, a State or Territory access regime may exist that is not the subject of a decision under s. 44N of the TPA, and it will be necessary to assess the State or Territory access regime against the principles set out in the Competition Principles Agreement.

(g) For the purposes of criterion (f), determine whether access would not be contrary to the public interest. This criterion comes into play if the other criteria are satisfied. It enables a consideration of factors not raised under the other three criteria — for example, the regulatory costs of providing access, and transitional pricing arrangements.

Source: (NCC 2002)

The following section describes alternative service scenarios and then assesses the alternative services against the criteria for determining whether there may be benefits in applying access regulation.

Would the service be a "service" for the purpose of Part IIIA of the Trade Practices Act?

Section 44B of Part IIIA of the Trade Practices Act defines a service as:

> "service" means a service provided by means of a facility and includes:
>
> (a) the use of an infrastructure facility such as a road or railway line;
>
> (b) handling or transporting things such as goods or people;
>
> (c) a communications service or similar service…
>
> but does not include:

(d) the supply of goods; or

(e) the use of intellectual property; or

(f) the use of a production process;

The following guidelines exist to identify the service to which access has been sought.[19]

- A service is separate and distinct from a facility — a right of access may be given to the services provided by means of the facility, not to the facility itself. That said, the service might consist merely of the use of a facility.
- A facility may provide different services or a number of instances of the same service. For example, gas transportation services provided to two parties by a gas pipeline with the same receipt and delivery points would be two instances of the same service being provided, whereas gas transportation services provided to two parties with different receipt and/or delivery points may represent two distinct services.
- In characterising the service, it may be necessary to specify the purpose for which access to the service is sought to ensure the right to negotiate access to the service following declaration is limited by a reference to purpose. This may also define the relevant upstream and downstream markets to be considered.
- A service cannot be differentiated simply in terms of the access seeker, the different operational ends to which to services may be put, or the market served by the access seeker.

The term "facility" is not defined in the Trade Practices Act, but has been found by the Australian Competition Tribunal to be:[20]

> …a physical asset (or set of assets) essential for service provision'… The relevant facility is therefore comprised of 'the minimum bundle of assets required to provide the relevant services subject to declaration'
>
> …[and]…
>
> delineating the set of physical assets that comprise a facility is a 'key issue' in determining whether criterion (b) is satisfied because:
>
> > The more comprehensive the definition of the set of physical assets ... the less likely it is that anyone ... would find it economical to develop 'another facility' within a meaningful time scale. Conversely, the narrower the definition of facility, the lower the investment hurdle and inhibition on development ...

The Tribunal has found that the declaration criteria should be restricted to a *facility* used to provide a service where it:

(a) exhibits natural monopoly characteristics — that is, one firm can meet the entire range of relevant demand at a lower cost than that of two or more firms; **and** [emphasis added]

(b) creates a bottleneck — that is, access to the facility is essential to compete in any dependent market(s).

[19] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, pp.22-27.

[20] National Competition Council, December 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, Part B Declaration*, p.31.

Would it be uneconomical for anyone to develop another facility to provide the service?

The test of whether it would be uneconomical for anyone to develop another facility to provide a service is, in effect, a test of whether that service has natural monopoly characteristics. That is, whether it is less costly for the service to be provided by single facility rather than multiple facilities, over a relevant range of demand for the service.

If the capacity of the facility is insufficient to meet foreseeable demand then it is necessary to consider whether it is less costly, from a social perspective, to expand or modify the facility or to construct another facility to meet foreseeable demand.

If foreseeable demand outstrips the facility's maximum potential capacity, then it is likely to be considered economical to develop another facility to provide the service.

Would access (or increased access) to the service promote a material increase in competition in related market?

The guidelines of the NCC indicate that the purpose of considering increases in competition in related markets is:

> … to limit declaration to circumstances where it is likely to enhance the environment for competition in any dependent market(s). Whether competition will be enhanced depends critically on the extent to which the incumbent service provider can, in the absence of declaration, use market power to adversely affect competition in the dependent market(s). If the service provider has market power, as well as the ability and incentive to use that power to adversely affect competition in a dependent market, declaration would be likely to improve the environment for competition, offering the prospect of tangible benefits to consumers (including reduced prices and better service provision)

In considering the effects of regulated access on competition in related markets:

- the relevant market(s) in which competition may be promoted must be defined, which must be separate from the market for the service to which access is sought; and
- whether access (or increased access) facilitated by declaration would promote a more competitive environment in the additional market(s) must be determined, which requires assessing:
  - whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s); and
  - whether the structure of the dependent market(s) is such that declaration would promote competition – in particular, high barriers to entry that are unrelated to the existence of the bottleneck facility may preclude any promotion of competition following declaration.

Is the facility of national significance?

The NCC guidelines indicate that this criterion is a test of materiality, intended to ensure that only facilities that have a significant national economic role are subject to Part IIIA. In order to determine whether the facility is of national significance, the NCC has regard to the size of the facility, the importance of the facility to commerce or trade, and the importance to the national economy. The guidelines note that only one of the criteria needs to be met.

Is access to the service already the subject of an effective access regime?

Infrastructure services that are already covered by an effective access regime cannot be declared for access under Part IIIA of the TPA. The main purpose is to allow state or territory governments to develop Competition Principles Agreement-compliant, industry specific access regimes that apply to services excluded under Part IIIA.

Would access (or increased access) to the service not be contrary to the public interest?

Neither Part IIIA of the *Trade Practices Act* nor other access regimes provide guidance on applying the general criterion that regulating access should not be contrary to the public interest. Past determinations on whether facilities should be subject to access regulation and the consideration of greenfields investments by the Productivity Commission and Ministerial Council on Energy suggest that the following factors are relevant in considering the public interest.

- Potential gains and losses in economic efficiency (that is, technical, allocative and dynamic efficiency) — for example, gains might include potentially lower prices resulting from entry or the threat of entry, while losses could include reducing incentives for investment.
- Costs of regulation — there are likely to be direct and indirect costs associated with access (or increased access) and with the administrative processes of regulation , which may also lead to economic efficiency gains or losses.
- Other public interest considerations — including, but not necessarily limited to: ecologically sustainable development, social welfare and equity considerations, economic and regional development and the competitiveness of Australian businesses.

Requirements for an effective access regime

Clause 6(3) of the Competition Principles Agreement outlines the infrastructure services that may be covered by an effective access regime.

> (3) For a State or Territory access regime to conform to the principles set out in this clause, it should:
>
> (a) apply to services provided by means of significant infrastructure facilities where:
>
> (i) it would not be economically feasible to duplicate the facility;
>
> (ii) access to the service is necessary in order to permit effective competition in downstream or upstream market; and
>
> (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and
>
> (b) incorporate the principles referred to in subclause (4).

The Clause 6(3) criteria are essentially a subset of the declaration criteria under section 44G(2) of the *Trade Practices Act*, other than that the coverage criteria under Clause 6(3) does not include the criterion of "national significance" of the infrastructure facility. This criterion may be present in the criteria for declaration as a determinant as to whether access should be regulated under the Commonwealth framework of the *Trade Practices Act*, as opposed to under a State or Territory framework, rather than as a more general principle of the public interest of access regulation.

C.3 Conclusion

There are well established policy and legal frameworks in Australia that govern the circumstances under which a right may be given to one party to gain access to infrastructure services owned and/or operated by another party.

These policy and legal frameworks provide an appropriate basis for an assessment of whether it may be in the public interest to regulate access to grain transportation, storage and export infrastructure. The criteria for declaration of an infrastructure service under Part IIIA of the *Trade Practices Act* provides a basis for deriving a set of principles to assess whether it is appropriate to regulate access to the infrastructure for grain transportation, storage and export. These principles are as follows:

- The infrastructure facility and service should be consistent with the concept of a "service" under the declaration criteria of Part IIIA of the *Trade Practices Act*.
- It would be uneconomical for anyone to develop another facility to provide the service (that is, the infrastructure facility has natural monopoly characteristics).
- Access (or increased access) to the service would promote a material increase in competition in a related market.
- Access (or increased access) to the service would not be contrary to the public interest.
- Access regulation is consistent with promoting efficient investment in, and efficient operation and use of, the infrastructure facility.

The Allen Consulting Group

Competition in the export grain supply chain

Summary Report

March 2008

Report to AWB Limited

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Contents

1.1 A new horizon for grains exports

The shape of the Australian export wheat market is changing.

Since 1939 the Commonwealth government has maintained a statutory monopoly in the export of bulk wheat. The monopoly rights were until 1999 exercised by a statutory authority, the Australian Wheat Board, and since then by AWB (International), a subsidiary of AWB Limited. This 'single desk' arrangement, maintained through the Commonwealth *Wheat Marketing Act 1989*, is to be replaced by a more open and competitive system based on accreditation of a number of exporters.

"...under Labor's plan there will be a single desk with multiple accredited exporters. Labor's plan will ensure that export marketing services are contestable thus applying downward pressure to export supply chain costs for the first time in Australian history" (O'Brien, 2007).

Changes now proposed to the *Wheat Marketing Act 1989* follow Labor's promise prior to the 2007 election to introduce a more competitive wheat market. It is also in line with the principles underpinning the National Competition Policy, which has seen the removal of other legislated monopolies.

Although the changes will in principle exert downwards pressure on supply chain costs, in practice the potential gains may be undermined by regional monopolies over vital elements of the supply chain infrastructure.

[We should ensure] "…we don't replace a national exporter…[to] simply end up with three regional monopolies" (Minister Tony Burke, in AFR 2008: 9).

The Government has stated that new export wheat marketing arrangements must support genuine competition, with companies being given access to the infrastructure of the three dominant bulk handlers in Australia, CBH Group (CBH) in Western Australia, and ABB and GrainCorp in the Eastern States.

Information asymmetries can impede the development of a fully competitive market.

The extent of competition in the export grain supply chain is affected by monopoly infrastructure services and information asymmetries. Analysis of the National Competition Policy, and the experience of other industries that have been the subject to pro-competitive reforms, provides pointers to policy options that will assist in achieving pro-competition objectives.

Is the TPA, on its own, a sufficient safeguard?

The key question is whether there is a need for specific pro-competitive policy measures, outside of the general framework provided by the *Trade Practices Act 1974*. The Act applies to anti-competitive behaviours throughout the economy; but for key sectors governments have at times introduced additional pro-competitive measures.

Until now, the single desk position of AWB(I) acted as a counterbalancing force in the market, and so the potential for misuse of regional supply chain monopolies was less of a policy concern. That situation is about to change.

This has applied particularly where there are elements of natural monopoly involved, or where entrenched incumbents (often previously government owned) have a high degree of market power.

1.2 Access to export wheat infrastructure

Part IIIA of the *Trade Practices Act* establishes three pathways for a party to seek access to an infrastructure service:

- through declaration;
- by using an existing effective access regime; or
- under terms and conditions set out in a voluntary undertaking approved by the Australian Competition and Consumer Commission (ACCC).

Section 44G(2) of the *Trade Practices Act* specifies the criteria that must be met in order for the Council to "declare" an infrastructure service, and so establish a right for a party to negotiate terms and conditions of access with the service provider.

The National Competition Council has published guidelines on application of the declaration criteria of Part IIIA of the *Trade Practices Act*. These place a heavy weight on economic and national significance criteria, together with public interest and regulatory costs. The Council of Australian Government (COAG) has also established specific agreements that apply to competition in relation to rail freight infrastructure and ports.

Application to the export grain supply chain

it is unlikely that receival sites would be seen as natural monopoly 'bottle-neck' facilities.

While some scale economies exist in up-country grain receival sites, it is unlikely that these facilities would meet the principles for access regulation. They are nevertheless critical elements of the overall supply chain, and their linkages to other steps in that chain could be considered as part of any other competition undertakings that might be provided (see below).

Conclusion 1

Access to up-country storage and handling infrastructure is important to ensuring competition in the supply chain. It does however pose lower barriers to entry than other elements of the supply chain with natural monopoly characteristics such as rail haulage services and export terminals at ports (including storage and handling at port terminals). It is therefore less likely to be a target for competition regulation, except insofar as it is integrated with those other elements.

Access to rail infrastructure

Western Australian rail access may prove a problematic given the degree of vertical integration in that State

In Western Australia, there are reports that ARG, the grain haulage service provider, is expected to negotiate an exclusive grain haulage 'network' contract with CBH, the dominant bulk handling company (BHC) in that State.

Road transport is a potential substitute; however, a competitive market is a preferable solution

This would mean that CBH would have gained effective control over the entire export grain supply chain in Western Australia (as it already controls 100 per cent of up-country storage and all port-based export terminals). While this situation does not apply in other parts of Australia, it is important given Western Australia produces more export grains than any other State.

Conclusion 2

In order to maximise competition in the export grain supply chain, bulk handling companies should not be able to extend their control over the export grain supply chain into the transportation of wheat (or other grains) through exclusive contracts with providers of haulage services.

Access to port infrastructure

"...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".

Competition and Infrastructure Reform Agreement 2006

The vertical integration of the operators of the majority of Australia's export grain terminals would create strong incentives for them to exploit their market power in the provision of natural monopoly port-based services to the advantage of their upstream (and downstream) activities.

there appears to be a case for regulating access to export grain terminals

As discussed in more detail in the main report, the potential for vertical integration in the broader grain export market to result in anti-competitive market outcomes in the provision of export services was recognised in South Australia and Victoria, where specific measures were implemented to minimise such risks even prior to the changes to export wheat arrangements currently under consideration. With proposed changes to export wheat marketing, it is arguable that these arrangements should be strengthened, and a prima facie case for them to be extended to other States.

An initial step that might be considered would be to implement a nationally consistent court-enforceable undertaking, similar to that in place in Victoria and South Australia. This is the least intrusive (although arguably least effective) of the three pathways for a party to seek access to an infrastructure service.

a voluntary undertaking does serve to focus attention on the key competitive concerns, and the undertaking is enforceable in court.

Key elements of such an undertaking could include transparency in charges, terms and conditions, fair access and non-discrimination between users.

Conclusion 3

To allay concerns and perceptions of discrimination in the provision of and charging for access to export grain facilities, consideration should be given to requiring operators of export grain facilities to agree to a nationally consistent court-enforceable undertaking with respect to these facilities, Key elements of such a voluntary undertaking would include:

- *to publish charges and standard terms and conditions for access to export grain facilities;*
- *to not unfairly or unreasonably hinder or deny access to the export grain facilities;*
- *to not unfairly or unreasonably discriminate between users of export grain facilities as to the charges, terms and conditions - including, priority of access and service levels - upon which access is provided; and*
- *a dispute resolution provision.*

Conclusion 4

In order to maximise competitive pressures in the whole of the export grain supply chain, a voluntary undertaking should require published standard charges, terms and conditions at export grain terminals to be consistent with the CIRA pricing obligations [Clause 2.4(b)]. That is:

- *generate expected revenue that is at least sufficient to meet the efficient cost of providing access to the export grain facilities, and include a return on investment commensurate with the regulatory and commercial risks involved;*
- *allow multipart pricing and price discrimination when it aids efficiency;*
- *do not allow vertically integrated operators of export gain terminals to set terms and conditions that discriminate in favour of its other operations, except to the extent that the cost of providing access to other firms is higher; and*
- *provide incentives to reduce costs or otherwise improve productivity.*

Further, in the absence of formal structural separation, vertically integrated operators of grain export facilities should be required to demonstrate that actual or notional charges (that is, internal transfer pricing), and the terms and conditions for services provided internally are consistent with published charges, terms and conditions.

1.3 Information asymmetries and conflicts of interest

There is currently a significant asymmetry in the information available to BHCs and grain marketers in terms of:

Information asymmetry is a particularly difficult area to identify and regulate – but can be the source of highly anti-competitive behaviours

- information on tonnages, grades, quality and location of grain entering the supply chain, including grain that has been sold to competing marketers; and
- the shipping stem (that is, the port-by-port breakdown of which ships are due at a given time).

These issues are not confined to the grains industry – but consideration of other industries is outside the scope of this report.

To address these information asymmetries and establish a more level playing field, information on the quantity, grades and quality of grain entering the supply chain, and on the shipping stem at each port should be available to all grain marketers.

The information to be published would desirably comprise basic information such as the name of the port, vessel, loading dates, commodity type, volume and grade, shipper name and contacts (see main report for more detail). That is, it would provide information in a statistical fashion, and only that information required to ensure open competition between marketers (that is, provide a level playing field between those marketers with monopoly access to shipping stem information and those not in this position). It ought not extend to commercially sensitive information that any individual marketer would normally expect to have protected.

Conclusion 5

In order to maximise competitive pressures in the export grain supply chain, vertically integrated operators of grain receival sites should be required to publish information on the quantity, grades and quality of grain received. This should be on a regular, at least weekly, basis and be available to all grain marketers.

Conclusion 6

In order to maximise competitive pressures in the export grain supply chain, operators of grain export facilities should be required to make available information to show that the vessel nomination process, and allocation of port-based storage and shipping capacity does not discriminate between shippers.

Conclusion 7

Operators of export grain facilities should be required to make available shipping stem information to all grain marketers. This information should be updated at least daily, and provide details for each vessel nomination advice the operator receives.

1.4 Minimising incentives to exploit market power

In the longer term the most effective means through which incentives to exploit market power can be minimised is through structural separation of the natural monopoly parts of an infrastructure provider from the competitive areas of its business.

Greater transparency, particularly with respect to pricing arrangements and the shipping stem, is likely to assist in monitoring whether the operators of export grain facilities are actually exploiting market power.

While these measures identified above would go a long way to maximising the level of competition in the export grain supply chain, and may assist in detecting and minimising opportunities for price and non-price discrimination, they do not address the incumbent's underlying incentive to restrict competition.

Options for separation may need to be considered in the event that transparency and disclosure proves ineffective in curbing anti-competitive behaviours in the grains export supply chain.

In addition, the annual reporting obligations proposed in Clause 13, and the access test proposed in Clause 20 of the *Wheat Export Marketing Amendment Bill 2008* exposure draft - while highly desirable - may of themselves be insufficient to deal with inherent incentives for exploitation of market power or to mitigate existing information asymmetries in the grain supply chain.

Options for structural separation are however not considered in this report: although they may be desirable in theory, the history and current structure of the grains export infrastructure suggest that this would be considered a radical step. Implementation of the measures outlined above would maximise competitive pressures in the export grain supply chain within existing structural constraints, and may of themselves support the evolution of a more competitive export grain supply chain structure.

In recent years governments have had a presumption in favour of light touch regulation, simplicity and cost effectiveness (reflected for example in South Australian grains regulatory reforms). Less intrusive regulation is preferable provided it achieves desired policy objectives.

There are other intermediate regulatory options available to governments in the event that anti-competitive behaviours emerge in the new export grains market which greater transparency and voluntary undertakings are unable to resolve. Other more intrusive options could include the use of the accreditation system proposed under changes to the *Wheat Marketing Act 1989* or additional regulatory mechanisms such as have applied to infrastructure in other industries such as electricity.

Stronger regulatory options are not considered in this report – but they should not be ruled out. They may be needed if the market structure evolves in ways that impede competition

At this stage there is no evidence of a need for more intrusive regulation; however, the grains industry is entering a period of new structural arrangements, which means that the situation will need to be monitored and possible further regulatory options considered if necessary.

Conclusion 8

The measures outlined in Conclusions 1-7 are necessary measures to maximise competitive pressures in the export grain supply chain. However, in the longer term, the most effective means through which to minimise the potential exploitation of market power by operators of export grain facilities is for formal structural separation of the natural monopoly parts of the business from the competitive areas.

These conclusions are based on detailed analysis (see main report) of the characteristics of the grains industry supply chain; the history of deregulation of storage, handling and transport to date; lessons from other industries; and application of Australia's National Competition principles. A summary of each of these elements follows.

1.5 The supply chain – key features

The first important step in the supply chain is the delivery by growers of grain to an 'up-country' receival facility, where the grain is weighed and sampled against receival standards.

...'up-country' receival sites are, in most cases, owned and operated by one of the three, largely State-based, storage and handling operators, CBH in Western Australia, ABB in South Australia or GrainCorp in New South Wales, Victoria and Queensland.

Although AWBI to date has in effect controlled bulk wheat exports, there is an active secondary market for wheat and growers may choose to sell either to AWBI (as operator of the National Pool), or to one of around 50 other wheat traders. Alternatively, the operator of the receival site may warehouse the grain on behalf of the grower for sale at a later date.

Operators of receival sites generate and control valuable commercial information on the overall tonnages and quality of grain entering the grain supply chain, and importantly, the location of that grain. This information will become more valuable to the operators in a more competitive market, and a source of competitive advantage to any operator that itself entered the export market.

Grain exports are different from many other commodity exports: the firms involved in holding and transporting the grain will generally hold more information about it than its owners until such time as it reaches port.

Rail tends to be the dominant means of transporting export-destined grain to port. The rail track infrastructures in all Australian States are covered by State-based access regimes. Although these have been certified as 'effective' access regimes, in practice there has not been any marked increase in third party provision of grain haulage services.

Although access regimes exist in all states, there are few examples of third party operators successfully establishing operations on rail networks.

Recent consolidation has resulted in there now being only one rail operator carrying bulk grain in New South Wales. There is little evidence of third party operators successfully using rail infrastructure access regimes in South Australia, Victoria or Western Australia.

However, market dominance in rail is offset by the threat of competition from road – this puts an upper bound on the capacity of owners of rail infrastructure to exploit their market position.

It is likely that the seasonal nature of the grain industry, substantial upfront capital costs and complexity of negotiating an access arrangement for multiple rail lines decrease the attractiveness of this market. While this implies rail grain haulage providers have a degree of market power, this is reduced to the extent there are opportunities for substitution with road transport.

Ports are a vital choke point in the grain export supply chain.

The next steps in the export grain supply chain then take place at port terminals. These provide a range of facilities: grain is weighed; quality tested; checked for insect infestation; unloaded; stored; combined (grain silos, shipping elevator towers and conveyor belts, are used to blend grain and transport it between silos and to the ship); weighed again (ship weigher); and loaded.

The facilities at port terminals are dominated by grain handling firms

There is no port terminal within Australia where there is separate ownership or management of receival, storage and ship-loading assets. At each port terminal, these various assets are owned and managed by a single entity, which other than in one instance, is either CBH in Western Australia, ABB in South Australia or GrainCorp in New South Wales, Victoria and Queensland.

Port delays can be costly with demurrage costs up to $50,000 per day

As the export marketing of grain is characterised by bulk sales in spot markets, timing to market is critical. A feature of the grain supply chain is that generally a marketer does not take firm control of the grain until it is delivered to the port terminal. That is, while a marketer may purchase an amount of wheat from a grower, it effectively only has notional control of this wheat until the wheat is delivered to port. This makes this point in the supply chain – and especially, the steps between delivery and loading – pivotal for competition in the market.

1.6 Competition issues

Storage and handling in each of the major export wheat producing States is dominated by a single integrated bulk handling company (BHC). Further, in most instances, these BHCs also own and control port-based grain export infrastructure in their respective States.

Incentives for an owner of monopoly infrastructure to set monopoly prices are especially strong if the firm is also active in downstream, and/or upstream, markets.

Further, operation by the BHCs of export port terminals gives these companies control over the 'shipping stem' (the port-by-port breakdown of which ships are due at a given time). There appears to be a general lack of transparency around the vessel nomination process, leaving open the possibility that in a more competitive market, some BHCs would have the ability to give preference to vessels transporting their grains ahead of the grain of competitors.

As the *Wheat Marketing Act 1989* currently effectively prevents the BHCs from competing with AWBI in the marketing of bulk export wheat, these companies are as yet unable to exploit these existing information asymmetries for financial and/or commercial advantage. However, this is likely to change should the BHCs in future enter the export wheat market.

1.7 The Royal Commission on grain storage, handling and transport – unfinished business

In 1986, Federal and State governments established a Royal Commission into Grain Storage, Handling and Transport to report on the most efficient integrated grain distribution system for Australia's future needs. The report of the Royal Commission (the 'McColl Report') was published in 1988.

Royal Commission on Grain Storage, Handling and Transport led to significant improvements in the supply chain and in price signals

It led to deregulation of the domestic wheat market, rationalisation of the grain transport network and significant improvements in price signals to growers.

A key recommendation of the McColl Report was that State Governments deregulate the grain storage and handling industry, and no longer restrict grain storage and handling services to only one licensed receiver in each State. This process was completed by the early-2000s, although the previous monopoly holders (or successor entities) remain dominant in their respective States.

State based deregulation of grain storage and handling was a lengthy process...

The McColl Report did not comment on the single desk arrangement, which the Commission saw as outside its terms of reference, but foreshadowed that in the event of deregulation of both domestic and export marketing arrangements there would be greater competitive pressure on grain distribution in Australia, together with a need to pay attention to "vertical integration of marketing and storage, handling and transport".

McColl foreshadowed need for further action in the event of changes to the single desk

The development of National Competition Policy in Australia in the early 1990s provides a sound set of guiding principles against which to consider the supply chain implications of proposed export wheat marketing arrangements.

National Competition Policy provides a template for consideration of what changes might be needed

The1993 report of the National Competition Policy Review Committee (the 'Hilmer Report') provided a firm platform for action. The Council of Australian Governments in 1995 agreed a plan to promote enhanced competition in Australia.

The Competition Principles Agreement underpinning the National Competition Policy includes:

- prices oversight of State and Territory government business enterprises, competitive neutrality, structural reform of public monopolies and legislation review and reform;
- public–interest factors that were to be considered when assessing the costs and benefits of a particular policy or course of action; and
- arrangements for access by third parties to services provided by significant infrastructure facilities.

"Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole"

(Hilmer 1993).

The rationale for regulating access to monopoly infrastructure, also often referred to as 'bottle-neck' facilities, is that in the absence of competition, an owner of monopoly infrastructure may exert market power to the detriment of buyers in the market and society as a whole. This may occur through:

National Competition Policy recognised that even where legislation supporting statutory monopolies was removed, remaining structural barriers to entry in some industries could impede effective competition.

- limiting competition in upstream or downstream markets by refusing to supply infrastructure services (that is, access to the monopoly infrastructure); and/or
- setting monopoly prices for infrastructure services provided by the monopoly infrastructure.

While other elements of the National Competition Policy were designed to promote a level competitive playing field, including providing for third party access and extending prohibitions against anti–competitive behaviour, as shown, it was also recognised that these initiatives would not always be sufficient to establish effective competition

"...strategies include liberalising market access and ensuring public monopolies adhere to competitive neutrality principles. These strategies, however, will not always be sufficient to establish effective competition. Structural reform may be needed to dismantle an integrated government monopoly business.

Such reform can involve separating the (potentially) competitive elements from the monopoly elements. Structural reform is important where a public monopoly is to be privatised."

National Competition Council, 2005

The Hilmer report concluded that:

- … when access to the natural monopoly element is essential for effective competition in the downstream or upstream market. …[this] raises concerns that control over access to the monopoly element may be misused to stifle or prevent competition in the potentially competitive sector. Even if access is not actually misused, the potential for such behaviour may deter new entry to, or limit vigorous competition in, markets dependent on access to the natural monopoly element…
- … There are two broad alternatives for addressing concerns of these kinds. First, the natural monopoly element can be separated from the potentially competitive elements. Alternatively, the integrated structure could be left intact, and reliance placed instead on more intrusive regulatory controls ….

This approach has influenced policy in a range of other sectors of the economy, including telecommunications, aviation and electricity.

Although there exists a statutory right of access to Telstra's copper wire network, non-price discrimination has emerged as a key competitive challenge in Australia's telecommunications market.

Australia's telecommunications market was opened to full retail competition in 1997. Capital infrastructure in the industry is dominated by Telstra's copper wire telephone network, a classic case of a natural monopoly. The Australian Competition and Consumer Commission has devoted considerable regulatory effort to ensuring competitors are able to access that network at reasonable prices, and that there is transparency in the operational and especially pricing arrangements to this end.

Domestic aviation has remained reasonably open to new entrants due to vigilance over access to key passenger infrastructure

In the domestic aviation industry, emerging competition issues in light of the economic deregulation that ended the former 'two-airline' policy included access to terminals, landing slots and other key infrastructure.

Electricity reform has resulted in increased competition

Australia's eastern seaboard electricity industry was an example of reform in an industry dominated by vertically integrated regional monopolies. Government reforms demonstrated the importance of adopting a comprehensive approach to the introduction of competition, including the separation of potentially competitive elements of the industry (generation and retail) from natural monopoly infrastructure elements (transmission and distribution).

Although this report does not canvass structural separation in grain storage, handling and transport, the experience in other industries suggests that at least some alternative competitive regulation will be needed.

The experience in these industries illustrates some of the issues involved with competition reform in Australia.

There has to date been little consideration of whether or not structural separation of infrastructure providers in the grains supply chain might be needed. This has largely reflected the more pressing competition issue of the AWBI export monopoly, and the fact that the market position of AWB provided a partial counterweight to discourage prospective anti-competitive behaviour by transport, storage and handling bodies.

1.8 Implications for the export wheat industry

While there are clear differences between the industries discussed above and the export wheat industry, there are common elements:

Natural monopolies are common in infrastructure networks

- *Natural monopoly characteristics* — in each case, the supply chain involves infrastructure facilities with monopoly characteristics, which would be prohibitively expensive (that is, uneconomic) to duplicate.

Especially where arrangements are a legacy of previous monopoly provision by governments.

- *High barriers to entry* — the markets are characterised by high barriers to entry, particularly through economies of scale and significant costs of key infrastructure.
- *Past legislative protection for incumbents* — in a number of cases the market was, and in the case of the wheat export market still is, characterised by substantial legislative protection for incumbents from competition.
- *Participation of vertically integrated firms* — both before and after deregulation, each of the markets was characterised by vertically integrated firms that are involved at several stages of the industry supply chain.

There may not only be direct barriers to competition, but also information asymmetries. The resulting non-price forms of discrimination are often the most difficult to eliminate.

The experience of new entrants in both the telecommunications and domestic aviation industries also highlight that formal regimes to provide access rights to monopoly infrastructure cannot solely be expected to curb anti-competitive behaviour by a vertically integrated competitor.

The role of structural reform

The National Competition Policy included two major reform 'strands':

...removing legislative restrictions on competition of themselves may not be sufficient to lead to an increase in competition.

- promotion of a level playing field, including through removing legislative restrictions and providing third party access; and
- structural reform of vertically integrated firms where they control natural monopoly infrastructure and compete in (potentially) competitive upstream or down stream markets.

The overall structure of the industry supply chain plays an important part in determining how competition subsequently evolves. In order to maximise competition, consideration must be given to:

- arrangements through which access is provided to monopoly infrastructure;
- minimising (or eliminating where possible) information asymmetries, and potential for conflicts of interest to arise where firms are vertically integrated and also compete in upstream or downstream markets.

The characteristics of the export wheat supply chain currently include:

- a legislatively protected export wheat marketer in AWBI (that until recently had the ability to exclude competitors);
- traditional separation of bulk handling and marketing roles (through State legislation), although this has eroded since the deregulation of the domestic wheat market; and
- natural monopoly infrastructure (railways and export terminals at ports).

"With a more open market growers will have greater choice...there is also scope for industry bodies to develop appropriate strategies on key issues such as rail transport and storage facilities, if their members believe it is warranted

Wheat Industry Expert Group March 2008

Changes that the Government intends to implement in the marketing of export wheat are likely to lead to BHCs seeking to gain accreditation to become export wheat marketers.

In light of the experience of other pro-competitive reforms, changes to the single desk should ideally also be accompanied by:

The new market structure gives rise to a need for more pro-competitive measures

- the establishment of firm rights for third parties to access monopoly export wheat supply chain infrastructure, where such access is required for effective competition in upstream or downstream markets;
- measures to reduce the information asymmetries between the BHCs and other marketers; and
- solutions to minimise the incentives for the vertically integrated bulk handling companies to engage in non-price discrimination.