

17<sup>th</sup> June 2013

The Senate Standing Committee on Rural and Regional Affairs and Transport

C/O: The Committee Secretary

PO Box 6100

Parliament House

Canberra ACT 2600

Australia

### **Senate Committee hearing into The Ownership Arrangements of Grain Handling**

The Victorian Farmer's Federation ("VFF") Grains Group would like to provide the following submission to the Senate Standing Committee on Rural and Regional Affairs and Transport, on behalf of Victorian grain producers who are ultimately impacted by the Committee's findings and the Government's subsequent actions.

The VFF Grains Group supports the need for an open, efficient, and transparent market to promote competition.

The VFF Consider there are four key failings within the grain industry which are impacted by the Ownership arrangements of Grain Handling Corporations, especially GrainCorp Limited ("GrainCorp") within Victoria. These problems or Market Failures include:

1. Monopoly/Market Power
2. Stocks Information
3. Grain Quality; and
4. Public/Industry Good Services (to a lesser extent)

It is incumbent on the Federal Government to address such Market Failures as well as ensuring the ownership arrangements of bulk grain handling Corporations are in the National Interest.

VFF consider that the proposed takeover of GrainCorp ownership arrangements by Archer Daniel's Midland ("ADM") will exacerbate existing market failures and will not be within the National Interest, unless appropriately regulated.

The VFF consider that the combined vertically and horizontally integrated assets of ADM and GrainCorp will dominate the prescribed sensitive sectors in relation to bulk food handling, transport, and port infrastructure. ADM will have the monopoly power to impact the efficient operations of a competitive Australian market.

VFF are concerned that a combined ADM/GrainCorp will have the scale, capacity, and demonstrated management practice that it may not provide fair and transparent access, and may favour their own entities at the expense of third-party providers and Australian producers and consumers.

Third party access to this essential up-country network infrastructure, ports, and network market (stocks) information can be achieved using existing regulatory instruments, including:

1. Existing ACCC port access provisions could be extended to up-country storages to guarantee access to this network infrastructure for all third party competitors; and
2. The Mandatory Code of Conduct announced by The Minister for Agriculture, Fisheries and Forestry in 2012, should include mandatory reporting of market (stocks) information in up-country storages as well as that in port infrastructure.

ADM have already made assurances along these lines to producers in an open letter stating that *“ADM will continue to provide access to GrainCorp’s bulk grain export terminals in accordance with GrainCorp’s access undertakings.....(and).....It is in ADM’s interest to ensure that its origination networks and up-country storage facilities are efficiently utilised by providing open access to all owners of grain.”*

Given ADM’s assurances, VFF consider that guaranteeing access to up-country infrastructure and up-country market (stocks) information through the ACCC and/or a Mandatory Code of Conduct should be relatively achievable conditions of sale that could be recommended by the Treasurer and be acceptable to all parties.

VFF also consider that an independent Industry Good entity should be established to provide Industry Good functions such as: Varietal Classification; minimum Export Standards; and Trade Access. Such an entity could be enabled by Government legislation and funded by industry using surplus Wheat Export Charge (WEC) funds combined with industry levy funding.

VFF consider the Federal Government’s obligation to act is three-fold: to ensure foreign ownership regimes are in the National Interest especially in prescribed sensitive sectors; secondly to ensure competition is not impeded; and finally to ensure existing market failures are not only addressed, but to ensure the action, or inaction, of Government does not further exacerbate market failure.

Yours Sincerely,

**Brett Hosking**  
**President**  
**Victorian Farmers Federation Grains Group**



Submission to the  
The Senate Standing Committee on Rural and Regional  
Affairs and Transport hearing into  
The Ownership Arrangements of Grain Handling

June 2013

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**Victorian Farmers Federation**  
**submission to the**  
**The Senate Standing Committee on Rural and Regional Affairs and Transport**  
**hearing into**  
**The Ownership Arrangements of Grain Handling**

## **1 Introduction**

The Victorian Farmer's Federation ("VFF") Grains Group would like to thank the The Senate Standing Committee on Rural and Regional Affairs and Transport for the opportunity to provide a submission and input into the hearing into The Ownership Arrangements of Grain Handling.

VFF Grains Group supports the need for an open, efficient, and transparent market to promote competition. Further, in the event of market failure through a monopoly position, Government intervention, currently in the form of access undertakings and a mandatory code of conduct, are warranted to ensure competition occurs.

VFF Grains Group's position is that we do not oppose the proposed acquisition of GrainCorp, subject to there being appropriate regulatory controls and undertakings to ensure access to essential infrastructure and access to essential market information occurs.

## **2 Background**

The Victorian Farmers Federation ("VFF") is one of the largest state farmer organisations in Australia, representing over 10,000 members who live and work on more than 6,000 farm businesses situated across Victoria. The VFF Grains Commodity Group, through its elected Council has the responsibility and autonomy to determine VFF policy regarding grains industry issues.

The VFF Grains Group works actively with all market participants from across the supply chain whether they be farm input providers, research & development organisations, government departments, bulk handlers, traders, and exporters. This includes GrainCorp as the largest bulk handler on the East Coast and primary service provider to grain producers in Victoria.

## **3 Executive Summary**

The VFF Grains Group supports the need for an open, efficient, and transparent market to promote competition. VFF Grains Group's position at time of submission is that it does not oppose the proposed acquisition of GrainCorp subject to there being appropriate ongoing regulatory controls in the form of ongoing access undertakings and a mandatory code of conduct to ensure access to both essential infrastructure and essential market (stocks) information.

The VFF consider that the combined vertically and horizontally integrated assets of ADM and GrainCorp will not be in the national interest unless such regulations are imposed.

The VFF also consider existing Market Failures within the grain industry which are impeding competition will be exacerbated by a takeover of GrainCorp by ADM. These include:

1. Monopoly/Market Power
2. Stocks Information
3. Grain Quality Outturn Standards
4. Public/Industry Good Services (to a limited extent)

The VFF consider that the combined vertically and horizontally integrated assets of ADM and GrainCorp will dominate the prescribed sensitive sectors in relation to bulk food handling, transport, and port infrastructure. ADM will have the monopoly power to impact the efficient operations of a competitive Australian market.

Therefore, it is incumbent on the Federal Government to address these Market Failures and ensure the takeover of GrainCorp by ADM is in the National Interest.

VFF are concerned that a combined ADM/GrainCorp will have the scale, capacity, and demonstrated management practice that it may not provide fair and transparent access, and may favour their own entities at the expense of third-party providers and Australian producers and consumers.

Third party access to this essential up-country network infrastructure and network market information can be achieved using existing regulatory instruments, including:

1. Existing ACCC port access provisions could be extended to up-country storages to guarantee access to this network infrastructure for all third party competitors; and
2. The Mandatory Code of Conduct announced by The Minister for Agriculture, Fisheries and Forestry in 2012, should include mandatory reporting of market (stocks) information in up-country storages as well as that in port infrastructure.

ADM have already made assurances along these lines to producers in an open letter stating that *“ADM will continue to provide access to GrainCorp’s bulk grain export terminals in accordance with GrainCorp’s access undertakings.....(and).....It is in ADM’s interest to ensure that its origination networks and up-country storage facilities are efficiently utilised by providing open access to all owners of grain.”*

Given ADM’s assurances, VFF consider that guaranteeing access to up-country infrastructure and up-country market (stocks) information through the ACCC and/or a Mandatory Code of Conduct should be relatively achievable conditions of sale that could be recommended by FIRB for imposition by the Treasurer and be acceptable to all parties.

VFF also consider that an independent Industry Good entity should be established to provide Industry Good functions such as: Varietal Classification; minimum Export Standards; and Trade Access. Such an entity could be enabled by Government legislation and funded by industry using surplus Wheat Export Charge (WEC) funds combined with industry levy funding.

#### **4 Grains Industry Ongoing Problems - ‘Market Failure’**

There are four fundamental problems in the Australian Grain industry related to Grain Handling:

1. Monopoly Power
2. Stocks Information
3. Grain Quality Outturns
4. Industry/Public Good Services

These are forms of what can be defined as “market failure”, that is situations when a market left to itself does not allocate resources efficiently. Where market failures exist, there is a role for government intervention to improve outcomes for the community, businesses and the economy.

### Summary Table – Grains Industry Issues

Grain Industry Problem (Market Failure)	Grains Industry Examples	Explanation why this is market failure	Government Remedy
<b>1. Market Power / Monopoly Power</b>	<ul style="list-style-type: none"> <li>• Grain Ports</li> <li>• Up-Country Storage &amp; Handling</li> </ul>	Where one or a few buyers or sellers in a market have the ability to <u>exert significant influence</u> .	<p>ACCC Access Provisions for Ports &amp; upcountry. Mandatory Code of Conduct</p> <p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>• ACCC Access Provisions</li> </ul>
<b>2. Stocks Information (Information Asymmetry)</b>	<ul style="list-style-type: none"> <li>• Unequal access to stocks information</li> </ul>	<p>Where one party to a transaction has more or better information than others.</p> <p>Barrier to competition as competitors cannot access stocks info to compete</p>	<p>Mandatory Code of Conduct to display Warehouse stocks information</p> <p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>• ASX rules</li> <li>• U.S. legislation</li> </ul>
<b>3. Grain Quality</b>	<ul style="list-style-type: none"> <li>• Ensuring BHC’s Outturn the quality paid for by buyers (blending)</li> <li>• Reputational risk to Australian grain exports</li> </ul>	<p>Resources are not being outturned ‘efficiently’, as BHC’s can arbitrage by swapping &amp; blending.</p> <p>In efficient markets ‘arbitrage’ is available to all &amp; priced out.</p> <p>BHC’s outturn grain at the minimum receival standard – not the standard actually received &amp; paid for by the grain buyer.</p>	<p>Access provisions to Sites + Stocks information + and Industry Outturn Standards.</p> <p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>• ASX rules</li> <li>• U.S. legislation</li> </ul>
<b>4. Industry or Public Goods</b>	<ul style="list-style-type: none"> <li>• Varietal Classification (WQA)</li> <li>• Min Outturn Standards</li> <li>• Trade Access &amp; Policy (GIMAF)</li> <li>• Technical Market Support</li> <li>• Receival Standards (GTA)</li> <li>• R&amp;D (GRDC)</li> </ul>	Goods or services which businesses cannot provide as they cannot capture the financial returns because benefits are shared or ‘public’, resulting in ‘free-rider’ effects. Often provided by or with the assistance of Government.	<p>Funding an independent Industry Good entity using Wheat Export Charge (WEC) funds + industry levy funds.</p> <p><u>Examples:</u></p> <ul style="list-style-type: none"> <li>• U.S. standards</li> <li>• Wheat Quality Australia</li> <li>• GIMAF; etc</li> </ul>

The fact that these issues have all been debated at length by industry since deregulation of the Single Desk in 2008, and have still not been resolved by industry, supports the argument that the industry requires a degree of government assistance and intervention in resolving these matters.

#### **4.1 Monopoly Power - Market Power**

Market power exists when one buyer or seller in a market has the ability to exert significant influence over the quantity of goods or services traded, or the price at which they are traded. In perfectly competitive markets, market participants have no market power. The existence of market power can result in economic inefficiency, it may allow firms to increase prices, or create barriers to entry.

It is clear that GrainCorp has a monopoly position in the service provision market of bulk grain storage, handling, and port loading services. VFF consider this market power has an anti-competitive impact on the market.

##### **4.1.1 Ports**

GrainCorp's market monopoly position is widely acknowledged by industry, and as recognised in GrainCorp's own press releases to the market in April 2013, as the company:

*"...Handles ~90% of eastern Australia's bulk grain exports;..."*

GrainCorp owns the vast majority of grain port loading facilities on the East Coast of Australia, 7 of the existing 8 grain port terminals. GrainCorp's monopoly market concentration is in effect acknowledged through ACCC existing access undertakings.

##### **4.1.2 Up-Country Storage & Handling**

GrainCorp also have a market dominant, if not monopoly position in the up-country storage & handling network for grains. That is, GrainCorp control the essential network infrastructure required to acquire, accumulate and deliver grain to port and end-users. GrainCorp:

*"...Handles ~75% of eastern Australia's annual grain production through direct receivals at either our country sites or port terminals;..."*

However, unlike Ports the ACCC currently do not regulate up-country grains network infrastructure. It is often argued that up-country storage & handling is a well contested market, however it is clear that GrainCorp in handling 75% of production still exert significant market power and oligopoly control of the up-country supply chain.

The next largest up-country storage & handler Cargill (Grainflow) has significantly less storage capacity, and given it does not own port infrastructure is still dependent on access to GrainCorp infrastructure.

VFF consider that access to this essential network infrastructure is critical to ensure true competition at port terminal. It can be said 'he who controls the supply chain controls the ports', and therefore barriers to up-country acquisition and accumulation are also a barrier to port loading services.

#### **4.2 Stocks Information – Exclusive information Access**

'Information asymmetry' is evident in the Grains industry as one party to a transaction, GrainCorp, has more if not exclusive access to information compared to the rest of the market. This is a market failure by definition which is preventing the operation of an efficient market.



Lack of open access to stocks information is a barrier to competitors being able to acquire stocks up-country for loading at port or to the domestic market. Similarly, this lack of transparency means that growers are making sales decisions based on imperfect information. That is, whether to sell at harvest when prices may be low, versus holding their grain paying carry costs to achieve a higher price.

While third-party exporters have access to ports & shipping 'slots' through ACCC access provisions, the inability to see and efficiently compete for and buy grain up-country to load a vessel is a very real barrier to competition for both domestic end-users and exporters.

BHC's contest that they 'own' this stocks information, however VFF consider that the Bulk Handler acts as a custodian of grain held in store, and as a result they do not 'own' the information. VFF consider the producers who warehouse the grain in store and retain title to the grain own the information. Where a bulk handler's marketing division does own title to Grain, then they would own that information just as other buyers do.

VFF consider that regulation requiring information disclosure is required to ensure access to this stocks information and address this 'information asymmetry'. That is, the Government should intervene to ensure a transparent, competitive market as in other markets like the ASX and overseas commodity markets like the US. This will remove barriers to competition up-country, at port, and allow producers to make more educated sales decisions.

#### **4.3 Grain Quality Out-turned – Transparency & Outturn Standards**

Monopoly power and lack of transparency is also resulting in market failure in relation to Grain Quality out-turned by bulk handlers. A combination of lack of stock transparency, arbitrage of stock through swapping and blending, and Bulk Handlers only guaranteeing to outturn grain to the minimum receival standard quality, means that buyers are not guaranteed to outturn the quality of grain they paid for.

As a result buyers cannot guarantee the quality they out-turn will meet the quality they paid for when they acquired the grain resulting in market inefficiency.

Transparency of stocks information, including grain quality, will assist in ensuring the integrity of actual stocks out-turned by bulk handlers. It will not prevent owners of the grain from arbitraging or blending grain, but on the contrary, transparency should facilitate this value add by all owners whether they be BHC, trader, or grower alike.

VFF also consider that an independent Industry Good entity could oversee grains industry Export Standards, as well as providing other Industry Good functions. Minimum quality standards for Australia could be set similar to U.S. standards. Such an entity could be funded by industry through surplus Wheat Export Charge (WEC) funds combined with industry levy funding.

#### **4.4 Industry Public Goods**

Public Goods are goods or services which businesses cannot provide as they cannot recoup the costs of provision because the benefits are shared or 'public'. That is, in providing the good to one person it is available to all at no extra cost. Public goods are therefore said to be 'non-excludable' and result in a 'free-rider' effect. As a result many public goods are provided by Government.

The Productivity Commission in its review of Wheat Export Marketing Arrangements (1 July 2010) adopted a view that Government should only intervene for 'pure' public goods whereas those with

some 'industry' characteristics should be provided by industry. In reality most public goods demonstrate features of both public and industry good, and require some Government intervention.

#### **4.4.1 Varietal Classification**

Varietal Classification is a clear example of Market Failure in the form of a Public Good in the grains industry. It meets the definition as a non-excludable non-rival good resulting in free-rider effects, and benefits the broader community & industry through increased food productivity.

This is one service that the Grains industry has universally agreed requires continued funding, however without intervention of industry and government funding through the GRDC this service would likely fail.

VFF consider ongoing funding is required to support this service through an independent industry body using surplus Wheat Export Charge (WEC) funds and industry levy funds.

#### **4.4.2 Other Public Industry Goods**

Similarly there is a case for an independent industry body to provide other Public Industry goods utilising surplus Wheat Export Charge (WEC) funds and industry levy funds. Examples include:

- Setting minimum Outturn Standards – as in the U.S. and Canada these markets have legislated minimum outturn standards for the export of grain.
- Trade Access & Policy – Grains Industry Market Access Forum (GIMAF) is currently Trade Access & Policy advocacy on behalf of the industry and Government using short term Government funding.
- Technical Market Support – an extension of both minimum Outturn Standards and Trade Access & Advocacy is provided by Australia's major competitors, and could arguably be an extension service provided by an independent industry body.

## **5 National Interest**

The proposed acquisition of GrainCorp Limited by Archer Daniels Midland ("ADM") has raised a number of potential National Interest issues. The VFF have raised the following issues for consideration by the Treasurer and the Foreign Investment Review Board ("FIRB") in its review of the proposed acquisition of GrainCorp by ADM:

- Prescribed Sensitive sectors – transport, port facilities, rail infrastructure, and shipping services provided within, or to and from, Australia
- Food Security - Australia's capacity to remain a reliable supplier of agricultural production both to the Australian community and our trading partners
- Potential global distortions to competitive market outcomes - the extent to which an investment may allow an investor to control the global supply of a product or service
- Impact on Market Power;
- Impact on Competition; and
- Impact on the Australian Economy

## **5.1 Prescribed Sensitive Sectors - Essential Storage, handling, and Port Infrastructure**

The proposed takeover of GrainCorp does fall into the prescribed sensitive sectors for transport, port facilities, rail infrastructure, and shipping services provided within as well as to and from, Australia.

GrainCorp is the predominant bulk commodity grain storage, handling and port service provider on the East Coast of Australia. GrainCorp handles 90% of Exports, owns 7 of the 8 existing grain port loading facilities, the majority of up-country network (silo) infrastructure, and approximately 19 grain trains.

The markets primarily include that of providing the services of bulk grain storage, handling and port loading. The cost of providing this service is the major cost component when determining the net price of grain to the farm producer.

The degree of control that ADM would gain in acquiring GrainCorp's sensitive essential infrastructure, including its port terminals is not only significant but market dominant.

## **5.2 Distortions to Competitive Market Outcomes**

ADM's global vertically integrated network of shipping services, marketing, and food processing assets when combined with GrainCorp's monopoly control of essential storage, handling, and port infrastructure, has the very real capacity to impact Australia's ability to remain a reliable supplier of agricultural production to both the Australian community and our trading partners.

ADM's reported 265 processing plants worldwide, including 30,000 employees, and 39 Ocean going vessels, have the capability to consume a significant volume of Australia's supply of bulk food grain commodities normally exported via a competitive export market.

Competition currently occurs at port for Australian grain exports, whereas ADM's control and overseas processing plants have the capacity to reduce the competitive and efficient market outcomes, by directing grain towards its own end-users within its own vertically integrated network.

## **5.3 Impact of Integration on Market Power**

Horizontal and vertical integration will have the combined effect of exacerbating GrainCorp's domestic Monopoly position by broadening this impact both:

- Horizontally across Australia's domestic food supply chain infrastructure (storage, handling & port loading);
- Horizontally across Australia's essential infrastructure for the supply of Food ingredients; and
- Vertically along the domestic and export global food supply chain.

The combination of all these assets will give ADM a dominant monopoly position in the Australian bulk (grain) commodity food supply chain from up-country storage and handling, port operations, domestic trading and food processing, and control of food exports in grain and sugar.

### **5.3.1 Horizontal Integration**

The ACCC have published both GrainCorp and ADM's interests in other food based bulk commodity handling organisations and food processing organisations in Australia. These included:

- ADM's 80% ownership of Toepfer International who trade grain domestically in Australia
- ADM's significant interest having 16% ownership in Wilmar International Pty Ltd, the largest Asian agribusiness and the second largest listed company on the Singapore Stock Exchange
- Wilmar International's 50% interest in Wilmar Gavilon Pty Ltd
- GrainCorp's global malt producing operations including Barrett Burston Malting which has facilities at Geelong, Burnley, Perth, Thornleigh and Pinkenba
- GrainCorp's 60% shareholding in Allied Mills in conjunction with Cargill
- GrainCorp's oil seed crushing operations and marketing of edible oils through the acquisition of Gardener Smith Holdings and Intergro Foods (now GrainCorp Oils)

FIRB should also note that Wilmar International acquired Sucrogen from CSR in 2010 giving it control of CSR's infrastructure on the East Coast of Australia. Sucrogen are the largest sugar refiner in Australia and New Zealand. The Australian industry also produces around 5 million tonnes of raw sugar annually and about 4 million tonnes of this total is exported.

### **5.3.2 Vertical Integration – Closed loop**

VFF understand that ADM are a global food supplier that turnover a significant proportion of the US crop and own or have interests in numerous shipping vessels and overseas milling and processing facilities. VFF consider that ADM has a global vertically integrated supply chain from the farm producer, through storage, handling, port loading, marketing, shipping, to end-use processing.

VFF are concerned that ADM's overseas management practices demonstrate the scale, capacity and willingness to implement 'closed-loop' management practices. That is, the capacity to limit or deny access to third party buyers at up-country essential network sites; limit access to essential market information; limit access to ports; and essentially export direct to ADM processors off-shore.

Some may consider that volume throughput is sufficient economic incentive to ensure that third-parties are provided access to upcountry networks. VFF contend however that it is the amalgamation of not just ADM's domestic interests with those of GrainCorp, but ADM's global scale of operations and vertically integrated network, that provide ADM the sheer volume capacity to export and process a large proportion of the East Coast crop of their own accord (if ADM so desired).

VFF Grains Group supports the need for ongoing market access undertakings and a mandatory code of conduct to prevent the implementation of 'closed-loop' management practices and thereby ensure ongoing competition and market access.

### **5.3.3 Transfer Pricing - ATO**

The potential for closed loop supply chain practices also may raise the issue of transfer pricing of potential tax revenues for the Australian Tax Office. This is a consideration more for FIRB and the Australian Government than VFF.

## **5.4 Impacts on Competition & Market Failure**

VFF are concerned that the combined strength of ADM and GrainCorp has the potential to exacerbate existing Market Failure & Competition issues in the Grains industry, including:

- Exacerbating Market Power/Monopoly Power;
- Exacerbating Information Asymmetry (lack of Stocks Transparency);

- Potential to reduce Access (up-country & at Port) – Closed Loop supply Chain; and
- Continue to outturn grain to third party competitors at minimum receival standard.

VFF consider that these existing Market Failures within the Australian Grain supply chain will be exacerbated by an ADM takeover of GrainCorp, and that it is incumbent on the Federal Government to intervene to address these failings and ensure the takeover is in the National Interest.